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*Law & Management have a deep nexus. It is important for the society not only to understand that businesses play a huge role in the development of an economy. At such a macro level, this journal seeks to connect not only to the Corporate world, but also to the array of areas that these subjects have in their fold. It gives us immense pleasure to release the First Volume of the International Journal of Law & Management Studies in furtherance of the goal.*

- Editor-in-Chief

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Thank you for your contribution



## **AN EXAMINATION OF CORPORATE SOCIAL RESPONSIBILITY AND ITS EFFECT IN INDIA: RELATIONSHIP BETWEEN CSR CONSUMPTION AND PRODUCTIVITY OF FIRMS**

**SHASHWAT JHA<sup>1</sup>**

### **ABSTRACT**

India's new Companies Act 2013 (Companies Act) has introduced several new provisions which change the essence of Indian corporate business" of Indian corporate business. One of such new<sup>2</sup> procurements is Corporate Social Responsibility (CSR). The idea of CSR lays on the belief system of give and take. Company's take assets as crude materials, HR and so on from the general public. By performing the assignment of CSR exercises, the companies are giving something back to the general public. Service of Corporate Affairs has as of late communicated Section 135 and Schedule VII of the Companies Act and additionally the procurements of the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CRS Rules) which have become effective from 1 April 2014.

Section 135 of the Companies Act gives as far as possible to materialness of the CSR to a Company i.e. (a) total assets of the company to be Rs 500 crore or more; (b) turnover of the company to be Rs 1000 crore or more; (c) net benefit of the company to be Rs 5 crore or more. Further according to the CSR Rules, the procurements of CSR are relevant to Indian companies, as well as pertinent to branch and venture startups of a foreign company in India.

CSR Committee and Policy: Every qualifying company requires spending of no less than 2% of its normal net benefit for the past 3 financial years on CSR exercises. Further, the qualifying company will be required to constitute an advisory group (CSR Committee) of the Board of Directors (Board) comprising of 3 or more directors. The CSR Committee might figure and prescribe to the Board, an approach which should demonstrate the exercises to be embraced (CSR Policy); prescribe the measure of consumption to be acquired on the exercises alluded and screen the CSR Policy of the

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<sup>1</sup> 3<sup>rd</sup> Year, B.Com LL.B (Hons), Institute of Law, Nirma University

company. The Board should consider the proposals made by the CSR Committee and support the CSR Policy of the company.

Meaning of the term CSR: The term CSR has been characterized under the CSR Rules which incorporates yet is not constrained to:

- Project identifying with exercises indicated in the Schedule; or
- Project projects identifying with exercises embraced by the Board in compatibility of suggestions of the CSR Committee according to the proclaimed CSR strategy subject to the condition that such arrangement spreads subjects specified in the Schedule.

This meaning of CSR expects enormity as it permits companies to participate in undertakings or projects identifying with exercises enrolled under the Schedule. Adaptability is likewise allowed to the companies by permitting them to pick their favored CSR engagements that are in similarity with the CSR strategy. The article intends to identify the CSR and its impact on the Indian social and corporate scenario.

## **INTRODUCTION**

According to the United Nations Industrial Development Organisation (UNIDO) corporate social responsibility (CSR) has been characterized as an administrative idea using which organizations coordinate social issues affecting people in general and natural issues faced by the planet, in their business operations and associations with their partners. CSR is a route in which organizations hope to accomplish a balancing act of their financial, ecological and social goals<sup>3</sup>.

CSR has been rehearsed by organizations of the developed world countries in a major manner. The expansive majority of successful private colleges in the United States of America (USA) were setup as a piece of CSR exercises embraced by huge corporate houses. A considerable measure of multinational organizations contributes towards the advancement of social orders in which they work. A most outstanding illustration is Shell, an Old Anglo-Dutch multinational oil and gas organization, which bolsters the social and economic status of several neighbourhood groups in

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<sup>3</sup> In the United Nations Industrial Development Organisation  
<http://www.unido.org/en/what-we-do/trade/csr/what-is-csr.html>



Nigeria. In India, an expansive scale of generous exercises was embraced in the post-autonomy period, which prompted the setting up of some of the absolutely prestigious establishments in the field of expert training. In turn, Organizations themselves additionally contributed by making contributions to non-government organisations (NGOs) and their own trusts as well, which were deductible under Section 80 G of the Income Tax (IT) Act<sup>4</sup>. In any case, these contributions were far from being straightforward and needed more responsibility.

### **CSR MADE OBLIGATORY**

Keeping in mind the end goal to streamline the altruistic exercises and guarantee more responsibility and straightforwardness, the government of India made it compulsory for organizations to undertake CSR exercises under the Companies Act of 2013. This idea of CSR is characterized in Section 135 of the aforementioned Act, and it is material to organizations which have a yearly turnover of Rs 1,000 Crore or more or net value of Rs 500 Crore or more, or a net profit of Rs 5 Crore or more<sup>5</sup>.

Under the context of provisions of this section, these organizations should set aside no less than 2% of their profits in the preceding three years for the purpose of CSR exercises. The law has set off a wide range of exercises under CSR, which cover exercises, for example, advancement of training, sex values and women empowerment, fighting fatal diseases like HIV/AIDS along intestinal sickness and different infections, annihilation of compelling destitution, commitment to the Prime Minister's National Relief Fund and other focal trusts, social business ventures, ensuring decrease in child mortality, enhancing maternal wellbeing and the natural maintainability and work upgrading professional abilities among others.

The organizations can do these exercises by teaming up either with a NGO, or through their own particular trusts and establishments or by pooling their assets with another organization. The law likewise involves setting up of a CSR board of trustees which should be in charge of choices on CSR use and sort of exercises to be attempted. This advisory group should comprise of three or more executives, with no less than one autonomous chief whose vicinity will guarantee a sure measure of popular government and differences in the choice making procedure.

The law is exceptionally vast, on the grounds that India is at the edge of demographic profit, and there is a dire requirement for the making of human and physical funding to harvest its prizes. Interest in

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<sup>4</sup> Section 80 G, Income Tax Act, 1961

<sup>5</sup> Section 135, Companies Act, 2013

education, wellbeing, expertise advancement and social framework will upgrade capacities of the young by enhancing their nutritious, aptitude and instructive level, which thusly will better their business prospects. Customarily, this has been the administration's obligation, however since open conveyance of products and administrations has been filled with debasement and bureaucratic wastefulness and the welfare plans are stopped with spillages, CSR is being seen as a different option for legislative procurement of legitimacy merchandise. CSR will expand accessibility of trusts for welfare exercises and may prompt conveyance of merchandise and administrations to the general population in a financially savvy way. The statement on natural supportability will help in cutting down contamination and discharge of nursery gasses and will help in consistence with global standards and regulations. In this manner, the provision on CSR is a stage towards accomplishing social and natural supportability, which will aid society in future.

In the first segment, the pattern of CSR consumption acquired by the top firms in the nation in the most recent, preceding three years and the progressions that have happened in the authorization's wake of the new Demonstration have been taken a gander at. The second segment highlights the positive connection in the between profits and CSR and how this relationship gets complemented as the firm size increments. In the third area, we have point by point the sorts of CSR exercises attempted by different organizations over ten noteworthy businesses in India.

### **EXPOSURE OF CSR EXERCISES MADE MANDATORY**

Preceding 2012-13, numerous organizations were intentionally making donations and spending on group advancement and relief of natural contamination. It is just since 2012-13 that organizations have begun designating stores for CSR exercises particularly. This was in light of the Securities and Exchange Board of India (SEBI) round dated August 2012, which ordered all main 100 recorded organizations to incorporate corporate responsibility report as a piece of their yearly report. Consequently the year 2012-13 denotes a defining moment, where it was seen that a stamped distinction in the CSR activities was embraced by the organizations. After having, looked at the donations made and CSR use acquired by firms in the most recent three years, utilizing firm level information from Prowess<sup>6</sup> (Place for Observing Indian Economy).

Despite the fact that it was not obligatory to spend on CSR activities in 2012-13, there was a checked increment in the normal CSR consumption by the organizations in 2012-13 in light of the Act's section

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<sup>6</sup> Reforms and Economic Transformation in India, Book 2 By Jagdish Bhagwati, Arvind Panagariya

in August 2013, when contrasted with the earlier year. CSR use by public companies expanded extensively in 2012-13, when contrasted with 2011-12. The enactment of the provision of the Companies ACT, 2013 likewise prompted an increment in the normal CSR spending of public segment firms from Rs 25.72 million in 2012 to Rs 147 million in 2013. There has additionally been a huge increment in the normal CSR consumption by Indian firms when contrasted with foreign firms. Normal CSR consumption by residential and outside firms was Rs 3.79 and 8.5 million separately in 2011-12, however this expanded to Rs 22.6 million and 19.5 million individually in 2012-13. Foreign firms expanded their use, in light of the fact that they may have been driven by the need to ensure their image name. Foreseen future weight from customers, financial specialists and NGOs might likewise have been the main thrust for outside firms to put resources into socially mindful exercises. The enactment of the Companies Act, 2013 additionally prompted a lofty ascent in the quantity of firms revealing their CSR consumption. In 2010-11, 336 organizations had unveiled their donations and consumption on group and environment related exercises. This number rose to 504 in 2011-12, and to 1,470 in 2012-13. There was an increment in natural reporting by firms also. In 2010-11, just 35 organizations had consented to ecological reporting, while 52 had recorded reports in 2011-12. In any case, in 2012-13, there was an increment of 211.5%, with 162 organizations unveiling their ecological execution data. In 2012-13, 760 organizations had crossed the edge of Rs 5 crore in net profit, however their aggregate CSR commitment was lesser than the 2% paradigm as set around by the Act. The aggregate CSR spending by firms was Rs 33,668 million, yet the obliged spending ought to have been Rs 45,154 million<sup>7</sup>.

### **RELATIONSHIP BETWEEN CSR CONSUMPTION AND PRODUCTIVITY OF FIRMS**

There has been a ton of open deliberation about the superfluous weight on the corporate part because of the CSR consumption determined in the Companies ACT, 2013. Corporate gatherings have censured the obligatory statement in the Act, as it will diminish the gainfulness of firms. The relationship between benefit after assessment and donation and group improvement use attempted by the organizations throughout the most recent three years and observe it to be sure and expanding has already been dissected.

Consumption on CSR expands firms' benefit by building their picture according to customers, suppliers and the administration. Firms likewise deliberately separate their items from rivals' items

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<sup>7</sup> By Sujeet Katiyar in CSR IMP (JAN 12, 2015)  
<https://www.linkedin.com/pulse/corporate-social-responsibility-analysis-india-sujeet-katiyar-1>

in the business sector on the premise of CSR. CSR activities in nearby groups by earth contaminating organizations additionally help in maintaining a strategic distance from challenge developments and future administrative regulations. This decreases dangers and instabilities and expands the security and returns of the organizations. Along these lines, CSR use prompts higher productivity for every single firm size.

Likewise it can be found that that there is a positive relationship in the relationship of CSR and Profit, and the likelihood of higher spending on CSR increments as the firm gets to be greater. CSR as we probably are aware has advanced from altruism to group improvement is the key to CSR. Smaller firms with lesser assets available to them are less inclined to embrace keys to CSR. They for the most part receive generosity and group advancement exercises, for example, schools for children of representatives, donations to religious associations and so forth.

On the other hand, CSR exercises are firmly connected to the organization's business objectives and falling in the domain of key to CSR (for example–women cleanliness classes by quick moving buyer products) have higher settlements and are for the most part done by bigger organizations. Thus, positive relationship exists in between profit and CSR use is upgraded as the company's span increments. It is profitable for a huge organization to spend on CSR, as it deliberately separates its item, which eventually pays off over the long haul. Vital separation might likewise lead to advancement, which may enhance conveyance of administrations.

After concentrating on the CSR exercises embraced by the main 200 organizations by experiencing their yearly reports for the year 2012-13 with a specific end goal to better comprehend the way of those exercises and the main impetuses that affected those exercises. Albeit a few studies have taken a gander at sorts of CSR exercises embraced by Indian organizations, it was possible to have secured a bigger number of firms over ten commercial enterprises and to do an industry level investigation.

Until 2013, numerous organizations had unveiled the exercises attempted by them, yet not the accurate sum they spent on every movement. It is possible to find that the organizations' majority attempt CSR use for the welfare of rural groups, particularly around their ranges of operation. A conceivable reason could be to create goodwill amongst individuals in the area and get comfortable with the territory and its needs, which thusly would minimize expenses of giving administrations. As opposed to the created nations where CSR exercises are embraced primarily in the territory of environment, in India it is mostly attempted in the social segment. In light of the late enactment, it is fascinating to perceive how organizations would change their CSR systems. After group

advancement, education (counting aptitude improvement) draws in the biggest offer of CSR use. Wellbeing is likewise a noteworthy zone where firms like to contribute. The accompanying table gives an industry-wise separation of the major CSR exercises attempted by every industry.

### **OIL AND GAS DIVISION**

In the oil and gas part, open segment endeavours have been found to spend the most on advancement of townships and group, with an uncommon spotlight on education. They attempt group improvement in and around their territories of operation. This may be on the grounds that the groups living near their range of operation are most influenced by negative generation externalities. Henceforth the organizations embrace CSR spending keeping in mind the end goal to diminish the negative impacts of their extraction exercises. They arrange wellbeing camps, which give free restorative registration to individuals. For instance, the Indian Oil Company runs versatile therapeutic units in Mathura and has setup a medical caretaker preparing foundation in Digboi, Assam. It has additionally spent a great deal on the school education of kids who live close to their plants and in their townships<sup>8</sup>.

### **IRON AND STEEL AREA**

In the iron and steel division, the Steel Authority of India Limited (SAIL) has put resources into wellbeing and education foundation for its representatives<sup>9</sup>. Numerous organizations spend on expertise improvement programs, which help in building human capital prompting better business prospects for individuals. The organizations support the school education of the kids living in the close-by groups and give grants for advanced education also.

### **SAVING MONEY DIVISION**

Organizations in the saving money segment spend principally on need segment territories. They check the 40% obligatory need area loaning as a piece of their CSR exercises. In any case, banks, for example, Jammu and Kashmir Bank embrace exercises other than need division giving too. They bolster schools and give trusts to meeting instructive costs. Studies have demonstrated that banks spend more on education and environment with a specific end goal to fortify their picture and expand buyer fulfilment. Expansive banks tend to tackle more CSR exercises to flag better market execution,

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<sup>8</sup> [https://www.iocl.com/download/IOCL\\_SR\\_Oct\\_2012-13.pdf](https://www.iocl.com/download/IOCL_SR_Oct_2012-13.pdf)

<sup>9</sup> <http://www.sail.co.in/sites/default/files/publications/SAIL-CSR-brochure.pdf>

while moderately less productive or littler banks may need to expand their CSR activities to construct more grounded associations with its partners.

In a substance examination study, it has been found that Indian banks vary in their CSR introduction as for their proprietorship structure, number of workers, and date of its consolidation. It has been found that there is a huge distinction in introduction in the zones of environment and rural improvement (when contrasting manages an account with deference with possession), in group welfare and environment and provincial advancement (when contrasting saves money with deference with number of workers), and in environment and commercial centre (when contrasting keeps money with deference with the date of joining of the bank). Indian banks no more see CSR as philanthropy, yet they see it as a method for building their picture and advertising their items.

### **VEHICLES SEGMENT**

The greater part of the organizations in the car division spend generally on ecological maintainability, while some like Tata engines concentrate more on education and expertise advancement. Mahindra and Mahindra concentrate more on environment by resolving to lessen nursery gas outflows. It has presented different manageability measures in its plants like xeriscaping, green structures and water productive plants. This can be credited to the way that the vehicles segment is a standout amongst the most dirtying commercial enterprises in India. The Centre for Science and Environment (CSE) has given a low score to Tata Motors and Mahindra and Mahindra in its green initiatives<sup>10</sup>. This may be to maintain a strategic distance from conceivable future natural regulations.

### **CEMENT INDUSTRY**

Concrete industry is a standout amongst the most contaminating commercial ventures in India. Shree Cements which was given a low evaluating by the CSE Green Rating project has focussed more on supportability. It has received the "triple main concern" approach, where the emphasis is on benefit amplification, worker welfare and ecological manageability. In its supportability report, it has focussed on environmental change and lessening of nursery gasses amid generation. Grasim Cements, which has a relatively higher rating, has focussed more on group improvement and rural advancement. Their CSR spending has been coordinated towards medicinal services, mother and kid welfare and training. Gujarat Alkalies and Chemicals Limited (GACL) and Madras Cement Limited

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<sup>10</sup> <http://www.slideshare.net/hrishysachan/csr-report-in-the-field-of-education-and-vocational-training-of-few-companies>

(MCL), which are auxiliaries of Ramco Cements, spend on group advancement and environment. GACL has embraced clean advancement system keeping in mind the end goal to diminish nursery gas emanations. Ultratech Cements CSR procedure is situated more towards group advancement. It has directed wellbeing camps in country regions around its plants and has empowered reasonable occupation through watershed administration and environment.

### **PAPER AND MASH INDUSTRY**

In the paper and mash industry, Ballarpur Industries (BILT) has focussed on reasonable advancement. Its CSR methodology concentrates on provincial improvement, with an accentuation on environment and groups. Additionally, JK Paper accentuates on social homestead ranger service and even distributes a semi-annual domain consistence report. Andhra Pradesh Paper Mills additionally concentrates on ecological supportability.

### **POWER DIVISION**

In the power division, firms spend prevalently on group and rural improvement. They embrace advancement measures for groups which remain nearby to their plants through establishment and trusts. They accentuate on the procurement of instructive offices and expertise advancement programs. For instance, Jindal Steel brings out its CSR exercises through its own trusts, which prompt sparing of exchange expenses and formation of goodwill in the neighbourhood. Open area units like NHPC and NTPC concentrate on recovery and resettlement of the groups uprooted by development ventures. Since these plants reason harm to the encompassing territories, CSR exercises may help in dodging unsettling by the neighbourhood groups and NGOs.

### **CONSUMER DURABLE PRODUCTS**

In the customer durables and quick moving buyer merchandise industry, organizations concentrate on social insurance and education. The Godrej group, so as to gather backings works towards natural manageability and protection of mangrove woodlands and embraces humanitarian exercises in the wellbeing and education area. They lead blood donation camps, conduct congenital fissure surgeries with Smile Train, a NGO. Additionally, Hindustan Unilever (HUL) concentrates on enhancing wellbeing and prosperity and decreasing the natural effect of its creation exercises. Subsequently in the buyer strong and quick moving shopper merchandise area, we find that organizations spend fundamentally on education and wellbeing activities.

## **PHARMACEUTICAL ORGANIZATIONS**

Organizations in the pharmaceutical division spend predominantly on education and wellbeing activities. Since pharmaceutical organizations work in the wellbeing segment and have enough talented labour, they direct numerous wellbeing camps in country territories. The push of their CSR exercises is to make medicinal services available to the minimized areas of the general public. Organizations like Aurobindo Pharma, Cadila Human services, Sun Pharma and Ajanta Pharma conduct restorative camps, while GlaxoSmithKline concentrates on the advancement of groups which dwell close to their plant.

## **FOUNDATION PART**

In the base area, firms spend vigorously on group advancement programs. We have taken firms occupied with development, designing, ports, shipping, street transport under foundation part. These organizations spend in the improvement of country territories. They bolster the midday meals programs in schools and expertise improvement programs for ladies and youth. In the matter of CSR usage, we find that these organizations attempt CSR for the most part through establishments and NGOs.

## **WORKING THROUGH THEIR OWN PARTICULAR ESTABLISHMENTS AND TRUSTS**

It has been found that 34% of the main 300 organizations in India work through own establishments or trusts. They serve the general public through different measures like group improvement, provincial advancement, and so on. Around 19% of the organizations arrange free restorative registration camps in rural territories, blood donation camps and instructive camps for agriculturists in the country ranges and school youngsters. Around 30% of the organizations work together with non-for-profit organisations to complete their CSR exercises. For instance, a few organizations like TVS motors, Godrej and different organizations finance the NGO Smile Train, which leads congenital fissure and sense of taste surgeries<sup>11</sup>.

Tata Motors work together with various modern preparing organizations to lead ability advancement programs. A number of organizations work together with government schools and backing the mid-day meal programs. Around 5% of the organizations receive earth feasible strategies for generation. These organizations have a place basically to the earth dirtying commercial ventures

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<sup>11</sup> [http://planningcommission.nic.in/reports/sereport/ser/isid\\_mining%20\\_report1206.pdf](http://planningcommission.nic.in/reports/sereport/ser/isid_mining%20_report1206.pdf)



like paper and mash. The greater part of the organizations in the paper and mash industry turn out with a half-yearly natural report on ecological consistence as governed by guidelines of the Ministry of Environment and Forest. 12% of the organizations make donations to neighbourhood schools and healing facilities. For the most part banks give restorative hardware and textbooks to nearby healing facilities and schools.

Thus, it can be seen that the vast majority of the organizations depend on establishments to do CSR exercises. Along these lines they find themselves able to screen the CSR exercises better, save money on exchange costs and make goodwill for their organization.

### **FINISHING UP COMMENTS**

The idea of CSR can possibly upset the economy's improvement. With rising financial shortage and spillages in the welfare plans, CSR looks to address the issues of society in a practical way. The idea can possibly create Rs 20,000-25,000 crore consistently, which can give a support to interest in human and physical capital<sup>12</sup>. In a matter of seconds, CSR use is for the most part caused at the neighbourhood level through the establishments built up by firms. This adjusts CSR activities to the belief system of the firm and minimizes exchange costs for it. For effective usage of stores apportioned for CSR and full acknowledgment of potential advantages, these uses require a heading.

The late duty of Rs 100 crore each, by two driving organizations, Tata Consultancy services and Bharti Airtel, as a piece of their CSR activities to construct toilets for young ladies in schools in the wake of government's Swachha Bharat Abhiyan is just the tip of the ice-berg<sup>13</sup>. There is considerable room for thought that should be given to the most squeezing issues of society and whether CSR assets could be used to address them. In opposition to some sceptical voices in the general public, CSR use may not influence benefits antagonistically and could help in building the brand name of the firm.

In spite of the fact that the new Companies Act, 2013, which made burning through 2% of their profits on CSR required, came into power just in April 2014, the last couple of years have seen a critical increment in CSR use by firms. This can be ascribed to the yearning of organizations to venture them as socially dependable. The CSR use by firms is influenced by the business to which they have a place. Firms in contaminating commercial ventures spend more on exercises identified with the earth,

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<sup>12</sup> <http://www.timetechnoplast.com/investor/11783-Time-Technoplast-AR-2015-Dummy-LR.pdf>

<sup>13</sup> By [Rajesh K Sharma](#) in The Free Press Journal (Dec 12, 2014 12:22 am)  
[Http://www.freepressjournal.in/corporate-india-shows-zeal-in-swachh-bharat/](http://www.freepressjournal.in/corporate-india-shows-zeal-in-swachh-bharat/)

while firms in the iron and steel and power segment spend more on nearby group advancement, as their tasks cause substantial scale dislodging. They additionally do it with the expectation that it may avert future blacklist and dissent developments.

As of not long ago, donations by firms were driven by their intrigues; it was self-assertive, and now and again little in examination to the organizations' measure. The CSR exercises of the organizations relied on the way of their industry and confined to the zone where the firm was found. This was generally determined by components, for example, cost minimisation and "perceivability" among the purchasers. However, this may change with the new law. Firms may be headed to expand their regions of operation and a popularity which had been deserted in the improvement procedure may pick up massively from this.

The idea of "corporate social responsibility" has become so sufficiently pervasive that it has earned its own particular acronym in business circles: CSR. The term implies that an organization ought to be responsible to a community, and also to shareholders, for its activities and operations. At the point when an enterprise embraces a CSR strategy, it plans to show an objective of maintaining moral qualities, and additionally regarding individuals, groups and nature. The organization attempts to screen its consistence with its expressed CSR arrangement and report this with the same recurrence that it reports its money related results.

### **PROFIT AND VALUE**

A CSR approach enhances organization productivity and worth. The presentation of vitality efficiencies and waste recycling cuts operational expenses and advantages the planet. CSR likewise expands organization responsibility and its straightforwardness with speculation experts and the media, shareholders and nearby groups. This thus upgrades its notoriety among speculators, for example, common subsidizes that incorporate CSR into their stock choice. The outcome is an ethical circle where the organization's stock worth increments and its entrance to venture capital is facilitated.

### **CLIENT RELATIONS**

A larger part of buyers close to 77 percent of purchasers believe that organizations ought to be socially capable, as per a study by marketing organization Landor Associates referred to by the

University of Pennsylvania's Wharton School<sup>14</sup>. Buyers are attracted to those organizations that have a notoriety of being a decent corporate subject. Research at Tilburg University in the Netherlands demonstrated that buyers are readied to pay a 10 percent higher cost for items they esteem to be socially dependable<sup>15</sup>.

### **ACES OF CSR**

A CSR methodology improves the benefit, the quality and the picture of an organization. The idea of vitality value and waste recycling diminishes operational expenses and enhances the earth. All the more decisively, for little organizations, CSR has likewise numerous advantages in light of numerous components: The more restricted extension and geographic range that little organizations collaborate with, the less individuals and levels included in the choice making procedures and the limitation in a relatively smaller group of the business exercises and obligation models. For instance, an organization needing to address ecological issues can join with neighbourhood natural recycling projects. In decades past, corporate responsibility was frequently considered as applying to one particular gathering: shareholders. Taking care of their requests and giving back a benefit on their venture were the essential targets for a few enterprises. After some time, mindfulness has developed among organizations that substantial and little of squeezing social difficulties, for example labourers' rights and anti-destitution. In the meantime, more shoppers have started demanding that the organizations with whom they work together exhibit responsiveness toward allaying social issues. Accordingly, another plan of action has risen. It is in light of the perspective that organizations must be mindful to their shareholders, as well as to their "partners" – their workers, suppliers and individuals from the groups in which they work together. More organizations are executing approaches with respect to corporate social responsibility (CSR), which can assist them with bettering their reaction to customer request and shine their notoriety in the commercial centre. They're putting resources into better approaches to diminish their effect on the planet's limited assets, patching up supply anchors to pick mindful merchants, and building up strategies to support workforce assorted qualities and equity. For a few organizations, even that is insufficient. They're looking to their groups and past for approaches to emphatically affect the world. A June 2013 article

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<sup>14</sup> In Knowledge@Wharton (May 23, 2012)

<http://knowledge.wharton.upenn.edu/article/from-fringe-to-mainstream-companies-integrate-csr-initiatives-into-everyday-business/>

<sup>15</sup> [http://ijbssnet.com/journals/Vol.\\_2\\_No.\\_3\\_\[Special\\_Issue\\_-\\_January\\_2011\]/2.pdf](http://ijbssnet.com/journals/Vol._2_No._3_[Special_Issue_-_January_2011]/2.pdf)

distributed by the University of Pennsylvania's Wharton business college highlighted a late study of corporate pioneers with respect to their perspectives on CSR. About 80% of administrators said that their organization sets out on CSR activities to help their notoriety. Other prevalent reasons referred to for putting resources into CSR were that it can enhance deals and benefits, and draw in donated workers. In any case, the study's creator reasoned that the larger part of corporate social responsibility endeavours are "past immaculate [public relations] ploys." "Social effect is a zone of unanticipated danger; from numerous points of view, CSR is a dangerous administration," said Wesley Hutchinson, staff executive at the Wharton Behavioural Laboratory. "It's not profiting today, but rather it profits over the long haul."<sup>16</sup>

### **MEASURING PROS AND CONS OF CSR**

In deciding to grasp corporate social responsibility, various elements ought to be measured, including: Organizations have constrained assets, and shareholders' interests must at present be viewed, even as different partners are being fulfilled. Becoming all the more socially mindful at the expense of productivity can spell inconvenience for a business. Organizations should not let CSR endeavours occupy them, from their fundamental mission. The objective is to discover social issues that bolster and adjust to the organization's advantage and reason, whether it's an area eatery picking provincially delivered farming or a worldwide attire producer advancing working environment wellbeing regulations in the manufacturing scene.

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<sup>16</sup> In Knowledge@Wharton (June 5, 2013)  
<http://knowledge.wharton.upenn.edu/article/does-the-good-outweigh-the-bad-sizing-up-selective-corporate-social-responsibility/>

**CASE COMMENT ON**  
**SHIROMANI GURDWARA PARBANDHAK COMMITTEE, AMRITSAR VS.**  
**SOMNATH DASS AND OTHERS**

**NISHTHA CHUGH<sup>17</sup>**

**ABSTRACT**

The deep faith of every earnest follower, when his pure conscience meets the divine under-current emanating from their Guru, produces a feeling of sacrifice and surrender and impels him to part with or gift out his wealth to any charity may be for gurdwaras, dharamshalas etc.. Such parting spiritualizes such follower for his spiritual upliftment, peace, tranquillity and enlightens him with resultant love and universalism. Such donors in the past, raised number of Gurdwaras. They gave their wealth in trust for its management to the trustees to sub serve their desire. They expected trustees to faithfully implement the objectives for which the wealth was entrusted. When selfishness invades any trustee, the core of trust starts leaking out. To stop such leakage, legislature and courts step in. This is what was happening in the absence of any organized management of Gurudwaras, when trustees were either mismanaging or attempting to usurp such trusts. The Sikh Gurdwaras and Shrines Act 1922 (VI of 1922) was enacted to meet the situation.

**INTRODUCTION**

The recent pronouncement of the Supreme Court of India that the Aad Guru Granth Sahib (AGGS) is a juristic person has attracted mixed reactions from the cross sections of society. The object of the present paper is to assess the impact of the judgment of the apex court. The court has taken into account the supreme and special status of the AGGS in Sikhism by distinguishing it from the sacred books of the other religions. The AGGS has also not been equated with Hindu idol for being the existing guru and guiding force for the Sikhs. The judgment will be helpful to save the property belonging to Sikh institutions which is owned by the AGGS as per revenue records and is occupied or is likely to be occupied by the usurpers. There is nothing in the judgment, which can be described as anti-Sikh or violation of Sikh principles.

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## **SIGNIFICANCE OF GURU GRANTH SAHIB**

Sikhism grew because of the vibrating divinity of Guru Nanakji and the 10 succeeding gurus, and the wealth of all their teachings is contained in Guru Granth Sahib. The last of the living guru was Guru Gobind Singhji who recorded the sanctity of Guru Granth Sahib and gave it the recognition of a living Guru. Thereafter, it remained not only a sacred book but is reckoned as a living guru.

## **ACTS INVOLVED**

The Sikh Gurdwaras and Shrines Act 1922 was enacted which failed to satisfy the aspirations of the Sikhs. The main reason being that it did not establish any permanent committee of management for Sikh gurdwara and did not provide for the speedy confirmation by judicial sanction of changes already introduced by the reforming party in the management of places of worship. The Sikh Gurdwaras Act, 1925 replaced this, under which the present case arises. This Act provided a legal procedure through which gurdwaras and shrines regarded by Sikhs as essential places of Sikh worship to be effectively and permanently brought under Sikh control and management, so as to make it consistent with the religious followings of this community.

## **FACTS**

The dispute-concerned land measuring 22 acres and buildings attached to Gurdwara Sahib Dharamsala at Village Bilaspur, District Patiala. The property was donated by way of loh (grant for food) to the Mahants to feed the devotees. A Royal Order of Patiala State transferred the property to Guru Granth Sahib in 1921. The formal entry in revenue records (mutation) was made in the name of "Guru Granth Sahib Brajman Dharamshala Deh (Patiala District)" as far back as 1928.

About 56 persons of villages Bilaspur, Ghodani, Dhamot, Lapran and Buani situated in the Village Bilaspur, District Patiala moved petition under Section 7(1) of the Sikh Gurudwara Act (hereinafter the act) for declaration that the disputed property is a Sikh Gurdwara. The State Government declared the same as Sikh Gurdwaras.

Thereafter, a composite petition under Sections 8<sup>18</sup> and 10<sup>19</sup> of the Act was filed who claimed it to be a dharamshala and Dera being owned and managed by the petitioners and their predecessors since the time of their forefathers and that they being the holders of the same, received the said Dera in succession, in accordance with their ancestral share. They also claimed to be in possession of the land attached to the said Dera. They denied it to be a Sikh Gurdwara. The Government forwarded this petition to the Sikh Gurdwara Tribunal, hereinafter referred to as the Tribunal. In reply to the notice, the Shiromani Gurdwara Parbandhak Committee, hereinafter referred to as the SGPC (appellant), claimed it to be a Sikh Gurdwara, having been established by the Sikhs for their worship, wherein Guru Granth Sahib was the only object of worship and it was the sole owner of the gurdwara property. It denied this institution to be an Udasi Dera. However, appellant Committee challenged the locus standee of the respondent to file this objection to the notification. The appellant's case was under Section 8 and objection could only be filed by any hereditary office-holders or by 20 or more worshippers of the gurdwara, which they were not. The Tribunal held that the petitioners before it

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<sup>18</sup> When a notification has been published under the provisions of sub-section (3) of section 7 in respect of any gurdwara, any hereditary office-holder or any twenty or more worshippers of the gurdwara, each of whom is more than twenty-one years of age and was on the commencement of this Act 4[or, in the case of the extended territories, on the commencement of the Amending Act, as the case may be,] a resident of a police station area in which the gurdwara is situated may forward to the [State] Government, through the 5[appropriate Secretary to Government], so as to reach the Secretary within ninety days from the date of the publication of the notification, a petition signed and verified by the petitioner, or petitioners, as the case may be, claiming that the gurdwara is not a Sikh Gurdwara, and may in such petition make a further claim that any hereditary office-holder or any person who would have succeeded to such office-holder under the system of management prevailing before the first day of January, 1920 1[or, in the case of the extended territories, before the 1st day of November, 1956, as the case may be,] may be restored to office on the grounds that such gurdwara is not a Sikh Gurdwara and that such office-holder ceased to be an office-holder after that day:

Provided that the 2[State] Government may in respect of any such gurdwara declare by notification that a petition of twenty or more worshippers of such gurdwara shall be deemed to be duly forwarded whether the petitioners were or were not on the commencement of this Act 1[or, in the case of the extended territories, on the commencement of the Amending Act, as the case may be,] residents in the police station area in which such gurdwara is situated, and shall thereafter deal with any petition that may be otherwise duly forwarded in respect of any such gurdwara as if the petition had been duly forwarded by petitioners who were such residents.

<sup>19</sup>(1) Any person may forward to the 1[State] Government through the 2[appropriate Secretary to Government], so as to reach the Secretary within ninety days from the date of the publication of a notification under the provisions of sub-section (3) of section 7, a petition claiming a right, title or interest in any property included in the list so published. (2) A petition forwarded under the provisions of sub-section (1) shall be signed and verified by the person forwarding it in the manner provided by the Code of Civil Procedure, 1908, for the signing and verification of plaints, and shall specify the nature of the right, title or interest claimed and the grounds of the claim. (3) The 1[State] Government shall, as soon as may be, after the expiry of the period for making a claim under the provisions of sub-section (1) publish notification, specifying the rights, titles or interests in any properties in respect of which no such claim has been made, and the notification shall be conclusive proof of the fact that no such claim was made in respect of any right, title or interest specified in the notification.

were not hereditary office holders, as they neither managed it nor performed any public worship. Thus, their petition under Section 8 was rejected on grounds that they have no locus standee. Aggrieved by this they filed first appeal, which was also dismissed by the High Court, which became final. Thereafter, the Tribunal took the petition under Section 10 in which the stand of SGPC was that the land and the buildings were the properties of Gurdwara Sahib Dharamshala Guru Granth Sahib at Bilaspur. The respondents and their predecessors along with their family members had all along been its managers and they had no personal rights in it. The Tribunal framed two issues:

- (1) What right, title or interest has the petitioners in the property in dispute?
- (2) What right, title or interest has the notified Sikh Gurdwara in the property in dispute?

The Tribunal decided both issue No.1 and issue No.2 in favor of SGPC and held that the disputed property belonged to them only. Aggrieved by this, again an appeal was filed and during the pendency of the same, the SGPC on the basis of final order passed earlier by the High Court filed a petition under section 25-A<sup>20</sup> of the Act for the possession of the building and the land. The respondents contested the suit by raising objection about mis-description of the property in the plaint and also raising an issue about jurisdiction since the income from the gurdwara was more than Rs.3,000/- per annum for which a committee was to be constituted before any suit could be filed. On contest, the said suit of SGPC was decreed and respondent's objections were rejected.

It will be relevant to mention that Ruler of the erstwhile princely state of Patiala had issued Farman-e-Shahi (Royal Order) that the properties attached to the religious institutions, though standing in the names of their Managers, were to be mutated and entered in the name of the Add Guru Granth Sahib of those institutions. Thus, it is abundantly clear that by the order of the Ruler of Patiala State, the Aad Guru Granth Sahib was recognized as capable of holding the property. Thus, the Add Guru Granth Sahib was recognized as a juristic person by this royal order in the State of Patiala. And it continues to be so by virtue of Article 372(1) of the Constitution, which provides for the continuation of pre-Constitution laws unless, amended or repealed. Taking a cue from the order of the princely

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<sup>20</sup> 25-A(1) When it has been decided under the provisions of this Act that a right, title or interest in immovable property belongs to a Notified Sikh Gurdwara, or any person, the Committee of the Gurdwara concerned or the person in whose favor declaration has been made may, within a period of one year from the date of the decision or the date of the constitution of the Committee, whichever is later, institute a suit before a tribunal claiming to be awarded possession of the right, title or interest in the immovable property in question as against the parties to the previous petition and the tribunal shall, if satisfied that the claim relates to the right, title or interest in the immovable property which has been held to belong to the Gurdwara, or to the person in whose favor the declaration has been made, pass a decree for possession accordingly;



state, the precedent could be followed and extended easily elsewhere. It was for the first time objection was raised by respondents through their counsel before the High Court contending that the entry in the revenue records in the name of Guru Granth Sahib was void as Guru Granth Sahib was not a juristic person.

### **PRECEDENT**

1. In a case entitled as *Piara Singh v. The Aad (Sri) Guru Granth Sahib*<sup>21</sup> a person had executed a will of certain property in favor of the Aad Guru Granth Sahib installed in the Gurdwara Sahib Madnipur. The appellant got the mutation of the property sanctioned in their names. The validity of mutation was questioned and the suit was brought for possession of the property by three plaintiffs, namely, the Aad Guru Granth Sahib, Gurdwara Sahib Madnipur and one Gujjar Singh (perhaps Manager of Gurdwara). The appellants, after losing in lower Courts, contended in the High Court that the Aad Guru Granth Sahib, not being a juristic person is not capable of holding the property and the suit is not maintainable in its name. The High Court did not express its opinion as to the juristic personality of the Aad Guru Granth Sahib though the lower courts categorically declared that it is not a juristic person. It was held that the suit was maintainable because the other two plaintiffs are capable of doing the same. The other contention as to the competency of the Aad Guru Granth Sahib to hold property for not being a juristic person was not permitted to be raised on the technical ground that the question was not raised before the lower courts. It is submitted that it was a fit case for the High Court to hold that the Aad Guru Granth Sahib is a juristic person and is capable of holding the property. It need not have disposed of the case on the ground of not allowing a new plea to be agitated in the second appeal. It could have very well disposed it of on merit with the same result, especially, when Farman-e-Shahi of ruler of Patiala State of entering the mutation in the name of Guru Granth Sahib was brought to the notice of the Court and the case related to the territory falling under the erstwhile state of Patiala. An assertion that the Aad Guru Granth Sahib is a juristic person was expected from the Court at least in obiter dicta.

2. In *Hindu Religious Endowments Board V. Veeraraghavacharlu*<sup>22</sup> it was expressly explained that purpose of making a gift to a temple is not to confer a benefit on God but to confer a benefit on those who worship in that temple, by making it possible for them to have the worship conducted in

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<sup>21</sup> AIR 1973 Punjab & Haryana High Court (P&H) 470.

<sup>22</sup> AIR 1937 Mad 750

a proper and impressive manner. This is the sense in which a temple and its endowments are regarded as a public trust.

3. In *Som Prakash Rekhi Vs. Union of India & Anr.*<sup>23</sup>, the Court held that a legal person is any entity other than a human being to which the law attributes personality.

### **DECISION OF HIGH COURT AND SUPREME COURT EXAMINATION**

Firstly, high Court based its decision on prior decisions of the courts that recognized an idol to be a juristic person but they did not recognize a temple to be so. So, on the same parity, a Gurdwara cannot be a juristic person and Guru Granth Sahib can only a sacred book. It cannot be equated with an idol nor does Sikhism believe in worshiping any idol. Hence Guru Granth Sahib cannot be treated as a juristic person. Supreme Court held that such a view is based on a Misconception as it is not necessary for Guru Granth Sahib to be declared as a juristic person that it should be equated with an idol. When belief and faith of two different religions are different, there is no question of equating one with the other. If Guru Granth Sahib by itself could stand the test of its being declared as such, it can be declared to be so.

Secondly, High Court felt was that there could not be two Juristic Persons in the same building. This they considered would lead to two juristic persons in one place viz., gurudwara and Guru Granth Sahib.

Supreme Court again on the same opinion regarded it as a misconceived notion. They are no two Juristic Persons at all. In fact both are so interwoven that they cannot be separated. The installation of Guru Granth Sahib is the nucleus or nectar of any gurudwara. If there is no Guru Granth Sahib in a Gurdwara it cannot be termed as gurudwara. When one refers a building to be a gurudwara, he refers it so only because Guru Granth Sahib is installed therein. Even if one holds a Gurdwara to be a juristic person, it is because it holds the Guru Granth Sahib. So, there do not exist two separate juristic persons, they are one integrated whole. Even otherwise in *Ram Jankijee Deities and Ors. Vs. State of Bihar and Ors.*<sup>24</sup>, the Court while considering two separate deities, of Ram Jankijee and Thakur Raja they were held to be separate Juristic Persons. So, in the same precincts, as a matter of law, existences of two separate juristic persons were held to be valid. Thirdly, it was held by high

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<sup>23</sup> 1981(1) SCC 449

<sup>24</sup> 1999 [5] SCC 50

court that if Guru Granth Sahib is a Juristic Person then every copy of Guru Granth Sahib would be a Juristic Person.

This again in opinion of Supreme Court is based on erroneous approach on the ground that every idol at private places, or carrying it with one self each would become a Juristic Person. This is a misconception. An idol becomes a juristic person only when it is consecrated and installed at a public place for public at large. Every idol is not a juristic person. So every Guru Granth Sahib cannot be a juristic person unless it takes juristic role through its installation in a gurudwara or at such other recognized public place.

Fourthly High Court held that Guru Granth Sahib is like any other sacred book, like Bible for Christians, Bhagwat Geeta and Ramayana for Hindus and Quran for Islamic followers and cannot be a Juristic Person. This submission also has no merit in the eyes of Supreme Court though it is true that Guru Granth Sahib is a sacred book like others but it cannot be equated with these other sacred books in that sense because Guru Granth Sahib is revered in gurudwara, like a Guru which projects a different perception. It is the very heart and spirit of gurudwara. The reverence of Guru Granth on the one hand and other sacred books on the other hand is based on different conceptual faith, belief and application.

Fifthly, High Court held that Sikh religion does not accept idolatry and hence Guru Granth Sahib cannot be a juristic person.

On the contrary Supreme Court held that it is true that the Sikh religion does not accept idolatry but, at the same time when the tenth guru declared that after him, the Guru Granth will be the Guru that does not amount to idolatry. The Granth replaces the guru henceforward, after the tenth Guru.

On the one hand where high court held Guru Granth sahib not to exist as a juristic person based on several reasons as explained above, Supreme Court upon examination did not find any strength in the reasoning of High Court in recording a finding that the Guru Granth Sahib is not a Juristic Person and as such prima facie The said findings of High Court is not sustainable both on fact and law.

#### **CONTROVERSY OF FARAMAN-I-SHAHI**

Subsequent challenge was that the basis for mutating of the name of Guru Granth Sahib Birajman Dharamshala Deh, by deleting the name of the ancestors of the respondents, based on Faraman-I-

shahi issued by the then ruler of the Patiala State dated is liable to be set aside, as this Faraman-I-Shahi did not direct the recording of the name of Guru Granth Sahib.

High Court expressly held that Guru Granth Sahib is not a juristic person but once the very foundation falls, and Guru Granth Sahib is held to be a juristic person, the finding of setting such a mutation aside automatically cannot stand.

On examining the merits Supreme Court found that the mutation in the revenue papers in the name of Guru Granth Sahib was made as far back as in the year 1928, in the presence of the ancestors of respondents and no objection was raised by anybody till the filing of the present objection by the respondents as aforesaid under Section 8/10 of the 1925 Act. This is after a long gap of about forty years. Further, this property was given in trust to the ancestors of respondents for a specified purpose but they did not perform their obligation. It is also settled, once an endowment, it never reverts even to the donor. Then no part of these rights could be claimed or usurped by the respondent's ancestors who in fact were trustees. Hence for these reasons the claim over this disputed property by the respondents fails and is rejected.

## CONCLUSION

It is submitted that the huge property belonging to the eternal Guru cannot be left to be taken over by unauthorized, unscrupulous and dishonest people only on the plea that name of the Aad Guru Granth Sahib should not be mentioned at all in the Courts. Besides, there cannot be two opinions that it will be better if it could be avoided. Therefore, via media adopted by the Draft Bill<sup>25</sup> seems to be correct.

There is an apprehension in the mind of some Sikhs that the declaration of Guru Granth Sahib as a juristic person will lead to filing of claims and suits against the Aad Guru Granth Sahib installed anywhere. In the judgment under discussion the Supreme Court has cleared by saying "every Guru Granth Sahib cannot be a juristic person unless it takes a juristic role through its installation in a Gurdwara or at such recognized public place". The Aad Guru Granth Sahib installed at specific

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<sup>25</sup> All India Sikh Gurdaras Draft Bill, 1999, Clause 14. For removal of doubts, it is hereby declared that notwithstanding any judgment, decree or order of any Court, Sri Guru Granth Sahib shall be deemed a juristic person for all intents and purposes and where any property is donated or held in the name of Sri Guru Granth Sahib, however described, it shall not be open to question on the ground that at the time of such donation or acquisition of property Sri Guru Granth Sahib was not considered a juristic person.

Gurdwaras and public places only will become entitled to the rights and subject to liabilities of a juristic person.

It is felt in some Sikh circles that declaration of the Aad Guru Granth Sahib as a legal entity has equated it with Hindu deity or idol. No doubt that the Aad Guru Granth Sahib is recognized as such just like as Hindu idol, it should not be understood that status of Guru Granth Sahib has in any way adversely affected by this judgment. As mentioned in the beginning, there is a wide variety of juristic persons, Hindu idol is not the only one; now the Aad Guru Granth Sahib has also been included. It does not mean that both are equated for all purposes. It can be said that the particular characteristic of being a juristic person is common to both just like some other characteristic, for example, venerability of both by the followers of respective faiths, then installation of both at the places of religious sanctity, etc. Peculiar identity of Guru Granth Sahib as eternal and living Guru of Sikhs has been specifically recognized and mentioned in the judgment. It is clearly mentioned in the judgment that "Guru Granth Sahib cannot be equated with an idol as idol worship is contrary to the principles of Sikhism".

On the whole, the judgment is not in any way repugnant or antagonistic to Sikh principles or Sikh interests. On the other hand, it is quite laudable for upholding and highlighting the ideals of Sikhism. The judges specifically noted that Sikhism is an independent religion, it abhors idol worship, and it has no living Guru after Guru Gobind Singh, the Aad Guru Granth Sahib (AGGS). Is the reigning Guru of the Sikhs and its installation place (Gurdwara) becomes sacred because of its presence. The judgment also recognizes the Supreme and special status of the AGGS. There is no doubt that it is a sacred book but it cannot be equated with other sacred books such as Gita, Quran and Bible because it is reigning Guru of the Sikhs and a guiding force for the community. Though the Aad Guru Granth Sahib has been recognized as a juristic person just like a Hindu idol, there is no equation or comparison between the two as idol worship is contrary to Sikhism. AGGS is not an idol

Even before this pronouncement by the Supreme Court, cases were filed in the courts for and against AGGS. Therefore this judgment cannot be criticized for allowing involvement of the AGGS in litigation. On the other hand declaration of the AGGS as juristic person will save the property of religious institutions from illegal occupation, which the devotees has endowed in the name of the AGGS. There is hardly any scope of multiplication of court cases against the AGGS due to this pronouncement. The AGGS is a 'person' in law provided it is duly installed in a Gurdwara. Every copy of the scripture anywhere cannot be given that status. No adverse impact of this judgment can be perceived on any

Sikh principle or institution. The judgment has correctly brought out the distinctive features of Sikhism besides holding the AGGS as a juristic person.

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## **CRITICAL ANALYSIS OF LAW RELATING TO FLOATING CHARGES**

**ANAMIKA, ILYANA AISHWARYA KIRAN<sup>26</sup>**

### **OBJECTIVES/AMIS OF THE STUDY:**

To understand charge which divided into two parts like floating and fix charge under the Companies Act and issue & characteristics of the floating charge. What problems come with the floating charge under the companies act? What is the invalidity of the floating charge? How to floating charge to crystallise into fixed charge?

### **HYPOTHESIS:**

Floating charge is the specific mortgage securities or not of the assets and it is future or present security of the assets of the company. What type of nature has floating charge? What happen in the case of crystallisation of floating charge? Floating charge has invalid in any case or not. What does effect in the case floating charge on the company? What advantage of get a company by the floating charges?

### **LIST OF CASES**

- *Dublin city Distillery Co. v. Deherty*
- *Lord Macnaghten in Lilingworth & another v. Houldsworth & another*
- *Government Stock Investment Co. Ltd. V. Manila Rly. Co. Ltd.*
- *Indra Sugar Works Ltd. v. Official Liquidators, Indra Sugar Works Ltd.*
- *Maheshwari Bros. v. Official Liquidators, Indra Sugar Works Ltd.*
- *Government Stock Investment Co. Ltd. V. Manila Rly. Co. Ltd.*
- *N.W. Robbie & Co. Ltd. v. Witney Warehouse Co. Ltd.*
- *Re Indus Film Corporation Ltd. case*
- *State of AP v. Sri Raja Ram Janadhan*

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<sup>26</sup> Year III, Damodaran Sanjivayya National Law University, Visakhapatnam

- *Re Hi Fi Equipment (Cabinets) Ltd*
- *Narotamdas Trikamdass Toprani v. Bobbay Dyeing & Manufacturing Co. Ltd.*
- *Re Eric Holmes Property Ltd.*
- *Banaras Bank v. Bank of Bihar*
- *Narendra Kumar Maheshwari v. Union of India*
- *Bank of India v. Depro Ltd.*

## **INTRODUCTION**

Company ordinarily means an association of a number of individuals formed for some common purpose. It involves two ideas firstly – the members of the association are so numerous that it cannot aptly be described as a firm or a partnership, and secondly - a member may transfer his interest in the association without the consent of the other members. Such an association may be incorporated according to law whereupon it becomes a body corporate or is called a corporation with perpetual succession and a common seal. A charge is creation of a security on the company's property or undertaking in favour of a company's creditor to secure repayment of a loan or debt or any other obligation. Charge is defined by section 100 of the transfer of property, 1882 as: 'where immovable property of one person is by act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property; and the provisions hereinbefore contained which apply to a simple mortgage shall, so far as may be, apply to such charge.' A charge includes a lien and also an equitable charge.

## **CHARGE**

A charge may be defined as a security given for securing loan or debenture by a mortgage on the assets of a company. As stated earlier, the power of a company to borrow money also includes power to give security. Generally, the debentures and other borrowings of a company are secured by a charge on its assets. A charge is created when a property, whether existing or future, is agreed to be made available as a security for the re-payment of debt. However, the creditor gets no legal right over the property so charged but only gets a right to have the security made available by an order of the court in the event of non-payment of debt. According to section 124 of the Companies Act a charge

includes a mortgage. It's also includes lien whether created by a written instrument or by the deposit of title deed.<sup>27</sup>

#### KINDS OF CHARGES

A charge on the property of the company as security for debenture or debt may is either

- (i) A fixed charge or
- (ii) (ii) A floating charge.

#### **FIXED OR SPECIFIC CHARGE**

A charge is a fixed or specific when it is made specifically to cover assets which are ascertainable and definite at the time of creating the charge e.g., land, buildings, heavy machinery etc. A fixed charge is therefore against security of certain ascertainable specific property. The company's right to dispose of the property is temporarily suspended during the period it is charged or encumbered. In the event of winding of a company, a debenture-holder or creditor secured by a fixed or specific charge shall be placed in the highest class of creditors.<sup>28</sup>

#### **FLOATING CHARGE**

A floating charge, on the other hand, is not attached to any definite property but covers property which is of a fluctuating nature such as stock in trade. It is an equitable charge on the assets for the time being of a going concern.<sup>29</sup> It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes.<sup>30</sup>

Floating security is not a future security; it is a present security which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security. a floating security is not a specific mortgage of the assets plus a licence to the mortgagor to dispose of them in the course of his business but is a floating mortgage applying to every item comprised in the security

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<sup>27</sup> Dublin city Distillery Co. v. Deherty, 1914, AC 823, Dr. N.V. Paranjape, Company Law, Central Law Agency, 5<sup>th</sup> Edt. 2012.

<sup>28</sup> Lord Macnaghten in Lilingworth & another v. Houldsworth & another, (1904) 73 Ch. 739, Ibid 1

<sup>29</sup> Government Stock Investment Co. Ltd. V. Manila Rly. Co. Ltd., (1897) AC 81 Per Lord Macnaghten, Ibid 1.

<sup>30</sup> Ibid.



but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security.<sup>31</sup>

*Indra Sugar Works Ltd. v. Official Liquidators, Indra Sugar Works Ltd.*<sup>32</sup> it was held that as the company was going concern, it was clearly never the intention of the parties that the property actually charged should remain forever subject to the charge. If that was the intention, then the good of the company could never have been sold and the machinery of the company could never be replaced when it became obsolete. It appeared that the parties intended to create a floating charge that is a charge which would fasten on the property when the time arrived for the charge to be enforced. If the tests laid down above were applied to the present charge it was clear that the charge was a floating one. That being so, the charge was void as against liquidators for non-registration.

*Maheshwari Bros. v. Official Liquidators, Indra Sugar Works Ltd.*<sup>33</sup> the Maheshwari Bros (appellant) had a made security deposit with the company and the relevant clause of the agreement stated that the amount of the security money will be the second charge on the machinery and other goods of the company. It was held that charge in the instant case was a floating one.

*N.W. Robbie & Co. Ltd. v. Witney Warehouse Co. Ltd.*<sup>34</sup> court was held that the fact that this charge was a floating charge could not operate to exclude assets from the agreement to charge. That particular quality of the charge only meant that its full operation was, so to speak, in suspense until certain events occurred and when such an event occurred, the charge lost that suspended quality. That in any way justified the conclusion that the field of the charge was in any way restricted: it only meant that after this particular quality disappeared equality will fasten the charge directly upon all assets thereafter coming into existence as soon as they did so. The consisting of the debts arising subsequent to the receiver's appointment became as they an equitable charge to the debenture holders. Just as an assigned of a chose in action takes subject to an already existing right of set off, so a debtor with no existing right of set off cannot assert set off of a cross claim which he first acquire after he has notice of the assignment of the claim against him. No right of set off of the subsequently acquired cross-debt could defeat the interest of the debenture holders.

## **CRYSTALLISATION OF FLOATING CHARGE**

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<sup>31</sup> Supra 4.

<sup>32</sup> (1938) 8 Comp. Cas.241 (ALL.)

<sup>33</sup> [1942] 12 Comp. Cas. 75 (ALL) (FB).

<sup>34</sup> [1964] 34 Comp. Cas. 178 (CA).

According to 'McDowell Purcell', a floating charge will generally convert into a fixed charge or "crystallise" upon the occurrence of specified events. These events can be divided into two categories:

### **AUTOMATIC CRYSTALLISATION**

These are the classic well known crystallisation event such as a winding up or the appointment of a receiver. It is accepted that crystallisation will occur automatically upon the occurrence of these events and this is usually re-iterated in the relevant security document; and

### **EXPRESS CRYSTALLISATION**

These events can vary from case to case and are set out in the relevant charging document as a matter of contract. For crystallisation to occur, some action on the part of the charge holder is usually required. Generally this will be the service of a "crystallisation" notice upon the occurrence of specified events.<sup>35</sup>

A floating charge generally remains dormant until it crystallises or becomes a fixed charge. A floating crystallises into a fixed security under the following condition-

- (i) When company goes into liquidation,
- (ii) When company ceases to carry on business,
- (iii) When debenture holders or creditors take steps to enforce the security e.g., by appointing a receiver to take possession of charged property,
- (iv) On happening of an event specified in the deed.

A company borrowed money on the security of its stock-in-trade. The charge so created will keep floating over the changing stock-in-trade and when the time comes for the lender to enforce his security he will do so by seizing whatever stock is then in company's hands. When happens, the floating charge becomes fixed or crystallised.<sup>36</sup>

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<sup>35</sup> <http://www.mcdowellpurcell.ie/news/crystallisation-floating-charge>.

<sup>36</sup> Dr. Avtar Singh, Company Law, 10<sup>th</sup> Ed 1991, p. 360.

## CHARACTERISTICS OF FLOATING CHARGE

A floating charge would be useless if the lender could not convert it into a fixed charge. In certain circumstances the lender can do this and that is called "crystallisation". It is the process whereby the equitable charge attaches specifically and finally to all the items of the class of mortgaged assets which the company owns at that date or subsequently acquires if future assets are within the scope of the particular charge.

The main characteristics of a floating charge which distinguishes it from a fixed charge as pointed out by Romer J. *Re Yorkshire Woollen Mills Association Ltd*<sup>37</sup>, are as follows:-

1. It should be a charge upon a class of assets both present and future.
2. The class of assets would be changing from time to time.
3. It should be contemplated by the charge that until some step is taken by the mortgagee, the company shall have the right to use the assets in ordinary course of business.

*Re Indus Film Corporation Ltd. case*<sup>38</sup> the court held that in the instant case, charged was our assets, including machinery, shed, laboratory materials, and settings. These assets were undoubtedly of a floating nature. It may be that the machinery, shed and laboratory were not assets which would fluctuate to any considerable extent, but materials, settings and other things appertaining to a film business were undoubtedly of an extremely fluctuating nature and must change from time to time in the ordinary conduct of the business of a film corporation. This is the first characteristic of a floating charge. Then again, no restraint of any kind whatever was placed upon the film corporation in the carrying on of the business. Even the third characteristic referred in the present case. Not till a demanded payment of the money lent by him and instituted a suit for the recovery thereof would the charge crystallise into a fixed security.

In *State of AP v. Sri Raja Ram Janadhan*<sup>39</sup>, the Andhra Pradesh HC observed that where the debentures are secured solely by a floating charge, the Company may dispose of the property on which the charge exists unencumbered without consulting the holders of charge i.e., debenture holders in this case, until an event a fixed charge. Before crystallisation, the company is free to dispose of the property charged in ordinary course of its business.

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<sup>37</sup> (1903) 2 Ch. 284.

<sup>38</sup> [1939] 9 Comp. Cas.166.

<sup>39</sup> (1965) 2 Comp LJ 222.

In *Re Hi Fi Equipment (Cabinets) Ltd*<sup>40</sup>, a charge was created on fixed plant and machinery which would have been a fixed charge, but since the company had no firmly fixed machinery, it was held to be a floating charge.

### **DEALING WITH PROPERTIES UNDER FLOATING CHARGE**

Before the crystallisation of the floating charge the company has power to create legal mortgages and equitable charge in priority is not affected by notice of the floating charge.<sup>41</sup> A company may not, however, create a further floating charge on the same assets to rank in priority to, or *pari passu* with, the existing charge unless such power is specified reserved.<sup>42</sup>

### **FURTHER CHARGES**

A company has right to create further charges (fixed or floating) on the same assets (already having a charge) to secure a new series of debenture. Debenture holders cannot stop the company from doing so if the deed does not provide otherwise. In such case, the company can issue further series of debenture by charging the same assets. On an objection of a debenture holder can be paid off if he so insists.<sup>43</sup>

### **FLOATING CHARGE ON ISSUE OF DEBENTURES**

The following points in respect of debentures secured by a floating charge were laid down by the SC:

1. A debenture is usually secured by a floating charge only.
2. A company which creates a floating charge has a right to create future securities which may rank superior in ranking. However, such right may be restricted by agreement.
3. Where no restriction is provided, any future specific charge will rank superior to the earlier floating charge [Section 123 of the Companies Act].
4. Where no specific provision is made in earlier floating charge with respect to the ranking of future charge, then any future floating charge will be inferior [*sic* superior] to the earlier floating charge. In this connection reference may be made to section 48 of the Transfer of the

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<sup>40</sup> (1988) BCLC 5 Ch. D.

<sup>41</sup> *Florence Land and Public Works Co., Re, Ex-parte Moore*, (1878) 10 Ch D530: 48 LJ Ch 137: WR 236: 39 LT 589.

<sup>42</sup> *Automatic Bottle Markers, Re*, (1926) ALL ER Rep 618: 134 LT 517: 70 SJ 402: 95 LJ Ch 185.

<sup>43</sup> *Narotamdas Trikamdass Toprani v. Bobbay Dyeing & Manufacturing Co. Ltd.*, (1990) 8 Comp Cas 300: (1986) 3 Comp LJ 179 (Bom).

Property Act. The risk of floating charge can be controlled by creating legal mortgage in favour of debenture holders.<sup>44</sup>

### **INVALIDITY OF FLOATING CHARGE**

A floating charge remains afloat until the winding up of the company commences, unless it is crystallised through the invention as the debenture holders. But the Companies Act prevents an unsecured creditor to get priority over other creditors by obtaining a floating charge when he learns that company is going to be wound up shortly. According to section 539 of the Companies Act provides that a floating charge which is created within twelve months immediately preceding the commencement of the winding up proceedings of a company shall be invalid unless it is proved that the company was solvent immediately after the creation of the charge.

*In Re Eric Holmes Property Ltd.*<sup>45</sup>, the company created a charge in favour of a creditor who advanced 400 pound in cash at the time. Winding up having followed within a year, the charge was held to be void as a fraudulent preference over other creditors.

### **REGISTRATION OF CHARGES**

Section 77 of the Companies Act, required a company to file within thirty days of the creation of a charge, with the Registrar of Companies, complete particulars together with the instrument, if any, creating, evidence or modifying the charge or a verified copy thereof in the prescribed manner for registration, otherwise the charge shall be void, and the money secured thereby shall become immediately payable. The charge may be got registered either by the company itself or the person having interest in the charge. If the application for registration of the charge is submitted by the company to the Registrar within the prescribed time limit of 30 days from the charge, the provisions of section 77 would be deemed to have been duly complied with and any delay in registration shall be immaterial.

In *Banaras Bank v. Bank of Bihar*,<sup>46</sup> the company submitted the application for registration of charge within specified period of 30 days but the charge was actually two and half years after the submission due to negligence of Registrar. The Court held that the formality of submission of application for

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<sup>44</sup> *Narendra Kumar Maheshwari v. Union of India*, (1989) 2 Comp LJ 95: AIR 1989 SC 2138: (1989) SCR 43: 1990 Supp SCC 440.

<sup>45</sup> (1965) 2 ALL ER 333.

<sup>46</sup> AIR 1947 Oudh 117; See also *Bank of India v. Depro Ltd.*, (1988) 64 Comp Cas 324.

registration of the charge having been complete with by the company within the prescribed time limit the charge was perfectly valid and enforceable.

### **CONCLUSION**

After the completion of my project I conclude that floating charge is not stable on the assets under the Companies' Act it is crystallise or into fixed charge. Floating charge is equitable on assets and it is also fluctuating nature in trade. Floating security is not a future security it is present security which affects all the assets of the company. Floating security is not a specific mortgage security of the assets under the Companies Act. According to section 539 of the Companies Act provides that a floating charge which is created within twelve months immediately preceding the commencement of the winding up proceedings of a company shall be invalid unless it is proved that the company was solvent immediately after the creation of the charge. When the floating charge convert into fixed charge then charge is invalid under the Companies Act. Sometime a company get an advantage of the floating by the debentures and when if floating charge is convert into the fixed charge then it affects the title of the property and transfer of interest.

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## CYBER LAW AND BUSINESS IN INDIA

RANADIP BHATTACHARYA<sup>47</sup>

### ABSTRACT

India is a country on the move, and is a leader when it comes to the outsourcing sector. The outsourcing sector is very much IT dependent, and IT is another sector where again India takes a leading position worldwide. Therefore, it is only natural that India should have a dedicated law for IT, and in India such a law is the Information Technology Act, 2000 as it stands amended by the Information Technology Amendment Act, 2008. This short article is a one on the efficacy of the IT Act to the Indian economy as well as society. To be more detailed whether the IT Act is actually useful from the business point of view of India and also from the criminal jurisprudence point of view in India. This article develops on such premises based on case studies and a critique of the Information Technology Act, 2000.

### INTRODUCTION

India is indeed on the move. From a country that was separated by bankruptcy by just US \$ 60 million, to a country that now has a trillion dollar economy, India has indeed covered a long and impressive distance. The best feature about the Indian economy is that we continue with the forward march at an enviable rate. India has recently advanced 12 positions above in the ease of doing business index in the world<sup>48</sup>. However, arguably, the greatest improvement may be seen in the field of information technology. Not only does India produce an impressive number of engineers every year and not only are US Corporations replete with Indian origin engineers- a popular joke goes that a person cannot throw a stone in Texas. We also have a robust number of IT consumers in India as well. In terms of Google usage, India stands at the second position, right after the US. In fact, currently, India occupies the second position in the world with regard to internet to internet users, the top position being occupied by China and the United States coming in at a close third<sup>49</sup>. It has also been predicted by the

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<sup>48</sup>World Bank Group, Doing Business in India, <<http://www.doingbusiness.org/data/exploreconomies/india/>> accessed 29<sup>th</sup> December 2015

<sup>49</sup>Dazeinfo, Internet Users in India: 354M, 60% Access from Mobile [REPORT], <<http://dazeinfo.com/2015/09/05/internet-users-in-india-number-mobile-iamai/>> 5<sup>th</sup> September 2015, accessed 29<sup>th</sup> December 2015

first half of 2016. India will, in all probability, overtake the US in terms of the active users of communication devices such as hardware fitted with Android software<sup>50</sup>.

The above fact implies one natural corollary: people in India are getting more and more dependent on technology and are getting more tech-savvy. People are using “online” and “cyber” modes of communication more than ever before. Even the central government is moving steadily towards an online repository of data for the citizens, data of a personal nature or otherwise. Now such a paradigm shift in the communication is bound to have its consequences- most notably social, technological as well as legal consequences. Now, in this article the researcher shall discuss only India’s legal regime that pertains specifically to the cyber realm. More importantly, the researcher shall try to find out what the current Indian law relating to cyber technology is and whether it is suited for the rapid flux that the Indian economy is currently in.

### **CYBER LAW: WHAT IS?**

The word cyber means “relating to or pertaining to the characteristics of the culture of computers, information technology and virtual reality”. Cyber law, by definition should therefore apply to any law that deals with the above given definition. In India the bulk of the cyber law is found in the Information Technology Act, 2000, as it stands amended in 2008. The Information technology Act may be said to be a novel piece of legislation in the sense that it acknowledges the need for such legislation in India. The Object of the Act itself states that it is “an Act to provide legal recognition for transactions carried out by means of electronic data interchange and other means of electronic data interchange and other means of electronic communications commonly referred to as ‘electronic commerce’”. It is the main piece of legislation in India that concerns itself with the aspects of cyber-crime and electronic records. The Information Technology Act has been modeled on the UNCITRAL (United Nations Model Law on Electronic Commerce, 1996) Model.

Provisions have been incorporated in the Act to create a legal structure which would regulate governance in the electronic mode. Measures to that end include recognizing electronic records and digital signatures. The Act also envisages the creation of Controller of Certifying Authorities. The main function of thus Authority is the regulation of the issuance of digital signatures. The Act also establishes a Cyber Appellate Tribunal Authority whose main function would be the resolution of conflicts that might arise and that fall within the domain of this law.

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<sup>50</sup> Ibid



One novel feature of the Information Technology Act, 2000 is that the Act targets at attributing legal validity to all electronic records and other actions that are affected through legal means. This will go a long way in clearing any doubt or confusion regarding the electronic data and it is hoped that this particular feature will prove beneficial in both the civil as well as the criminal jurisprudences. The act goes on to lay down that a contract may be agreed to electronically- by communicating one's acceptance electronically- and such an acceptance would stand as legally valid and enforceable.

The second chapter of this Act says that an electronic record may be authenticated by a subscriber through the means of subscribing one's digital signature on the same. The third chapter provides that any information that is made available in an electronic mode and in such manner that it may be retrieved easily in future shall be deemed to be made available in writing, printed or in a type-written form.

Without a doubt the above features aim at increasing convenience and ease of doing business in India. This feature conforms to the pro-business approach of the current dispensation at the level of the Central Government in India. If implemented properly, these measures would indeed go a long way in ensuring that India becomes an investor-friendly destination, at least from the point of view of cyber law. The IT Act also comes with its share of data privacy laws that aim at ensuring that data- of business, personal or otherwise nature- retain their privacy and confidentiality. This provision is important because in the absence of such a provision no investor would feel comfortable to invest in India. Although there are complaints that the current data privacy laws in India are unduly strict.

Currently in India the BPO industry is a robust one, enjoying a healthy share in India's GDP. Outsourcing in India is a big deal mainly because India has a large young and energetic workforce that speaks good English. Statistically speaking, the outsourcing industry in India generates revenue to the tune of \$1 billion annually this roughly translates to around 1% of India's GDP<sup>51</sup>. The trend of outsourcing is not limited to just business processes outsourcing, in fact even knowledge processes outsourcing and legal processes outsourcing are in the loop too. "Outsourcing" and "processes" the use of these two terms necessarily imply two natural corollaries: one trade and the other information. Trade is implied by the use of the word "outsourcing" and "processes" imply the involvement of some information or method. What happens is business- or legal or knowledge- processes are sent from one country to another country, the exporting country generally being developed countries with less

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<sup>51</sup> Outsource2india.com, The BPO Industry in India,< <https://www.outsource2india.com/india/bpo-industry-india.asp>> accessed 29<sup>th</sup> December 2015

population and the importing country being third world countries with a large population that can afford to provide cheap labour. USA and UK are notably the two major countries that outsource their jobs to other countries<sup>52</sup>, so much so that when the century was about to turn, along with the turn of the millennium, outsourcing became the most popular word in the United States. In terms of provision of services, India is a major leader in the world. BPOs were and in fact still continue to be very popular. In fact such was the level of their popularity that celebrated Indian author Chetan Bhagat wrote his second book, during his halcyon days as an author, on the lives of six BPO employees and aptly entitled “One Night @ the Call Center”.

Essentially outsourcing implies the transmission of data and this is mostly done either online or through telephonic modes. The raw data is then processed in the receiving/importing country and the processed data is transmitted back to the country of origin. Undoubtedly this is a good business proposition which uses computers or telephones as its means of communications. So, from this point of view, cyber law gets attracted into this issue. Thus, it would be good if we were to ask ourselves the question as to whether the cyber law in India is business-effective or not. We have already seen the business-friendly features of the Indian IT Act, 2000 wherein electronic documents and digital signatures have been accorded legal recognition. However, sadly the provisions stop at just that. Particularly from the point of view of “outsourcing”, there is no mention of the word “outsourcing” throughout the Act. It is still the GATS that holds sway in respect of outsourcing. It would be good to bear in mind that there is no law that is peculiar to the BPOs, or even to the LPOs or the KPOs for that matter.

Of course the IT Act does take a step towards data privacy. This is so because ensuring privacy and confidentiality of data is sacrosanct and a sine qua non for maintaining India’s position in the outsourcing industry. No country would be willing to export raw data out to India until and unless privacy of such data is ensured. As it is the US has decided not to export medical data to India based on privacy concerns and after public demand against the same<sup>53</sup>. Having said that, it must be borne in mind that several companies had complained data privacy laws in India are unnecessarily strict<sup>54</sup>. Upon the IT Act being brought into force many Indian as well as US companies had expressed concern

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<sup>52</sup> Statistic Brain Research Institute, <<http://www.statisticbrain.com/outsourcing-statistics-by-country/>> accessed 29<sup>th</sup> December 2015

<sup>53</sup> NBCNEWS.com, Some U.S. Hospitals outsourcing Work, <[http://www.nbcnews.com/id/6621014/ns/health-health\\_care/t/some-us-hospitals-outsourcing-work/#.VoNyv7Z97IU](http://www.nbcnews.com/id/6621014/ns/health-health_care/t/some-us-hospitals-outsourcing-work/#.VoNyv7Z97IU)> 12<sup>th</sup> June 2004, accessed 29<sup>th</sup> December 2015

<sup>54</sup> The Washington Post, India data privacy rules may be too strict for some U.S. companies, 21<sup>st</sup> May 2011, accessed 27<sup>th</sup> December 2015

at the strict data privacy protection regime envisioned in that Act. But the then Minister for Communications and Information Technology Sachin Pilot had rubbished such skepticisms as misplaced and claimed that such a law was needed for bring Indian standards at par with global standards<sup>55</sup>.

Honestly and practically speaking, the above measures, if looked at statistically, do not seem to have affected the Indian ITES-BPO Industry adversely. It still is going strong on its growth trajectory. It registered a growth of 54% in revenue coupled with an annual growth rate of 50%<sup>56</sup>. In fact India's BPOs together manage the lion's share in the business processes outsourcing in the world- precisely it stands at 56%<sup>57</sup>. The bottom line is that whether we like it or not, the Indian BPO Industry is here to stay.

### **OTHER BUSINESS VENTURES**

According to the database maintained by the World Bank, India has been able to improve its rank by 12 ranks by coming up to rank 130 from its previous ranking of 142. However, since we are concerned mainly with cyber law, the city of Mumbai, considered as an investor friendly destination in the country, requires 1-3 days to procure a digital signature at a cost of INR 700 to INR 2,500 per digital signature<sup>58</sup>. The Information Technology Act, 2000 stood radically amended by the Information Technology Amendment Act, 2008. This particular amendment was moved in order to bring the IT Act of India at par with globally accepted and recognized standards. Although the IT Act in India had been brought into force at the turn of the millennium, its usage, need and pertinence are being acutely felt now more than ever before. IT Act in India covers not only the computer related aspects, but even mobile phone usage, and mobile phone penetration in India is very high.

### **IT ACT AS IT STANDS NOW**

After the amendment several novel attributes of the Act are:

1. Stress being laid on maintaining privacy of data;
2. Stress being thrust on information security;

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<sup>55</sup> Sandeep Joshi, The Hindu, Pilot: More security for BPO women employees soon, 30<sup>th</sup> November 2010, retrieved 27<sup>th</sup> December 2015

<sup>56</sup> NASSCOM, Impact of IT-BPO Industry on the Indian Economy and Society, <<http://www.nasscom.in/impact-itbpo-industry-indian-economy-and-society?fg=71038>> accessed 27<sup>th</sup> December 2015

<sup>57</sup> Ibid

<sup>58</sup> Supra note 1

3. According a specific definition to cyber café;
4. Digital signature has been made technology neutral;
5. The reasonable security practices that are to be followed by the corporate have also been laid down specifically and explicitly in the Act;
6. Intermediaries and their roles have been defined afresh;
7. The Indian Computer Emergency Response Team has been accorded recognition;
8. Several cyber crimes like cyber-bullying, cyber terrorism and child pornography have been included in addition to the already existing crimes;
9. After the amendment, an Inspector has been given the authority to conduct investigation into cyber offences, previously such authorization vested only with the DSP.

The IT Act is applicable throughout the whole of India and save as otherwise laid down it can also be applied to any offence or any contravention which may have been committed outside India by any Indian. However, the IT Act does not affect any negotiable instrument as defined in section 10 of the Negotiable Instruments Act, 1881. However, it must be borne in mind that a cheque has been brought under the purview of the IT Act. Other exclusions to the IT Act include a power of attorney, a trust as well as a will or any other testamentary disposition.

Cyber crime as defined in the Act may be defined in two meanings: the narrow sense and the broad sense. Corporate and contractual malpractices are included within the ambit of the broad definitions<sup>59</sup>. Other provisions in the IT Act deal mainly with criminal and social elements. Major thrust has been laid on cyber crimes such as cyber-bullying, cyber terrorism and cyber stalking. The ITAA has also brought about major changes in the IPC wherein voyeurism has been defined as a standalone crime. Till date the most notable and major cases under the IT Act have been of a criminal nature with allied sections having a major role and the IT Act sections being relegated to the background as just an issue of discussion, an aspect of the *obiter dicta* of the court. Major such cases are the Avnish Bajaj Case<sup>60</sup>, more popularly known as the DPS MMS Scandal case and more recently Shreya Singhal v Union of India<sup>61</sup>.

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<sup>59</sup> Talwant Singh, cyber law and Information Technology, <<http://delhicourts.nic.in/CYBER%20LAW.pdf>> accessed 29<sup>th</sup> December 2015

<sup>60</sup> Avnish Bajaj V N.C.T of Delhi, (2005) 3 CompLJ 364 Del

<sup>61</sup> Shreya Singhal V Union of India W.P. (Crl.) No. 167 of 2012

There are several cases under the IT Act that deal with corporate misdemeanor. One such case is the Mphasis India case<sup>62</sup> wherein several employees of a BPO fraudulently transferred money from others' accounts into their accounts. The case details are as follows: it is a 2005 case and the facts clearly reveal the seamy side of a globalized economy wherein borders are transgressed as easily as snapping of one's fingers. In this case employees of a Pune based IT services and BPO company by the name of Mphasis BFL had siphoned off money to the tune of Rs 1.50 crores from the bank account of many customers in Citibank. The accused had misused their position as employees of the BPO and the training they had received for customer handling to gather information from unsuspecting customers to get their account details and siphon off money from such accounts of those customers. Undoubtedly, this case rattled the BPO sector which, as specified earlier, is considered as a sunrise industry in India. Luckily, Citibank lodged a complaint and the Pune police took prompt action and the culprits were brought to book. This case was said to be the first case to have been instituted that dealt with cyber crime.

The second such case may be said to be the Sonysambandh.com<sup>63</sup> case. The facts of this case are that Sony India Private Limited used to run a website by the name of [www.sonysambandh.com](http://www.sonysambandh.com) through which Non-resident Indians could purchase and send gifts to their relatives living in India. The order placing and purchasing all had to be done online. A particular individual from Noida got a bogus order made in the name of one "Barbara Campa" and got a Sony colour television set and a cordless headphone delivered to himself. However, around a month and a half later, the credit card company called to inform that the said transaction was a fraudulent one as the original owner of the credit card had called to inform that such a transaction had never been made. Upon investigation it was revealed that the individual who had received the goods had actually misused his position as a call-center employee to gain access to credit card numbers of American nationals and had used the same to place such bogus orders and get the goods for himself.

However, one very important thing must be clearly noted here, in the Mphasis case, the accused were charged under the relevant sections of the IPC as well as the relevant portions of the IT Act, 2000 but in the Sonysambandh case the accused was brought to book only under the IPC under the sections 418, 419, 420. One very important case is the Andhra Pradesh Tax evasion case wherein the suspect activities of a trader from the state of Andhra Pradesh were uncovered. In this case, the

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<sup>62</sup> Cyberra Legal Services, Important Cyber Law Case Studies, <<http://www.cyberralegalservices.com/detail-casestudies.php>> accessed 29<sup>th</sup> December 2015

<sup>63</sup> Ibid

trader had generated fake and bogus vouchers, challans and bills, numbering up to 6,000, to justify and thereby evade taxes to the tune of Rs 22 crores. This crime fell under the domain of cybercrime because of two reasons: one the accused had used computer resources to generate the fake and bogus bills and two the police used evidence procured from computer records to nail the crime and bring the accused to book. The trend, it seems, that the IT Act lacks the strength to stand alone or that the administration is averse to using the IT Act singly for such offences.

### **DATA PRIVACY**

From the business point of view, data privacy is a pressing issue. Informational privacy is a sine qua non to good business practices and ethics to that end, the Indian law may be said to be lacking. India does not yet have a dedicated data protection law. Of course there is the Personal Data [Protection] Bill, 2013, but as clear from the name, it is still stuck in the Bill stage. India takes after the US in this regard. The US too conspicuously lacks dedicated data protection legislation. The US has a rather piecemeal approach, wherein there are sector specific laws. For example, in the health sector, the privacy of an individual is protected by the Health Insurance Privacy Protection Act. Online privacy is protected by the Online Privacy Protection Act. Even individual states have individual privacy protection laws, mention may be made of the California Online Privacy Protection Act that deals with online privacy issues.

Coming to India, India too does not have any dedicated data protection regime. Since we are talking of the IT Act, it has to be borne in mind that the IT Act does have a provision relating to privacy, but its utility and efficacy are yet to be fully appreciated or yet to be applied by the courts. Of course there is the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011, but these rules too are yet to be appreciated and the awareness relating to such rules has to be increased. The provision that particularly deals with privacy responsibility entrusted upon the body corporate is section 43-A of the IT Act, 2000. This section lays down the penal provisions in cases where a body corporate is negligent in providing adequate data protection mechanisms. Thus, this section is obviously an important one when it comes to the data protection regime in India. The provision prescribes the penalty to be imposed upon the body corporate whose delinquency has led to the loss of data. But as already said, till the time of the writing of this article, this section was yet to be invoked.

## **CONCLUSION**

Success always comes with a concomitant price. Sometimes the prices are heavy and sometimes the prices are light. While talking of human action, the price that social success exacts is an accompanying increase in crime, because try as we might, crime and criminal elements are actual realities of life that we need to live with. The Indian IT revolution is no exception. The revolution may still be in a nascent stage in India but we have already been witness to the seamy side of such an IT revolution. Cybercrimes such as ATM card fraud, phishing are on the rise. Therefore it is only natural that we should create and maintain- and obviously develop- an appropriate mechanism to fight and effectively prevent such crimes.

Undeniably, the greatest deterrent and remedy to crimes are legal mechanisms. The law should be such that the beneficiaries of the IT revolution in India- and the greatest beneficiary is obviously the common man- feels assured and at ease while enjoying the benefits of such a revolution. The law should not only be stringent, but its implementation should be even more stringent to ensure that the law thrives in spirit, not merely in letters. The peculiarities of the cyber world is that it provides scope for all kinds of criminal activities, civil, criminal or moral. In fact it may be said that the cyber world has in reality provided another outlet for the criminals and those that are criminally minded for their criminal activities.

The current legislation, viz, the Information Technology Act, 2000 is obviously a step in the right direction. The Act was passed in 2000, radically amended in 2008 and is being implemented now. Of course there have been many changes in the Act and the researcher is sure that there will be many more such changes to come in the future; after all, change is the only constant in life. It is said that well begun is half done, keeping that in mind, we have really made a good beginning but we still have miles to go before we sleep.

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## **ET TU BRUTE? BREACH OF CONFIDENCE UNDER INTELLECTUAL PROPERTY RIGHTS**

**HANSA SINHA<sup>64</sup>**

### **ABSTRACT**

The sharing of information between human beings is often selective. It is not meant for all ears. However, if it should trespass its own formed territory, then what are the problems that arise? The breach of confidence, as the legal world would like to call it, is an offence under the law. Strictly codified under foreign laws and developing stage under the Indian laws. This article in its first part gives a brief introduction to the breach of confidence under the intellectual property rights. The second part discussed certain important and basic provisions from TRIPS, NAFTA etc. Next part discusses how information may be classified. Whether it is in fact worthy of protection? Part four of this article throws light on the liability of parties in maintaining confidentiality. It is essential that the recipient of confidential information was at least aware that confidential information is being imparted to him/her. This is discussed with special emphasis on the employee-employer relationship and obligations. The Faccenda Chicken case is a suitable example in this regard. After setting the stage with the legislations and authorities from foreign jurisdictions, the article delves into the same concept, except it is closer home. The Indian scenario shows that although breach of confidentiality is not effectively codified, it resonates in various important legislations, and that the courts have taken their responsibilities seriously, in safeguarding the confidentiality in a balanced manner.

### **INTRODUCTION**

In the day to day interactions, human beings collect and transmit information. It may be through words, written or spoken. Technology has revolutionized the communication system. Now information travels through computers, phones, smart phones, watches, television, radio and the list goes on. This information may be shared with loved ones or strangers, employees or bosses, spouse or children or public at large. The information transferred under these heads may be under different obligations. For eg obligation to not disclose, this can be tacit or explicit. The communication system

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also enables easy storage of such communications. Herein raises the question of protection of such information. This article looks into how ideas and information have come to be protected under the Intellectual Property Rights and what are the different settings in which information arise and the protection they deserve or not deserve.

### **AGREEMENT ON TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS (TRIPS)**

TRIPS became one of the first international treaties to give recognition to the action of any breach of confidence. Prior to TRIPS if an undisclosed data was submitted to the government authorities it had protection of the principles of breach of confidence.<sup>65</sup> EU and US later enforced the concept of data exclusivity which granted protection to data exclusively for a specific period. The genesis is found in Article 39 of TRIPS which states in its relevant part as follows:

*1. In the course of ensuring effective protection against unfair competition as provided in Article 10bis of the Paris Convention (1967), Members shall protect undisclosed information in accordance with paragraph 2 and data submitted to governments or governmental agencies in accordance with paragraph 3.<sup>66</sup>*

The first clause to the article lays down the foundation. The second clause explains that this right is available to both legal and natural persons. It further explains that the information should be a secret which is not 'generally known', has 'commercial value' and for which lawful steps have been taken by the person in control of the information to keep it a secret.

Article 1711 of (NAFTA)<sup>67</sup> defines trade secret as follows:

- 1. Each party shall provide the legal means for any person to prevent trade secrets from being disclosed to, acquired by or used by others, without the consent of the person lawfully in control of the information in a manner contrary to honest commercial practices, in so far as:*

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<sup>65</sup> N.S. Gopalakrishnan & Adv. Benoy K. Kadavan, *Study on Testdata Protection in India, Centre for Intellectual Property Rights Studies*, SCHOOL OF LEGAL STUDIES, COCHIN UNIVERSITY OF SCIENCE & TECHNOLOGY, (December 2003), [http://wtocentre.iift.ac.in/DOC/Report%20-%20\\_Natural%20Resources%20Pricing\\_NSg.pdf](http://wtocentre.iift.ac.in/DOC/Report%20-%20_Natural%20Resources%20Pricing_NSg.pdf)

<sup>66</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), art. 39, 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994) [hereinafter TRIPS Agreement]

<sup>67</sup> See North American Free Trade Agreement, U.S.-Can-Mex., art. 1711, Dec. 17, 1992, 32 I.L.M. 289 (1993) (establishing free trade among Canada, the United States, and Mexico).

- (a) *The information is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons that normally deal with the kind of information in question;*
- (b) *The information has actual or potential commercial value because it is secret; and*
- (c) *The person lawfully in control of the information has taken reasonable steps under the circumstances to keep it secret.*

The jurists usually categorize the 'secrecy' as defined under this Article into four categories, namely objective secrecy (required), relative secrecy (adequate), secrecy cannot be denied on the basis of a mosaic-like regrouping of bits of information that are already in public domain and reasonable measures to protect the confidentiality of the information (pre-requisite of the protection).<sup>68</sup> This article protects trade secrets and move at the instance of the United States.<sup>69</sup> Trade secret acts as an incentive to the incremental innovation in the arena of technology not meeting the non-obviousness standard of patent law and copyrights. A pivotal role is therefore played by these trade secrets in protecting innovations and establishing rights to use new technology.<sup>70</sup>

#### **CLASSIFICATION OF INFORMATION FOR PROTECTION**

Any information must qualify for protection. If there is a pool of information and the confidential information is not precisely distinguished with the non-confidential information, it may not be given any protection at all.<sup>71</sup> Thus while making a claim for protection it is important that 'proper particulars of claim' should be present.<sup>72</sup> Normally, there are four limitations put on the information i.e. when it is trivial, immoral, vague, in the public domain, novel and original information or private information. Trivial information is easy to understand but difficult to impose because of its relative nature. Whether wedding photographs of a celebrity comprise trivial information, is a moot point.<sup>73</sup> It is therefore, often a difficult task to categorize any information as trivial in the courts.<sup>74</sup> Immoral

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<sup>68</sup> Dr. Francois Dessemontet, *Protection of Trade Secret and Confidential Information*, <http://www.unil.ch/files/live/sites/cedidac/files/Articles/Protection%20Trade%20Secrets.pdf>

<sup>69</sup> Surinder Kaur Verma, *Protection of Trade Secrets under the TRIPS Agreement, and Developing Countries*, THE JOURNAL OF WORLD INTELLECTUAL PROPERTY, Volume 1 Issue 5 pages 723-742 (September 1998), <http://onlinelibrary.wiley.com/doi/10.1111/j.1747-1796.1998.tb00031.x/abstract>

<sup>70</sup> Md Zafar Mahfooz Noman, Faizanur Rahman, *Intellection of Trade Secret and Innovation Laws in India*, Vol 16, (July 2011), 341, JOURNAL OF INTELLECTUAL PROPERTY RIGHTS. [http://nopr.niscair.res.in/bitstream/123456789/12449/1/IJPR%2016\(4\)%20341-350.pdf](http://nopr.niscair.res.in/bitstream/123456789/12449/1/IJPR%2016(4)%20341-350.pdf)

<sup>71</sup> *Suhner v Transradio* [1967] RPC 334

<sup>72</sup> *Ocular Sciences* [1997] RPC 289, 359

<sup>73</sup> *Douglas vs. Hello* [2001] EMLR 957

<sup>74</sup> Lionel Bently & Brad Sherman, *Intellectual Property Law*, 1145 (4<sup>th</sup> ed. 2014) [hereinafter Bently & Sherman]

information is an apple from the same tree and doesn't fall farther from trivial information categorization. Any information that is vague does not deserve to be protected as per the courts as it is not novel. For example, if A shares the idea of opening a beauty parlour which attends to the needs of women and men alike and is open 8 hours a day, with B, this is a general idea. If B were to open the same kind of parlour or share this idea elsewhere this would not be protected. Similar concerns had been raised in the court pertaining to idea of a Dance club, which was rendered vague by the court.<sup>75</sup> The next category is by far the most logical one. Any idea of breach of confidentiality, where the information is already in public domain is a foolish one. However, it becomes important to define the public domain. In case of patent, disclosure to even one more person may be considered to be public domain. In other cases it may be a case of 'relative secrecy, where the information remains confidential even after being disclosed to a few people. Novel and original hinge upon the evidence of a vague information and while examining private information the court has to examine various factors such as if the person concerned has reasonable expectancy of privacy, if the photographs of public figure fall into this category, whether the private character can be retained after disclosure to wide number of people etc.

#### **LIABILITY OF PARTIES IN MAINTAINING CONFIDENTIALITY**

For a breach of confidence to arise, it is vital that there is a party who had a liability to maintain the confidence and subsequently failed to do so. Therefore, the kind of relationship has to be established between two people. For example, a psychiatrist and her/his patient are bound in such a relationship. This would be a direct relationship, where there exists maximum amount of commitment towards each other. This is straightforward and easy to perceive by anyone. A husband and wife relationship also falls under this category. The contractual obligations between two people involved in a direct relationship can be either expressed or implied. For example in the contractual relationship between an insurance agent and person being insured there is an underlining facet of *uberimae fidae*. Logic and reason then become the two very strong pillars to determine such liability. The liability can also be drawn from the manner in which the information was communicated. If a reasonable person would perceive such communication to be confidential it indeed becomes confidential A party may directly express confidentiality of information while communicating it to the other party.

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<sup>75</sup> De Maudsley v. Palumbo [1996] FSR 447, 456.

This situation gets trickier when one party passes on the information to another party. Further, if a stranger like a burglar discovers confidential files, or any other accidental situation, it is challenging for a court to impose the obligation.

Another very important relationship is that of employee and employer. An employee is bound by obligation of the relationship during and sometimes even after the employment has ended. While entering into employment the contract forms the express duties of an employee. These are the general rules that are to be understood by all. Further, an employee may be bound by implied duties such as fiduciary and exclusive in nature. After the end of employment the obligations arise as to maintaining confidentiality with regard to activities carried out and information acquired during the employment.<sup>76</sup>

#### *Faccenda Chicken case*<sup>77</sup>

The *Faccenda* case has discussed the obligations related to former employees and also determination of information amounting to trade secrets. The attempt of a former employee was not allowed to participate in a competing venture as to that of the former employer as this would entail utilization of trade secrets of the employer. The Court of Appeal further identified four categories for determination of information amounting to trade secret. Firstly, the nature of employment i.e. how important or serious was the position; secondly, nature of information, thirdly, whether the employer impressed on the employee the confidentiality of the information and lastly, ease of isolation of information i.e whether the information can be separated from employee's own information for instance.

### **INDIAN SCENARIO**

Although Indian law on trade secrets is derived from English Common law and English case laws, India unlike USA and UK does not have a well defined law.<sup>78</sup> However, over the years law of contracts and Constitution have carved out a path for confidentiality which finds face in numerous judgments. Even in various judgments of Indian courts one finds liberal reference to English case laws, denoting their importance. India recognizes both breach of privacy and breach of confidence. Both principles

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<sup>76</sup> Bently & Sherman, *supra* at 1167.

<sup>77</sup> *Faccenda Chicken v. Fowler* [1986] 3 WLR 288, 301

<sup>78</sup> *Majumdar & Co., Contracts of Confidentiality*,

<http://www.majumdarindia.com/pdf/Contracts%20of%20confidentiality%20and%20noncompete%20with%20employees.pdf>

supplement each other rather than qualifying over each other. An example would be where the conditions required for the application of the law of confidentiality do not exist such as disclosure of personal information by a person who did not receive it in a confidential capacity, the principle of privacy could be applied to prevent such information being disclosed or claim a remedy after disclosure. Similarly, any information that is not of a personal nature, could utilize the law of confidentiality to prevent disclosure or claim damages.<sup>79</sup>

*Konrad Wiedemann GmbH v. Standard Castings Pvt. Ltd*<sup>80</sup>

While determining confidentiality of the information, the court herein, heavily relied on Lord Green's observations in the *Saltman case*<sup>81</sup>. Lord Green made the following observations:

*The information to be confidential must, I apprehend, apart from contract, have the necessary quality of confidence about it, namely, it must not be something which is public property and public knowledge. On the other hand it is perfectly possible to have a confidential document, be it a formula, a plan, a sketch or something of that kind, which is the result of work done by the maker upon materials which may be available for the use of anybody; but what makes it confidential is the fact that the maker of the document has used his brain and thus produced a result which can only be produced by somebody who goes through the same process.*

Today the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011 protect personal information. Indian remedies for invasions of privacy existed under tort law and the Supreme Court of India accorded limited constitutional recognition to the right to privacy under Article 21 of the Indian constitution. Therefore the IT Rules, 2011 form the only codified provisions protecting the privacy of individuals and their personal information. Rule 3 of the Rules defines sensitive personal data as follows:

*Sensitive personal data or information of a person means such personal information which consists of information relating to-*

- (i) Password
- (ii) Financial information such as bank account or credit card or debit card or other payment instrument details;

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<sup>79</sup> Vipul Kharbanda, *Relationship between Privacy and Confidentiality*, THE CENTRE FOR INTERNET & SOCIETY, (Dec. 30, 2014) <http://cis-india.org/internet-governance/blog/relationship-between-privacy-and-confidentiality>

<sup>80</sup> [1985] (10) IPLR 243

<sup>81</sup> *Saltman Eng'g Co. Ltd v. Campbell Eng'g Co. Ltd*, [1948] 65 RPC 203

- (iii) *Physical, physiological and mental health condition;*
- (iv) *Sexual orientation;*
- (v) *Medical records and history;*
- (vi) *Biometric information;*
- (vii) *Any detail relating to the above clauses as provided to body corporate for providing service; and*
- (viii) *Any of the information received under above clauses by body corporate for processing, stored or processed under lawful contract or otherwise:*

*Provided that, any information that is freely available or accessible in public domain or furnished under the Right to Information Act, 2005 or any other law for the time being in force shall not be regarded as sensitive personal data or information for the purposes of these rules.<sup>82</sup>*

Further section 72 of the IT Act, prescribes penalty for breach of confidentiality and privacy. A penalty of Rs. 1 Lakh or imprisonment of up to two years or both for any person who, in pursuance of any powers conferred under the IT Act, rules or regulation made there under, has secured access to any electronic record, book, register, correspondence, information, document or other material without the consent of the person concerned discloses such material to any other person.<sup>83</sup> Rule 8 of the same legislation prescribes reasonable security practices and procedures that are necessary for protecting personal information and sensitive personal data.

*Petronet LNG Ltd v. Indian Petro Group and Another<sup>84</sup>*

LNG Petronet (a company involved in setting of LNG terminals in India) pleaded the Court to restrain the Defendant from publishing information relating to the plaintiff's commercial developments on defendant's website. These were allegedly interfering with contract negotiations. It formed a claim for right to confidentiality and privacy. The right to privacy was denied by the courts after looking at the corporation status of the plaintiff and the type of information involved. The injunction claimed by corporation with respect to right to confidentiality was granted by the court. The court drew reference to various English cases such as *Coco<sup>85</sup>*, *Douglas<sup>86</sup>*, and *Guardian<sup>87</sup>* case to emphasize that

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<sup>82</sup> Information Technology Rules, 2011, Rule 3

<sup>83</sup> Geetika Rustagi, *Indian Law only determines the situations where privacy will be afforded legal protection, Interview with Sajai Singh, J. Sagar Associate on the implications of a photo leak in India*, LIVE MINT E-PAPER (Sep. 5, 2014) <http://www.livemint.com/Consumer/x32Rcm7I26gT1cRNMDPAMP/Indian-law-only-determines-the-situations-where-privacy-will.html>

<sup>84</sup> CS (OS) No. 1102/2006 <http://indiankanoon.org/doc/8534067/>

<sup>85</sup> *Coco v Clark* [1969] RPC 41

<sup>86</sup> *Douglas v Hello!* [2008] 1 AC 1

<sup>87</sup> *Guardian Media Groups v Associated Newspapers* (20 Jan 2000) (EWCA Civ, unreported)

there could be situations where a third party is obliged to maintain confidentiality, having regard to the nature and sensitivity of the information.

*Beyond Dreams Entertainment Pvt vs. Zee Entertainment Enterprises*<sup>88</sup>

This is a case which explores the interface between confidentiality and copyright. Confidentiality is definitely a broader claim, and therefore operates in a different sphere in comparison with copyright.<sup>89</sup> The Plaintiff filed the suit for preventing misuse of confidential information as well as infringement of copyright. The two companies allegedly discussed concept for one show. The discussions and negotiations failed to the effect that the show was not supposed to run. Thereafter the defendant created a new show on the same concept, thereby utilizing the scripts and production notes of the first show in the process.<sup>90</sup> The court identified three elements for protection of confidence. The information must be of a confidential nature, it must be communicated under the circumstances which create obligation of confidence on the defendant and that information is used or threatened to be used by defendant without the authority of the plaintiff.<sup>91</sup> With regard to the confidential nature of information it further identified three sub-elements namely, identification of confidential information, original information which is not in public domain.<sup>92</sup> The court while taking help from the “spring board” doctrine contemplated that whether defendant used the plaintiff’s idea as a spring board and devised certain additional material to produce some work. However, following the precedent of *Zee Telefilms*<sup>93</sup> the court found that defendant may still be liable for breach of confidence. At first count the court found that the concept notes were identified to be confidential and were conveyed in the circumstances of confidence to defendant. Therefore, the first two requirements of confidentiality were sufficiently established. To identify novelty, the concept of older woman marrying a younger man was discussed. It was pointed out that although there was a common theme between the show at hand and another show called ‘Astitva’, the concept notes were materially different. Thus, all the elements of confidentiality of information satisfied the court on prima facie

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<sup>88</sup> *Beyond Dreams Entertainment Pvt vs. Zee Entertainment Enterprises Ltd & Anr*, NOTICE OF MOTION (L) No. 785 of 2015 in SUIT (L) No. 251 of 2015, <http://indiankanoon.org/doc/162638144/> [Hereinafter Beyond Dreams]

<sup>89</sup> *See id* Para 7 Beyond Dreams

<sup>90</sup> Thomas J. Vallianeth, *Confidentiality and Copyright: The Bombay High Court clarifies the interface*, (May 1, 2015), SPICY IP, DE-CODING INDIAN INTELLECTUAL PROPERTY LAW <http://spicyip.com/2015/04/confidentiality-and-copyright-the-bombay-high-court-clarifies-the-interface.html>

<sup>91</sup> *See supra* Para 8 Beyond Dreams

<sup>92</sup> *See supra* Para 9, Beyond Dreams

<sup>93</sup> *Zee Telefilms Ltd vs. Sundal Communications Pvt Ltd* 2003 (5) BomCR 404 <http://indiankanoon.org/doc/603848/>

basis. The personalities and character sketches of both male and female protagonists of the respective concept notes of defendants were observed to be copied.<sup>94</sup>

## **CONCLUSION**

Thus, in India only civil and equitable remedies are available for any action of breach of confidence. These range from award of injunction “preventing a third party from disclosing the trade secrets,” the return of all “confidential and proprietary information,” and compensation or damages “for any loss suffered due to disclosure of trade secrets. As far as criminal prosecution is concerned, as explained above it is only available under the Information Technology Act, 2000.

The infant jurisprudence with regard to confidentiality has formed an undefined but good foundation. Herein the efforts of the Indian courts deserve appreciation as nearly all the cases have appreciated a balanced approach and explored every case with a fresh perspective. Although this gives rise to slight inconsistencies and uncertainties in the interpretation of confidentiality provisions in the agreement, it opens a way for the future developments in this field.

Where the world has become smaller and where business relationships are being formed across languages, borders and jurisdictions, defining and enforcing uniform commercial principles becomes all the more important.

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<sup>94</sup> See *supra* Para 18, Beyond Dreams



## **HARMONIOUS INTEGRATION OF OPEN SOURCE WITH INTELLECTUAL PROPERTY REGIME**

**FAZAL ALI AHMAD<sup>95</sup>**

### **ABSTRACT**

One of the biggest disruptive technologies in recent times has been the Open Source Software (OSS) – an antithesis to Proprietary and Copyright which promotes a highly utopian ideology of free access to copy and modify source code and dispel the concept of ‘trade secrets’. Open source, as implied, embraces transparency and a goodwill which is almost altruistic in nature. It propagates a paradigm shift in the thinking of Howard Roark, the protagonist of ‘The Fountainhead’ as it is perceived to give no attribution to the original creator /author of the software.

In the legal backdrop, the debate between Open Source Software and Proprietary is intertwined with Intellectual Property Rights (IPR) and Licensing regime. While there is a consensus for free and open source software ("FOSS"), this paper will attempt to clear the misconception that OSS is in public domain and not protected by IPR or any infringement law. It will highlight OSS as an enabler and not an anomaly to creativity and entrepreneurship. Open source regime has evoked innumerable discussions on re-evaluating and re-interpreting IP jurisprudence including an understanding on the need for a parallel regime despite the ideological clash. OSS provides a good counter-balance to ‘Proprietary,’ prevents market monopoly and ushers in greater variety of software through widespread ‘inclusion’.

Given the growing popularity and usage of OSS, the paper takes a stance to harmoniously integrate and accommodate it in the IP legislation. Finally in the last section, interpretation of Open Source would attempt to free its philosophy from just being applicable to code source of Software. While re-defining Open Source in the Indian context, the paper will evaluate proliferation of Mobile Apps, take up case study from Biomedicine and conclude highlighting synergy with Net Neutrality to achieve the end objective of e-Governance.

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## **INTRODUCTION**

Open source propagates a paradigm shift in the thinking of Howard Roark, the protagonist of 'The Fountainhead' - as it is perceived to give no attribution to the original creator /author of the software. But does Open Source conflict the ideology behind IPR or act as a catalyst for innovation and development? This paper will attempt to examine few anomalies surrounding the legal operating framework and open source applications for benefits to society at large.

In a short span of time, the need to upscale and mainstream open source software has risen sharply. While developers bask in an autonomy and easy access to such softwares and their source code, a plethora of derivative needs and purposes have evolved. A certification standard issued by the Open Source Initiative (OSI) indicates that the source code of a computer program is free of charge to the general public<sup>96</sup>. Infact Open Sourcing is an established platform which is secure and more stable than privately owned software, largely because of the high stakes involved. Academicians and students across the world can access the core functioning of the system and learn about the development of these softwares, as they are useful for long-term projects. Programmers can charge for the open source software (through a licensing fee), while the licenses permit non-exclusive, commercial exploitation of the licensed work.

The advantage of open sourcing is that it is stable, easy to manage and good for competition. Continuous improvements can be regularly made by hands on exploration through R&D facilities to the software, while the company enjoys its independence. Yet, uncertainties still do arise vis-à-vis the image that open source software developers claim to portray. The use of such software is never entirely free and there is always some restriction in its usage. Technical proficiency is still required since users may not be accurate with the compatible software. Further there is a huge risk of bifurcations in major programmes, which has led to the Open Source Initiative in forming 'License Selection Policies'.

## **OPEN SOURCE AND INDIAN GOVERNMENT**

The use of open source softwares serves different varieties of markets across the world. In India, the Supreme Court itself has adopted open source operating system and has directed over 17,000 courts

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<sup>96</sup> Vangie Beal, Open Source, *Webopedia*  
<[http://www.webopedia.com/TERM/O/open\\_source.html](http://www.webopedia.com/TERM/O/open_source.html)>

across the country to switch to open source operating system by publishing the 'Guidelines for Roll-out and Installation of Ubuntu Linux for Indian Judiciary'.<sup>97</sup> Currently, most e-governance solutions are developed using Closed Source Software (CSS), which is licensed under the exclusive legal right of the software manufacturer. In such cases, the user (the government in this case) has limited rights to ensure any modifications, sharing, studying, redistribution or reverse engineering. With the use of Open Source Software, the Government can now centrally create, modify and redistribute the software without any costs involved.<sup>98</sup>

The Indian government, announced a policy in 2015 that would make it mandatory to use open-source software in building apps and services, in an effort to 'ensure efficiency, transparency and reliability of such services at affordable costs'. The policy stated that all government organizations must include a requirement for their software suppliers to consider open-source options when implementing e-governance applications and systems. This move would bring the Indian government in line with other countries including the US, UK and Germany that have opted for the use of open source software over proprietary tools<sup>99</sup>.

## **HISTORY AND DEVELOPMENT**

### **HISTORY OF THE OPEN SOURCE PHENOMENON**

The history of sharing technology and information to the world can be traced back to the 19<sup>th</sup> century when medical researchers and doctors were in hopes for various cures of plague hit society. Diseases such as small pox, influenza, cholera etc. were rapidly spreading across Europe and America. To prevent more outbreaks, money had been invested in intense research and publishing papers. This information was shared openly amongst the medical fraternity to redress the massive inflow of patients.

The concept of open sourcing evolved into the pre internet age when cross-licensing agreements were introduced to tackle the monopolization of products. The value of patents started falling when

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<sup>97</sup> eCommittee, The Supreme Court Guidelines for Ubuntu Linux Operating System, 2011 <<http://supremecourtindia.nic.in/ecommittee/Guidelines%20for%20Ubuntu%20Linux%20Roll-out%20&%20Installation.pdf>>

<sup>98</sup> Editorial Staff, Use of Open Source Software Now Mandatory in Govt Offices as per new Policy, *Track.in* <<http://trak.in/tags/business/2015/03/30/open-source-software-mandatory-govt-offices/>>

<sup>99</sup> Department of Electronics & Information Technology, Policy on Adoption of Open Source Software for Government of India, *Ministry of Communications & Information Technology* <[http://deity.gov.in/sites/upload\\_files/dit/files/policy\\_on\\_adoption\\_of\\_oss.pdf](http://deity.gov.in/sites/upload_files/dit/files/policy_on_adoption_of_oss.pdf)>

they started being shared openly without any exchange of money among the manufacturers, notably after the Selden patent case<sup>100</sup> in 1911. In the early years of development of automobiles, a group of capital monopolists owned the rights to a 2-cycle gasoline engine patent originally filed by George B. Selden. With the patent, they were able to monopolize the industry and force car manufacturers to adhere to their demands, or risk a lawsuit. In 1911, independent automaker Henry Ford won a challenge to the Selden patent. The result was that the Selden patent became virtually worthless and a new association (the Motor Vehicle Manufacturers Association) was formed. This association instituted a cross-licensing agreement among all US automobile manufacturers. As per the agreement, each company could develop technology and file patents, but these patents were to be shared openly without the exchange of money among all the manufacturers. By the time the US entered World War II, 92 Ford patents and 515 patents from other companies were being shared among these manufacturers, without any exchange of money (or lawsuits)<sup>101</sup>.

### **SUBSEQUENT DEVELOPMENT OF OPEN SOURCE SOFTWARE**

The development of the open source movement was initiated by two academic institutions- the Massachusetts Institute of Technology and the University of California, Berkeley. The GNU General Public License (GPL) and the Berkeley Software Distribution (BSD) License were the two factions of licenses that were formed by these two institutions, the former being a copyleft license<sup>102</sup> and the latter being a non-copyleft license. The GNU General Public License was designed to ensure a free software produced by GNU along with the production of more new free software. In order to promote freedom for all users, these licenses insist that a program modified out of a free software must be free as well. The BSD License on the other hand however, did impose a few restrictions on free software where the user modifying the free software had to use a disclaimer acknowledging the University of California, Berkeley as the contributors. When one talks about open sourcing in the present day, it primarily pertains to a computer program. With the advent of the internet age, there was a vital need

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<sup>100</sup> James M. Rubenstein, *The Changing U.S. Auto Industry: A Geographical Analysis*, 1992, p.57-60  
<[https://books.google.co.in/books?id=IMiHAgAAQBAJ&pg=PA56&lpg=PA56&dq=Selden+patent+case&source=bl&ots=OFGIBih1cH&sig=Mb-KzOIOnvqzXT3KVuvG3sUaUYA&hl=en&sa=X&ved=0CDQQ6AEwBDgKahUKEwiQrqqyvvK\\_HAhVOwI4KHUYICtk#v=onepage&q=Selden%20patent%20case&f=false](https://books.google.co.in/books?id=IMiHAgAAQBAJ&pg=PA56&lpg=PA56&dq=Selden+patent+case&source=bl&ots=OFGIBih1cH&sig=Mb-KzOIOnvqzXT3KVuvG3sUaUYA&hl=en&sa=X&ved=0CDQQ6AEwBDgKahUKEwiQrqqyvvK_HAhVOwI4KHUYICtk#v=onepage&q=Selden%20patent%20case&f=false)>

<sup>101</sup> Frank Tobe, *The Patent Grip loosens*, *Robohub.org*  
<<http://robohub.org/the-patent-grip-loosens/>>

<sup>102</sup> Copyleft is a general method for making a program (or other work) free, and requiring all modified and extended versions of the program to be free as well; *GNU Website*  
<<http://www.gnu.org/licenses/copyleft.en.html>>

for reworking computer source codes. By opening the source code, a self-enhancing diversity of production models, communication paths and interactive communities could be enabled and developed. Open sourcing thus promotes free access to a product's design and at the same time, allows possible improvements by any programmer through the issuance of a license.

### **TYPES OF OPEN SOURCE SOFTWARE**

Two different types of open source software have developed: the community open source (which is software developed by a community) and commercial open source (a software that are for profit making entity /company). In the community case, individual developers decide on which contributions should be accepted in the source code base. In the commercial case, a company decides on what should be accepted into the software code base. The company also maintains the copyright and decides what to implement next. Hence market barriers exist on the commercial open source market, but not in the community open source situation, where grant of license can be given<sup>103</sup>. The Advanced Research Projects Agency Network (ARPANET) was the network designed to communicate and share computer resources primarily among scientific users at the linked institutions. Developers who had access to the ARPANET began to develop telecommunication network protocols which eventually led to the birth of the internet. With the development of the TCP/IP protocols in the 1970s, the size of networks was able to expand considerably. A few years later, Netscape Corporation created the third faction that boosted the open source movement represented by the Mozilla Public License (MPL). The terms of the license were very similar to the GPL, but could charge royalties for modified versions and could also include source code within larger works licensed under different license types. The MPL license required the copyright notices and warranty disclaimers to be retained and the original developers were indemnified for any claims arising as a result. The sharing of source code on the Internet began with software distributed via UUCP, Usenet, IRC and Gopher channels. Linux, one of the most popular computer operating system followed these models. Linux eventually turned out to become one of the most protruding instances of the free and open-source software alliance. Anyone with licenses, like the GNU General Public License may use, modify and distribute the open source software, either commercially or non-commercially.

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<sup>103</sup> Cornelia Boldyreff, Open Source Ecosystems: Diverse Communities Interacting (5<sup>th</sup> IFIP WG 2.13 International Conference on Open Source Systems, OSS 2009) p.145  
<[https://books.google.co.in/books?id=cEBuCQAAQBAJ&pg=PA145&lpg=PA145&dq=open+source+phenomenon&source=bl&ots=g6Scku14JZ&sig=\\_WjZrNrMz6BVqftetJXwQ6rBTi0&hl=en&sa=X&ei=JFSjVYvxO4i\\_0gTGzr-IDw&ved=0CD0Q6AEwCDgK#v=onepage&q=open%20source%20phenomenon&f=false](https://books.google.co.in/books?id=cEBuCQAAQBAJ&pg=PA145&lpg=PA145&dq=open+source+phenomenon&source=bl&ots=g6Scku14JZ&sig=_WjZrNrMz6BVqftetJXwQ6rBTi0&hl=en&sa=X&ei=JFSjVYvxO4i_0gTGzr-IDw&ved=0CD0Q6AEwCDgK#v=onepage&q=open%20source%20phenomenon&f=false)>

The term 'free and open-source software' emerged by 1988<sup>104</sup> and the "open source" label was created at a strategy session held on February 3<sup>rd</sup> of that year in Palo Alto, California, shortly after the announcement of the release of the Netscape source code. The Open Source Initiative (OSI) published its first formal list of approved licenses by October, 1999. This list has been subject to updates since then and has remained the undisputed list of open source licenses. It is a recognized source of reference by many third parties, including governments and standards bodies.

The OSI campaigned to tackle and reduce the sudden upsurge in the number of open source licenses in 2004. Following an increase in the number of open source licenses by 2004, the OSI launched a campaign to reduce the growth in the number of open source licenses. Eventually, this led to the publication of a License Proliferation report in 2006. The license list was recategorised into groupings of licenses based on usage and content. The problem of license proliferation was now brought into the limelight, and a sudden campaign to reduce the creation and use of new license was advocated by the OSI<sup>105</sup>.

### **LICENSING & REVENUE SOURCING**

The Supreme Court of India considers computer software as 'goods' as per the Sale of Goods Act and states that computer software is Intellectual Property (IP) since it is a commodity capable of being transmitted, transferred, delivered, stored, processed and is liable to sales tax as well<sup>106</sup>. The legal instrument for propagating open source is through 'licensing'. Open Source Licenses are licenses that allow software to be freely used, modified, and shared. To be approved by the Open Source Initiative (also known as the OSI), a license must go through the Open Source Initiative's license review process<sup>107</sup>.

Licensing allows competitors to compete fairly in a market by using a license of the patented program for a fee. The validity of open source licenses is yet to be specifically decided by Indian Courts and the legislature. Once it is determined that they are a valid contract with an offer, acceptance and

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<sup>104</sup> Cohn & Wolfe, 'New Foundation to Advance Software Standards, Develop and Provide Open Software Environment', Press Release., May 17, 1988

<<https://groups.google.com/forum/#!msg/comp.unix.questions/rDqLt9NlqZc/CVNzbAhu01UJ>>

<sup>105</sup> Open Source Initiative, History of the OSI, *OpenSource.org*

<<http://opensource.org/history>> accessed 28 October 2015

<sup>106</sup> *Tata Consultancy Services v. State of Andhra Pradesh* [2005] 1 SCC 308

<sup>107</sup> Open Source Initiative, Licenses & Standards, *OpenSource.org*

<<http://opensource.org/licenses>>

consideration in the form of a promise of the licensee to abide by licensor's terms, they become enforceable. A US Court also confirmed the enforceability of licensing agreement on both open-source software and proprietary software. Thus the terms and conditions of an Open Source License are enforceable copyright conditions<sup>108</sup>.

Many licenses have not been updated over a span of years and frictions arise when there is breach in license compliance. Licenses are criticized for attempting to privatize IPR, enhancing transaction costs, causing proliferation and confusion as regards interpretation and application. To tackle the issues faced in licensing, Contract Law is thus seen as a temporary alternative. It is important to note that one cannot release a software under Open Source licensing for non-commercial use only. Further, if the source code is not distributed, then what is distributed cannot implicitly be called 'Open Source'. Doubts arise for the functionality of open-sourcing, especially when the question of revenue inflow is brought up. Revenue inflow usually forms its source from dual licensing<sup>109</sup>. Companies develop these softwares through their in-house R&D facilities and eventually sell their professional services and branded merchandise to that particular market. Developers also earn by selling their certificate, license or the trademark use, advertising supported software, selling of optional proprietary extensions, proprietary parts of a software product or re-licensing under a proprietary license. Some developers even enter into partnerships with funding organizations like educational institutes, NGOS and the Government.

### **CONFLICT OF IP & OPEN SOURCE REGIME**

The distinction between open source software and proprietary software lies in the free use of the software and the licensing structure. While proprietary software is released in the market by concealing the source code, under open sourcing the source code is made available with the object code<sup>110</sup>. In proprietary software, the consumer is bound by the terms of license. One of the major concerns for open source arena is the infiltration of open source code in proprietary code and vice-versa. Most recently, SCO claimed that IBM illegally incorporated SCO's proprietary UNIX code into the open-source Linux operating system, and thus every Linux distributor, developer,

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<sup>108</sup> *Jacobsen v. Katzer* No. 3:06-cv-01905 (N.D. Cal. Aug. 17, 2007)

<sup>109</sup> Dual licensing is possible when licences are based on the idea of both open source licences and commercial/proprietary licence.

<sup>110</sup> Potter Shawn W, Opening up to open source, *Richmond Journal of Law and Technology*, Vol. VI, 2000  
<<http://jolt.richmond.edu/v6i5/article3.html#h20>>

and user would become copyright infringers if they did not pay licensing fees. The Court ultimately ruled that 326 lines of code in the Linux kernel were potentially infringing<sup>111</sup>.

### **IPR LITIGATION:**

The fundamental aim of free art licensing is to promote and protect artistic practices and free them from the rules of the market economy. Computer programmes are basically writings and are also defined under the Copyrights Act in India. In India, literary works include computer programmes as per *Section 2(o)* of Copyrights Act. There is no law in India that specifically deals with the 'protection' of computer software. It can be protected through Patent laws, Copyright laws and through Trade secrets as well as be regulated through Information Technology laws. The IT Act accords legal recognition to digital signatures, electronic records and sets up the framework for prevention of computer crimes, but does not deal with IP protection to computer software. Contrary to popular belief, open source programs are not for the public domain since they are protected by intellectual property laws. They are distributed under restrictive access terms which allow other developers to freely copy, share, and modify such software. Infact, trade secrets are the pillars of software protection, while open source software creates a rift and increases ideological conflicts. Trade secret matters were also raised in litigation for instance when Red Hat sought to obtain a declaratory judgment arguing that Linux being publicly available was not protected by trade secret. Hence, Red Hat had not violated SCO's trade secret, which was freely accessible on the Linux open source platform<sup>112</sup>.

Developers who want to establish free knowledge flow, create agreements and licenses that authorize others the use of their IP work. However the owner cannot prevent in part or full, further distribution of that work.

Under the Agreement on *Trade Related Aspects of Intellectual Property Rights* (TRIPS), copyright protection is provided to computer programmes<sup>113</sup>. Copyrights take away another person's freedom to share and change work. However, they cannot protect a process, procedure, system, method of operation, concept, principle or any discovery. Copyrights, infact, are capable of being reproduced from a fixed medium. Licensing, on the other hand allows select leeway to borrow, change and further

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<sup>111</sup> *Caldera Sys Inc v Int'l Bus Mach's Corp* (D.Utah 2003) (No. 03-CV-0294).

<sup>112</sup> *Red Hat Inc v. The SCO Group*, [2003] (Civil Action No. 03-772)

<sup>113</sup> Article 10 (1), TRIPS



add value. Stakeholders believe that IP laws do not only provide benefit to individuals through the 'consent process', although it may be extremely technical and restrictive, but also provide mechanism to protect unique creativity of developers.

Under *Article 2(1) of the Berne Convention*, the purpose for which Open Source Software writings are created is immaterial from the perspective of their qualifying as literary works. They do not infringe any person's intellectual work, as long as they are original intellectual creations and the expression of their idea is different from any other presentation of that idea. Trademarks, moral rights and design protection laws are also applied for protection of open source software. Any software that is easy to copy is not fit to be protected by trade secrets. Even when the license contains a stipulation that the licensee shall not disclose any confidential information relating to the licensed software that may not prevent third party access to it<sup>114</sup>. Moral rights attribute reputation and monetary awards to the developer of the software. This is also recognized under *Section 57 of the Indian Copyright Act, 1957* which acknowledged the paternity and integrity in context of computer programs.

Software patents pose a variable threat to open sourcing. If a program is infringed even a little bit then its development must come to an effective stop, at-least in the open source arena<sup>115</sup>. The open source movement is shoring its resources to combat any potential threat, through techniques like licensing, creating patent pools, establishing prior art databases, emphasizing on proper prior art examination etc. There is a fundamental difference in treatment of improvements under copyright law and patent law. The copyright owner has statutory entitlement to control improvements, whereas this is not there for patents<sup>116</sup>. Further, common law protection (passing off) is available for copyright but not for patents.

To conclude, while the IP regime seemingly appears to be an anomaly to Open-Source Software, they are not really a hindrance to development, innovations and promotion of software ingenuity.

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<sup>114</sup> *Zawels v. Edutronics Inc.*, 520 NW 2d 520 (Minn. App. 1994); where the misuse of confidential information about a computer based teaching system was held to constitute misappropriation of trade secrets.

<sup>115</sup> Vikrant Narayan Vasudeva, Open Source Software Paradigm and Intellectual Property Rights, *Journal of Intellectual Property Rights Vol 17, Nov 2012*, p.511-520.

<[http://nopr.niscair.res.in/bitstream/123456789/15019/1/JIPR%2017\(6\)%20511-520.pdf](http://nopr.niscair.res.in/bitstream/123456789/15019/1/JIPR%2017(6)%20511-520.pdf)>

<sup>116</sup> Milgrim R and Bensen E, Milgrim on Licensing, *Mathew Bender, NY*, 2010

<[http://nopr.niscair.res.in/bitstream/123456789/15019/1/JIPR%2017\(6\)%20511-520.pdf](http://nopr.niscair.res.in/bitstream/123456789/15019/1/JIPR%2017(6)%20511-520.pdf)>

Through its multiple pillars and licensing provisions in trade secrets, copyrights, patency, they are able to complement and enrich the very essence of 'attribution' and 'free flow of information'.

### **OPEN SOURCE & NET NEUTRALITY**

For decades, the definition of Open Source has remained restricted to Software programming and language. However, in recent times open source has become more of a reference to the idea and concept of 'free access' to information and knowledge aggregating source or platforms. The internet has been instrumental in creating the means and tools for globalized information access and a level playing field. Open and non-prejudiced access to the Internet has revolutionized the way information is transferred around the world. Net neutrality is a principle that Internet service providers and governments should treat all data equally and not discriminate or charge consumers for the content or nature of the data usage. To achieve net neutrality, open access and prevention of broadband discrimination are the prime means. Countries like Brazil, Chile, France, Netherlands, Singapore, South Korea and even USA and UK (to some extent) have taken or proposed a specific legislative measure to enforce Net Neutrality principles. This includes no blocking or throttling and no discrimination in treatment of traffic.

### **NET NEUTRALITY IN INDIA: A CASE STUDY FOR OPEN SOURCE**

Net neutrality has not been defined per se in the Indian context, but its essence is being deliberated upon by Governmental bodies and industry experts. The Telecom Regulatory Authority of India (TRAI) has shown its support to net neutrality through its guidelines, and the Department of Telecommunication (DoT) too released a report in the first week of July, 2015 in support of net neutrality<sup>117</sup>.

To ensure net neutrality, the following principles have been proposed by the Telecom Regulatory Authority of India (TRAI):

- i. *The Internet must be kept open and neutral. Reachability between all endpoints connected to the Internet, without any form of restriction, must be maintained.*

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<sup>117</sup> The Economic Times, Jul 2, 2015

- ii. *All data traffic should be treated on an equitable basis no matter its sender, recipient, type, or content. All forms of discriminatory traffic management, such as blocking or throttling should be prohibited.*
- iii. *Network service providers should refrain from any interference with internet users' freedom to access content (including applications of their choice)*
- iv. *There should be restricted use of packet inspection software (including storage and re-use of associated data) to control traffic.*
- v. *Complete information on reasonable traffic management practices and justifications for the same must be accessible and available to the public. Telecom operators should be transparent and accountable to any changes in practices.*
- vi. *Non-neutral treatment of traffic for "voluntary" law enforcement purposes must be prohibited unless there is a legal basis for it<sup>118</sup>.*

Controversy surrounding violation of net neutrality principles in India, has mushroomed since the time service providers such as Airtel and Vodafone have proposed a levy of fee on Over-the-Top (OTT) services. Facebook, in association with Reliance, started a basic service called Internet.org while Airtel started Net Zero in which users were allowed to access certain sites and applications without paying for data charges. Mark Zuckerberg went to the extent of claiming that internet.org would help internet proliferation in India. However, it resulted in clear violation of the principles of net neutrality and ended favouring Facebook services over its competitors. While customers were charged for accessing other sites and applications, select sites and applications were allowed free access by the service providers. The fear was that both operators were luring consumers with their very attractive offerings and were a pre-cursor to blocking and throttling access for certain sites.

OTT players contend that since content providers have already been paying TSPs/ ISPs through hosting, connectivity charges and domain registration charges, there is no valid reason to charge them additionally for content a well. Issues have been raised by the consumer that the service provider could possibly discriminate against certain types of content, which would eventually hurt consumers. This also raises anti-competitive concerns. *Section 4 of the Competition Act, 2002* prevents the abuse of an entity's dominant position in any market and the Service Provider's attempt to block and restrict the principle of net neutrality is detrimental to the OTT players in the market.

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<sup>118</sup> TRAI, Consultation Paper on Regulatory Framework for Over-the-top (OTT) services, No: 2/2015  
<<http://www.trai.gov.in/WriteReaddata/ConsultationPaper/Document/OTT-CP-27032015.pdf>>

OTT players argue that the platform of service providers can be the incubation grounds like those of open source software and as such can allow development of services and applications for the larger benefit of the community. Hence, there should be no additional charges infringing their mainstreaming.

A major concern is that a cartel of telecom operators may degrade traditional internet access to force application and content providers to use the telecom operator's new 'premium' service (without degrading access). However, the competition angle gets diluted when the matter of public policy and welfare come into picture. Further, issues such as right to information, free internet access, security, speed of internet, rising costs in internet access due to rise in data traffic etc. are said to be the major concerns of the consumer, if the net neutrality principles are encroached upon. TRAI however, seems helpless in its stand. Even though they do support net neutrality in principle, they cannot stop the service providers from acting against it because of the high capital expenditure undertaken by telecommunication companies while setting up the network infrastructure, as well as the levy of high spectrum licensing fee. Since there is no legislation governing net-neutrality, charging of high rates would not be illegal. Further, Article 19 (6)<sup>119</sup> imposes reasonable restrictions on entities such as the OTT players to carry on their business, especially if it is against the interest of the general public. With 'alleged' discriminatory practices such as 'Net Zero', Article 19 (6) could bar OTT players from prevailing in the market. There are a lot of other considerations to be accounted for when debating net neutrality. The bandwidth of the internet is limited. Some users require comparatively more bandwidth compared to others, without any lag, for sending bulk emails or for using services such as Skype or YouTube. Each data packets sent for different services, vary in nature. It would only be fair to charge for a higher price because more space and traffic needs to be sent on priority by the service provider, depending on which one of the services are being availed. This argument however, conflicts with the principle of net neutrality.

Service providers are of the view that for any activity on the network created by them, which results in a commercial gain to the OTT players, a revenue sharing model needs to be established. Their argument is that huge amount of money and effort has been invested in buying the spectrum, setting up the network, ensuring regulatory guidelines (which are quite restrictive in India) and supporting law enforcing agencies in tracking crime. OTT players such as Whatsapp, Viber, Skype, and Facebook are offering the same service of either messaging, voice or data transmission (such as photographs, video) using an established network for which they do not need to spend money in either buying

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<sup>119</sup> The Constitution of India

separate spectrum or license, or establishing network. For voice calls the OTT player do not even need to follow the guidelines issued by law enforcing agencies that have been laid down for the service provider and these voice calls are rapidly consuming the revenues of TSPs and ISPs. Service providers have countered the 'abuse of dominant position' claim by the OTT players by defending that they have become a direct competition without any large investment or regulation. By doing so, the Service Providers aim to achieve a level playing field. The principle of net neutrality needs to be regulated and constrained so as to be subject to certain conditions, in order to protect networks from disruptive attacks. The flow of Internet traffic needs to be managed with suitable tools, legal obligations need to be complied with, and the quality of services needs to be maintained for services. Certain regulations need to be put in place to ensure legal interception by authorities in case of need, license fees and quality checks.

The Department of Telecommunications recommended that commercial considerations cannot form the basis for acceptability. Principles such as network limitations, congestion management and legal public policy requirements amongst others can be permissible approaches to acceptable traffic management on the Internet<sup>120</sup>. The DoT very pragmatically suggested that an overdose of high data consuming sites may result in crippling of the network, causing breakage of basic net service to consumers. Therefore, network management and regulation in allowing OTT operations becomes a critical factor in following the true essence of net neutrality. With voice calls made over OTT apps, even the Government loses revenue as the 6-8% revenue sharing agreement between them and the service providers does not exist. Traceability of calls made through OTT cannot be established, causing serious security concerns which has been laid down as principles of voice calling to service providers. Net neutrality is not just a commercial, but a social issue, providing free and cheap internet access to the masses, resulting in easier governance, information dissemination, e-commerce, electronic communication which creates a platform for open source technology. Affordable, quality and universal broadband should be achieved to all users main goal. Their right to send, receive, display, use or post any legal content or application should not be restricted. However unregulated content can be a bane to the society such as pornography, spreading of false propaganda, data theft, money laundering, terrorism and violence etc. and a check needs to be kept on this content. Law enforcing agencies use the telecommunication network in a big way for tracking crime based on tower locations of the last call made and establishing multiple circles of calls made by the suspect.

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<sup>120</sup> Department of Telecommunication, Committee Report on Net Neutrality, May 2015  
<[http://www.dot.gov.in/sites/default/files/u10/Net\\_Neutrality\\_Committee\\_report%20%281%29.pdf](http://www.dot.gov.in/sites/default/files/u10/Net_Neutrality_Committee_report%20%281%29.pdf)>

Tracing of calls without defined regulations on OTT players may not be possible and therefore may result in increase of crime, and be a major security threat to society.

It is safe to assume that net neutrality is a bi-product of Open Source. Whether new policies are required to be implemented by the legislature or amendments to existing policies are needed, it is certain that at present, the TRAI and DoT are in two minds and unstable on their stance on net neutrality and the debate about possible future legislations continue to heat up the conference tables in India. It must also be taken into consideration that the general public are the end users of these services. Policies must be accorded and balanced out to their needs as well the service provider's needs. It would be strenuous and practically impossible for the Consumer Dispute Redressal Agencies to address each grievance on an individual basis. Popular OTT services such as Facebook, and even WhatsApp to some extent have primarily used the Open Source platform for development and to expand their network. Net Neutrality restrictions would in fact restrain the phenomenon of open source from flourishing, hence it is important for the Government to come up with a policy for the issue of net neutrality in view and respect of the open source phenomena. Dampening the open source availability would only send the country back a decade, in terms of fair competition and sustainable growth.

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## **IMPLIED CONDITIONS AND WARRANTIES: A COMPREHENSIVE STUDY**

**RUDRAKSHI JOSHI<sup>121</sup>**

### **ABSTRACT**

A condition is a stipulation essential to the main purpose of the contract, the breach of which gives right to repudiate the contract and to claim damages. For example, P goes to R, a horse dealer, and says I want a horse which can run at a speed of 30 KM. per hour. The horse dealer points out at a particular horse and says, this will suit you. P buys the horse. Later on P finds that the horse can only run at a speed of 20 KM./HR. There is breach of condition, P can repudiate the contract, return the horse to R and get back the price. A warranty is a stipulation collateral to the purpose of the contract, the breach of which gives the aggrieved party a right to sue for damages only, and not to avoid the contract. For example, assume that a farmer, intending to plant no-till soybeans, approaches a seller to buy herbicide. Assume further that the buyer requests a particular herbicide mix but the seller suggests a less expensive mix. If the chemical fails to kill crabgrass and the farmer has a low yield of soybeans, the farmer could sue the seller for breach of the warranty of fitness for a particular purpose because the seller knew what the farmer required.

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## INTRODUCTION

Stipulations essential for the main purpose of the contract of sale of goods are termed as 'implied conditions'.<sup>122</sup> Other stipulations, which are not essential are termed as 'implied warranties'.<sup>123</sup> Thus, a stipulation in a contract of sale with reference to goods which are the subject thereof may be termed as implied conditions or warranties.<sup>124</sup> Implied conditions are condition as to title, sale by description, sale by sample, sale by sample as well as description, condition as to quality or fitness and condition as to wholesomeness.<sup>125</sup> Implied warranties are warranty as to quiet possession and warranty as to goods to be free from encumbrances.<sup>126</sup>

In this research project in addition to what the contract may provide, the law implies into every sale of goods a number of conditions and warranties.<sup>127</sup> They are read into every contract of sale unless they are expressly excluded.<sup>128</sup> These are called as implied conditions and warranties.<sup>129</sup>

## SECTION 11 – STIPULATIONS AS TO TIME

- **Scope :-** Section 11 of the Act prescribes that stipulations as to time are to be gathered from the contract.<sup>130</sup> Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be of the essence of the contract or not depends on the terms of the contract.<sup>131</sup> Ordinarily in commercial contracts, as regards stipulations other than such as relate to time of payment, time is the essence of the contract.<sup>132</sup>
- **Time for payment :-** Section 11 of the Sale of Goods Act, says unless a different intention appears from the terms of the contract, stipulations as to the time of payment are not deemed to be the essence of a contract of sale.<sup>133</sup> It is well established that it is only in cases where the time is the

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<sup>122</sup> Conditions and warranties (caveat emptor), *available at* : <http://www.slideshare.net/niravjshah1994/conditions-warranties-caveat-emptor> (Last Modified July 18, 2014).

<sup>123</sup> *Ibid.*

<sup>124</sup> *Ibid.*

<sup>125</sup> *Ibid.*

<sup>126</sup> *Ibid.*

<sup>127</sup> *Id.* at 15.

<sup>128</sup> *Ibid.*

<sup>129</sup> *Ibid.*

<sup>130</sup> Dr. V. Krishnama Chary & Anita B. Gogia, *A Short Commentary on The Sale of Goods Act, 1930* 57 (Bharat Gogia (H.U.F.), Hyderabad, 3<sup>rd</sup> edn., 2012).

<sup>131</sup> Satish J. Shah, *Pollock & Mulla The Sale Of Goods Act* 120 (Lexis Nexis, Nagpur, 8<sup>th</sup> edn., 2011).

<sup>132</sup> *Ibid.*

<sup>133</sup> *Supra* note 19 at 58.

essence of the contract, the vendor can cancel the contract for non-payment of the price within the time stipulated.<sup>134</sup>

- **Time for performance** :- “In *Frebald and Sturznickel vs. Circle Products Ltd.*<sup>135</sup>, German Sellers sold toys to English buyer’s F.O.B. Continental port on the terms that the goods were to be delivered in time to catch the Christmas Trade.<sup>136</sup> The goods were shipped from Rotterdam and reached London on November 13, but because of an over sight for which the sellers were not responsible, the buyers were not notified of the arrival of the goods until the following January 17.<sup>137</sup> It was held that the sellers were not in breach as they had delivered the goods in accordance with the requirements of the contract by shipping them in such a way as would normally have resulted in their arrival in time for the Christmas trade.”<sup>138</sup>
- **Time – an essence of commercial contracts** :- In commercial or mercantile contracts, the need for certainty is of great importance and it is this aspect of the matter that compels courts generally to construe time as of the essence of commercial contracts.<sup>139</sup> The law relating to time being of the essence of contract has been neatly summarised in the passage in Halsbury’s Laws of England.<sup>140</sup> “The modern law follows : Time will not be considered to be of the essence unless the parties expressly stipulate that conditions as to time must be strictly complied with; or the nature of the subject matter of the contract or the surrounding circumstances show that time should be considered to be of the essence; or a party who has been subjected to unreasonable delay gives notice to the party in default making time of the essence.”<sup>141</sup>

## SECTION 12 – CONDITION AND WARRANTY

- A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty,
- A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated,

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<sup>134</sup> *Ibid.*

<sup>135</sup> (1970).

<sup>136</sup> *Supra* note 19 at 59.

<sup>137</sup> *Ibid.*

<sup>138</sup> *Id.* at 60.

<sup>139</sup> *Ibid.*

<sup>140</sup> *Ibid.*

<sup>141</sup> *Ibid.*

- A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated,
- Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.<sup>142</sup>
  
- **Scope :-** When the terms of the contract make it clear that the estimate given there is only an anticipative one and is not a term of the contract to clear-fall, and cannot be regarded as in the nature of warranty.<sup>143</sup>
- **Applicability of maxim “caveat emptor” :-** Upon a sale of goods, the general rule with regard to their nature or quality is caveat emptor, so that in the absence of fraud, the buyer has no remedy against the seller for any defects in the goods not covered by some condition or warranty, expressed or implied.<sup>144</sup> The buyer according to the maxim has to be cautious, as the risk is his and not that of the seller.<sup>145</sup>
- **Conditions and warranties :-** In Halsbury’s Law of England, it is observed as follows that “the predominant modern approach is to consider the nature of the terms of the contract in order to decide whether those terms are conditions or warranties.<sup>146</sup> Prima facie, a breach of condition entitles the innocent party to rescind the contract and claim damages for any loss he may have suffered, where as a breach of warranty only entitles him to damages.”<sup>147</sup>
- **Breach of Warranty :-** When the breach of condition is treated as breach of warranty, in view of Section 12(3), the breach of warranty gives a right to claim for damages but not to a right to reject the goods and treat the contract as repudiated.<sup>148</sup>
- **Breach of Condition :-** A condition is more vital undertaking than a warranty, and that the consequences that flow from its breach are different.<sup>149</sup> In the usual sense, the condition means an essential undertaking in the contract which one party promises that it will be made good.<sup>150</sup> If

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<sup>142</sup> The Sale of Goods Act, 1930 (Act 3 of 1930).

<sup>143</sup> *Supra* note 19 at 67.

<sup>144</sup> *Id* at 68.

<sup>145</sup> *Ibid.*

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*

<sup>148</sup> *Id* at 69.

<sup>149</sup> *Ibid.*

<sup>150</sup> *Ibid.*

it is not made good, not only the other party be entitled to repudiate the contract, but also sue for damages for breach.<sup>151</sup>

➤ **Implied Conditions and Warranties :-** Although the parties may have used no express words that would create such a stipulation, the law annexes to many contracts conditions, the breach of which may be treated by the buyer as avoiding the contract or giving a right to damages.<sup>152</sup> These are called implied conditions and are enforced on the grounds that the law infers from all the circumstances of the case that the parties intended to add such a stipulation to their contract, but did not put it into express words; such implied conditions are dealt with in sub-section 14-17.<sup>153</sup> The existence of an implied condition or warranty may be rebutted by proof of facts which show a contrary intention.<sup>154</sup> Sometimes, however, a warranty in the strict sense of the term is implied by law where no inference of an implied condition would arise.<sup>155</sup>

In *Wallis, Son and Wells vs. Pratt*<sup>156</sup>, the distinction between a condition and a warranty is summarised.<sup>157</sup> "A party to a contract who has performed, or who is ready and willing to perform, his obligations under that contract, is entitled to the performance by the other contracting property of all the obligations which rest upon him.<sup>158</sup> But from a very early period of our law, it has been recognized that such obligations are not all of equal importance.<sup>159</sup> There are some which go so directly to the substance of the contract, or in other words, are so essential to its very nature that their non-performance may fairly be considered by the other party as a substantial failure to perform the contract at all.<sup>160</sup> On the other hand, there are other obligations which though they must be performed, are not so vital that a failure to perform them goes to the substance of the contract."<sup>161</sup>

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<sup>151</sup> *Ibid.*

<sup>152</sup> *Supra* note 20 at 131.

<sup>153</sup> *Ibid.*

<sup>154</sup> *Ibid.*

<sup>155</sup> *Ibid.*

<sup>156</sup> (1910) 2 KB 1003.

<sup>157</sup> *Supra* note 19 at 69.

<sup>158</sup> *Ibid.*

<sup>159</sup> *Ibid.*

<sup>160</sup> *Ibid.*

<sup>161</sup> *Ibid.*

The distinction is of great importance.<sup>162</sup> The breach of a condition entitles the injured party to repudiate the contract, to refuse the goods, and, if has already paid for them, to recover the price.<sup>163</sup> The only remedy for the breach of warranty is the recovery of damages.<sup>164</sup>

### **SECTION 13 – WHEN CONDITION TO BE TREATED**

- Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated,
  - Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect,
  - Nothing in this section shall affect the case of any condition or warranty fulfilment of which is excused by law by reason of impossibility or otherwise.<sup>165</sup>
- **Corresponding Law** :- Section 13(2) of Indian Sale of Goods Act purport to enumerate the circumstances under which a stipulation having normally the effect of a “condition” is reduced to the status of “warranty”.<sup>166</sup> Where a contract is for specific goods, the property in which has passed to the buyer, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty.<sup>167</sup>
- **Scope** :- Where the seller commits a breach of condition express or implied whether as to title or quality or fitness, if the buyer ignoring the breach of condition takes delivery of the goods, he is said to have elected to treat as breach of condition as breach of warranty.<sup>168</sup>

In *Taylor & Co. vs. Landauer & Co.*,<sup>169</sup> the contract was an ordinary CIF contract under which the sellers were bound in due course to give notice of appropriation and to tender documents.<sup>170</sup>

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<sup>162</sup> *Id.* at 70.

<sup>163</sup> *Ibid.*

<sup>164</sup> *Ibid.*

<sup>165</sup> *Supra* note 31.

<sup>166</sup> *Supra* note 19 at 70.

<sup>167</sup> *Id.* at 71.

<sup>168</sup> *Ibid.*

<sup>169</sup> [1940] 4 AII ER 335.

<sup>170</sup> *Supra* note 20 at 138.

Before the due date of notice and tender arrived, war broke out and an order of council was made forbidding the buying or selling the cereals outside the United Kingdom without a licence.<sup>171</sup> It was held that the order did not have the effect of defeating or putting an end to the contract : the duty of the sellers was to apply for a licence to enable them to perform the contract, and there was no reason to suppose that the licence, if applied for, would not have been granted; and the sellers were not, therefore, excused from performance of the contract.<sup>172</sup>

#### **SECTION 14 – IMPLIED UNDERTAKING AS TO TITLE, ETC**

In a contract for sale, unless the circumstances of the contract are such as to show a different intention there is –

- An implied condition on the part of the seller that, in case of a sale, he has a right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass,
- An implied warranty that the buyer shall have and enjoy quiet possession of the goods,
- An implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made.<sup>173</sup>

➤ **The section may be illustrated by the following example :**

Sale of a motor car : After the buyer had used it for some months, it was discovered that the car had been stolen and the buyer was compelled to return it to the true owner. The buyer was held entitled to recover the price from the seller.<sup>174</sup>

- **Seller Responsible for Title :-** It was formerly said that by the Common Law, the seller of goods was not bound in the absence of express agreement, to answer for his title to the goods sold, but the exceptions allowed to the supposed rule were in the modern authorities of more importance than the rule, and in 1851, Lord Campbell CJ definitely said that the exceptions had well-nigh eaten up the rule as in the case of *Sims vs. Marryat*.<sup>175</sup>

- **Warranty for Quiet Enjoyment :-** Both the effect and the importance of this warranty are uncertain.<sup>176</sup> The buyer is already protected by the condition as to title, which amounts to an undertaking by the seller that he has the complete right of disposal of the goods; and, as the

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<sup>171</sup> *Ibid.*

<sup>172</sup> *Ibid.*

<sup>173</sup> *Supra* note 31.

<sup>174</sup> *Supra* note 20 at 140.

<sup>175</sup> [1851] 17 QB 281, 85 RR 462.

<sup>176</sup> *Supra* note 62 at 142.

condition is broken if by reason of the seller's defective title, the buyer is subsequently disturbed in his possession of the goods by the lawful act of a third party, the warranty for quiet enjoyment is, as regards such cases, superfluous.<sup>177</sup> And as regard cases in which the buyer is prevented from obtaining possession of the goods by such an act, the buyer would appear to have a sufficient remedy under section 31 and need not rely on this implied warranty : and similarly with respect to other breaches of contract or tortuous acts of the seller.<sup>178</sup>

- **Warranty of Freedom from Incumbrances :-** This warranty amounts to a promise by the seller that the buyer's possession shall not be disturbed by reason of the existence of an incumbrance, and there will be a breach of it if the buyer is compelled to discharge any such incumbrance.<sup>179</sup> The practical effect of it appears to be that, if the buyer does discharge such an incumbrance, he may recover the amount from the seller, by virtue of the provisions of section 69 of the Indian Contract Act, 1872, for it will not be a voluntary payment, and the subsection makes it clear that in the absence of an agreement to the contrary, the buyer does not buy subject to incumbrances.<sup>180</sup>

## SECTION 15 – SALE BY DESCRIPTION

- **Scope :-** Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description; and if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods correspond with the sample if the goods do not also correspond with the description.<sup>181</sup>
- **Condition precedent :-** A stipulation as to time of shipment contained in a commercial contract is a part of the description of the goods sold and is a condition precedent which must be fulfilled in order to the performance of the contract.<sup>182</sup> According to Halsbury's Law of England, "The general principle of this implied condition is clear and founded on the consensual basis of the law of contract.<sup>183</sup> If the description of the goods tendered is different from that of the goods agreed to be sold, it is not the article bargained for and the buyer is not bound to take it."<sup>184</sup>

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<sup>177</sup> *Ibid.*

<sup>178</sup> *Id.* at 143.

<sup>179</sup> *Ibid.*

<sup>180</sup> *Ibid.*

<sup>181</sup> *Supra* note 19 at 72.

<sup>182</sup> *Id.* at 73.

<sup>183</sup> *Ibid.*

<sup>184</sup> *Ibid.*

- **Goods to be as per description :-** In *Wimble, Sons and Co. vs. Lillico and Sons*<sup>185</sup>, the Court had to consider whether a contract for the sale of cotton cake “containing approximately 40 per cent protein and 10 per cent oil” was a sale by description.<sup>186</sup> McCardie, J., held that the words as to the percentages were words of description under Section 13 of the (English) Sale of Goods Act, 1893, that the sale was an implied condition that the goods must comply with the description.<sup>187</sup>
- **The section may be illustrated by the following example :** Sale of a ship advertised as copper-fastened to be taken with all faults without allowance for any defects whatsoever.<sup>188</sup> The ship was only partly copper-fastened and not what is described in the trade as a copper-fastened vessel.<sup>189</sup> The buyer was entitled to reject or recover damages for the breach of the condition.<sup>190</sup>

### **SECTION 16 – IMPLIED CONDITIONS AS TO QUALITY OR FITNESS**

Subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows :-

- Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller’s skill or judgement, and the goods are of a description which it is in the course of the seller’s business to supply (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be reasonably fit for such purpose :

Provided that, in the case of a contract for the sale of specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose,

- Where goods are brought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality :

Provided that, if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed,

- An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade,

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<sup>185</sup> (1992) 38 TLR 296.

<sup>186</sup> *Supra* note 70 at 73.

<sup>187</sup> *Ibid.*

<sup>188</sup> *Supra* note 20 at 145.

<sup>189</sup> *Ibid.*

<sup>190</sup> *Ibid.*



- An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.<sup>191</sup>
  
- **General :-** Section 16 is an exception to the rule of 'caveat emptor'.<sup>192</sup> The rule of 'caveat emptor' applies whenever the buyer voluntarily chooses what he buys.<sup>193</sup> It does not mean that the buyer should 'take chance', but it means he should 'take care'.<sup>194</sup> The most important exception to the rule of caveat emptor are the implied conditions of fitness for a particular purpose and the merchantableness of the product.<sup>195</sup> When a man sells an article, he thereby warrants that it is merchantable, ie, it is fit for some purpose, he thereby warrants it for that purpose.<sup>196</sup>
  
- **Caveat Emptor :-** This section is based upon section 14 of the English Act of 1893, the drafting of which caused considerable difficulty.<sup>197</sup> It starts with the principle that it is for the buyer to satisfy himself that the goods which he is purchasing are of the quality which he requires or, if he is buying them for a specific purpose, that they are fit for that purpose.<sup>198</sup> This principle is summed up in the maxim 'caveat emptor' and is based upon the presumption that the buyer is relying on his own skill and judgement, when he effects a purchase.<sup>199</sup>

*Mckenzie & Co. vs. Nagendra Nath*<sup>200</sup> was a case of a motor car sale by description by a seller who deals in cars of that description.<sup>201</sup> It was observed that when in such a case a latent defect which is not expected in a car of the description of average quality is discovered subsequently; there was not only a breach of the implied condition of merchantability under the Second Exception of Section 16, but also of an implied condition of conformity with description under Section 15, and in either case the buyer can under Section 13 of the Act treat such a breach of warranty and claim damages

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<sup>191</sup> *Supra* note 31.

<sup>192</sup> *Id.* at 152.

<sup>193</sup> *Ibid.*

<sup>194</sup> *Ibid.*

<sup>195</sup> *Ibid.*

<sup>196</sup> *Ibid.*

<sup>197</sup> *Id.* at 155.

<sup>198</sup> *Ibid.*

<sup>199</sup> *Ibid.*

<sup>200</sup> (1946) 50 Cal. WN 21.

<sup>201</sup> *Supra* note 19 at 77.

without repudiating the contract of sale.<sup>202</sup> Section 13 of the Act was not limited to a breach of an express condition but extended also to a breach of an implied condition.<sup>203</sup>

### **SECTION 17 – SALE BY SAMPLE**

- A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect.<sup>204</sup> When the offer is made on the basis of a specimen or sample and the same has been accepted, the sale is made upon that specimen notwithstanding that the specimen is turned into a formula, the offer and acceptance must be regarded as being made on the basis of the accepted specimen.<sup>205</sup>
- In the case of a contract for sale by sample, there is an implied condition-
  - that the bulk shall correspond with the sample in quality,
  - that the buyer shall have a reasonable opportunity of comparing the bulk with the sample,
  - that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.<sup>206</sup>

#### **➤ The section may be illustrated by the following example :**

Sale by sample of mixed worsted coatings to be in quality and weight equal to the samples.<sup>207</sup> The goods owing to a latent defect would not stand ordinary wear when made up into coats and were therefore not merchantable.<sup>208</sup> The same defect appeared in the samples but could not be detected on a reasonable examination.<sup>209</sup> The buyer was held entitled to recover damages.<sup>210</sup>

In *Lalchand vs. Baijnath*<sup>211</sup>, Ameer Ali J, decided that where samples are analysed and transformed into a formula, the same may still be by sample.<sup>212</sup> The extent to which the goods must correspond with the sample would depend on the contract and what is contemplated by the parties in regard to it.<sup>213</sup>

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<sup>202</sup> *Ibid.*

<sup>203</sup> *Ibid.*

<sup>204</sup> *Supra* note 31.

<sup>205</sup> *Ibid.*

<sup>206</sup> *Ibid.*

<sup>207</sup> *Supra* note 20 at 172.

<sup>208</sup> *Ibid.*

<sup>209</sup> *Ibid.*

<sup>210</sup> *Ibid.*

<sup>211</sup> (1937) 63 Cal 736, 169 IC 128, AIR 1937 Cal 140.

<sup>212</sup> *Supra* note 96 at 173.

<sup>213</sup> *Ibid.*

### CONCLUSIONS FROM THE STUDY

Confusion has been created in this branch of law by the use of the term 'implied warranty' to denote what is really an implied condition. This confusion is avoided by 'The Sale of Goods Act, 1930'. Sometimes, however a warranty in the strict sense of the term is implied by law where no inference of an implied condition would arise.

Through this research project, we conclude the differences between implied conditions and warranties which has a mention in Section 12(2)(3). The differences are as follows :-

#### CONDITION

1. It is essential to the main purpose of the contract,
2. The aggrieved party have a right to repudiate the contract and claim for Damages.
3. This can be treated as a breach of warranty.<sup>214</sup>

#### WARRANTY

1. It is collateral to the main purpose of the contract,
2. The aggrieved party have a right to claim for damages only,
3. This cannot be treated as a breach of condition.<sup>215</sup>

Thus, there is a need for means of improving the operation of existing statutory implied conditions and warranties so as to maintain the adequacy of the current laws.<sup>216</sup> Also, there is a requirement for amendments to the current laws on implied conditions and warranties and how those amendments would improve existing laws *and better empower regulators to ensure compliance with those laws.*<sup>217</sup> The existence of extended warranties in the market place and their interaction with laws on implied conditions and warranties would add to its effect.<sup>218</sup>

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<sup>214</sup> *Supra* note 1.

<sup>215</sup> *Ibid.*

<sup>216</sup> C Neave, "Consumer Rights : Statuory implied conditions and warranties", *Australian Government, The Treasury* (2009).

<sup>217</sup> *Ibid.*

<sup>218</sup> *Ibid.*

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## INSIDER TRADING REGULATIONS - THE OLD LAW AND THE NEW ONE

SURABHI SHARMA, SUBHALAXMI SEN<sup>219</sup>

### ABSTRACT

The existence of unfair trade practices is as old as the Indian securities market itself. The Securities and Exchange Board of India as the market watchdog has attempted to curb these unfair practices. However, insider trading is an unfair trading practice that has been rampant for the last two decades. The SEBI (Prohibition of Insider Trading) Regulations, 1992 existed to prevent insider trading but it suffered from a lot of discrepancies and was additionally not in line with international jurisprudence in this regards. The SEBI (Prohibition of Insider Trading) Regulations, 2015 overhauled the old framework and brought in a clear, precise and more concrete law. This paper analyses the changes in 4 key areas of the new insider trading law – the definition of insider, the definition of connected person, the definition of unpublished price sensitive information and the defences to insider trading – as compared to the old law.

### INTRODUCTION:

Since the introduction of the SEBI Act, the Indian Stock Markets in the last 2 decades have seen a lot of unfair trade practices. To combat this, the law makers and legislator framers decided to put in place stringent measures to curb these unfair practices.

As far as unfair trading practice go, one that was (and still is to a large extent) rampant in the country's securities market, and a serious threat to its fair functioning was Insider Trading. In the year 2014 alone, 137 complaints<sup>220</sup> of Insider Trading was received by SCORES<sup>221</sup>. In simple terms, insider trading can be described as the trading in securities by a person (an insider) who is in possession of unpublished information that may materially affect the price of securities in the market and carries out the transaction for personal gain to the disadvantage of other investors.<sup>222</sup> It is quite

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<sup>219</sup> Year III, Symbiosis Law School, Pune

<sup>220</sup>D. Ajit, Sarat Malik, Sneha Nautiyal, *Effectiveness of SEBI's Complaint Redressal System (SCORES) in India*, Securities and Exchange Board of India, 2014

<sup>221</sup> SEBI's Complaint Redressal System.

<sup>222</sup> *Ranjana R. Kothari v. SEBI*, Appeal No, 125/2011, SAT Order dated 26.08.2011

evident that such a practice would need to be prevented as it would undermine the confidence of the investors in the fairness and integrity of the regulating systems.

It is a common notion the world over that prevention of Insider Trading should be one of the functions of a market regulator. In USA, significant resources are allocated to keeping a check on insider trading. This notion has also been imported to India and accordingly SEBI, as the market regulator and watchdog has undertaken the responsibility, exercising its powers under S. 11 of the SEBI Act, to prevent insider trading and ensure that the investors remain confident in the honest operations of the Stock Market.

The prohibition of Insider trading in India is primarily based on statutory sources. It is prohibited under S. 12A, sub - section (d) and (e) of the Securities and Exchange Board of India Act, 1992<sup>223</sup> (hereinafter referred to as the SEBI Act), The SEBI (Prohibition of Insider Trading) Regulations, 2015 (hereinafter referred to as PIT Regulations, 2015) and S. 195 of the Companies Act, 2013. The penalty for insider trading is provided under section 15G of the SEBI Act.

PIT Regulation, 2015 came into force on May 15<sup>th</sup>, 2015 thereby overhauling the SEBI (Prohibition of Insider Trading) Regulations, 1992 (hereinafter referred to as PIT Regulations, 1992). This legislation is framed on the lines of the Justice Sodhi Committee recommendations. SEBI had constituted this high level Committee under the chairmanship of Hon'be Justice N.K. Sodhi, retired Chief Justice of the Karnataka High Court and the Former Presiding officer of the Securities Appellate Tribunal (SAT), to review the then existing Insider Trading law amended and evolved by case law to make it in line with the current global practices. Justice Sodhi Committee submitted its recommendations to the chairman of SEBI, Mr. U.K. Sinha at Chandigarh. The Committee made a range of recommendations to make the insider trading regulations appropriate for the present market scenario and in line with international jurisprudence in this regard. They also suggested that a note on legislative intent be appended to each regulatory provision.<sup>224</sup> The current PIT Regulations, 2015 are "*predictable, precise and clear*" with a few new and much needed additions.

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<sup>223</sup> 12A. Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.—No person shall directly or indirectly—

(d) engage in insider trading

(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;

<sup>224</sup> *Justice Sodhi Committee on Insider Trading Regulations submits reports to SEBI*, Press Release, PR No. 120/2013

The present paper will draw an analysis between the 1992 Regulations and the 2015 Regulations. For the convenience of the reader the paper is divided into 4 parts.

**Part I** is an analysis of the change in definition of “insider”. **Part II** is an analysis in the change in definition of “connected person”. **Part III** is an analysis in the change in definition of Unpublished Price Sensitive Information (UPSI) and **Part IV** is an analysis of the defences under the 1992 Regulations and the 2015 Regulations.

**PART I – CHANGE IN THE DEFINITION OF INSIDER**

The definition of an ‘insider’ is an important instrument for determining and affixing liability, and has undergone many changes over the years.

SEBI (PIT) Regulations, 2015	SEBI (PIT) Regulations, 1992
<p>2(g) "insider" means any person who is:</p> <ul style="list-style-type: none"> <li>i) <b>a connected person; or</b></li> <li>ii) <b>in possession of or having access to unpublished price sensitive information</b></li> </ul> <p><b><u>NOTE:</u></b> Since “generally available information” is defined, it is intended that <b>anyone in possession of or having access to unpublished price sensitive information should be considered an “insider”</b> regardless of how one came in possession of or had access to such information. Various circumstances are provided for such a person to demonstrate that he has not indulged in insider trading. Therefore, this definition is intended to bring within its reach any person who is in receipt of or has access to unpublished price</p>	<p>2(e) “insider” means any person who,</p> <ul style="list-style-type: none"> <li>(i) <b>is or was connected with the company or is deemed to have been connected with the company and is reasonably expected to have access to unpublished price sensitive information in respect of securities of [a] company,</b> or</li> <li>(ii) <b>has received or has had access to such unpublished price sensitive information</b></li> </ul>

sensitive information. The **onus of showing that a certain person was in possession of** or had access to unpublished price sensitive information at the time of trading **would, therefore, be on the person levelling the charge after which the person who has traded when in possession of or having access to unpublished price sensitive information may demonstrate that he was not in such possession** or that he has not traded or he could not access or that his trading when in possession of such information was squarely covered by the exonerating circumstances.

The 1992 definition of Insider envisaged 2 kinds of insiders –

1. Who are connected or deemed to be connected and could reasonably be expected to have or had access to unpublished price sensitive information
2. Who are not actually connected or deemed to be connected to the Company but have actually received or have had access to UPSI

The 1992s Regulations had already taken into account the expanded definition of Insider as employed by the US. The definition used by the US includes insiders as well as persons who obtain inside information from an insider, i.e. connected persons.<sup>225</sup> This then gave rise to the question, whether a connected person was automatically an insider if obtained such information from an insider. Under the old law, the qualifying test for a connected person to be an insider was whether he could also be reasonably expected to have access to unpublished price sensitive information.<sup>226</sup> The test for the second provision would depend upon the factum of whether he actually received such information or not. Under the 2015 Regulations, this test has been done away with and every connected person is an insider.

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<sup>225</sup> *United States v. Chiarella*; 588 F.2d 1358, 1365 (2d Cir. 1978)

<sup>226</sup> Insider Trading Regulations – A primer, July 2013 *Nishith Desai and Associates*



The law with regards to non – connected persons was settled in the case KLG Capital Services Limited<sup>227</sup> where SAT held that even a person who might not be a connected person could be an insider if he had gained access to or received unpublished price sensitive information thereby overruling the judgement in the Hindustan Lever case<sup>228</sup>. This was supported by subsequent judicial pronouncements in which the SAT sought to plug the gaping loophole in the legislation and clarified that “a person who has received UPSI or has had access to such information becomes an insider.”<sup>229</sup> The new regulations have not deviated from this stand. It follows the misappropriation theory which explains why outsiders who owe no fiduciary duty to the company but have only obtained the information from an insider are liable for insider trading. Under this theory, a person who trades on wrongfully obtained material, non-public information is liable solely for misappropriating this information regardless of the trader owing any fiduciary duty.<sup>230</sup>

There isn't any particular change in the definition of “insider” however, the definition has been expanded by expanding the definition of “connected person”.<sup>231</sup>

## PART II – CHANGE IN THE DEFINITION OF “CONNECTED PERSON”

SEBI (PIT) Regulations, 2015	SEBI (PIT) Regulations, 1992
2(d) "connected person" means,- (i) any person who is or has during the <b>six months prior to the concerned act</b> been <b>associated</b> with a company, <b>directly or indirectly, in any capacity including by reason of frequent communication</b> with its officers or by being in <b>any contractual, fiduciary or employment relationship</b> or by being a <b>director, officer or an employee</b>	2(h) “person is deemed to be a connected person”, if such person— (i) is a company under the same management or group, or any subsidiary company thereof within the meaning of sub-section (1B) of section 370, or sub-section (11) of section 372, of the Companies Act, 1956 (1 of 1956)

<sup>227</sup> SEBI Order No. WTM/MSS/ISD/18/2009

<sup>228</sup> [1998] 18 SCL 311 (AA)

<sup>229</sup> *Rajiv B Gandhi, Sandhya R Gandhi, Amishi B Gandhi v SEBI*, Appeal No. 50 of 2007

<sup>230</sup> *United States v. O'Hagan*, 521 U.S. 642, 652 (1997)

<sup>231</sup> SEBI PIT Regulations, Key changes and analysis – *Normura Research Institute*

of the company or **holds any position including a professional or business relationship between himself and the company** whether temporary or permanent, that **allows such person**, directly or indirectly, **access to unpublished price sensitive information** or is reasonably expected to allow such access.

(ii) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established, -

- (a). An immediate relative of connected persons specified in clause (i) or
- (b). A holding company or associate company or subsidiary company; or
- (c). an intermediary as specified in section 12 of the Act or an employee or director thereof; or
- (d). an investment company, trustee company, asset management company or an employee or director thereof; or
- (e). An official of a stock exchange or of clearing house or corporation; or
- (f). a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or
- (g). A member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or

or sub-clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969) as the case may be; or 12

- (ii) is an intermediary as specified in section 12 of the Act, Investment company, Trustee Company, Asset Management Company or an employee or director thereof or an official of a stock exchange or of clearing house or corporation
- (iii) is a merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, Investment Advisor, sub-broker, Investment Company or an employee thereof, or is member of the Board of Trustees of a mutual fund or a member of the Board of Directors of the Asset Management Company of a mutual fund or is an employee thereof who have a fiduciary relationship with the company
- (iv) is a Member of the Board of Directors or an employee of a public financial institution as defined in section 4A of the Companies Act, 1956;
- (v) is an official or an employee of a Self-regulatory Organisation

(h). An official or an employee of a self-regulatory organization recognised or authorized by the Board; or  
(i). A banker of the company; or  
(j). A concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent. of the holding or interest

***NOTE:*** It is intended that a connected person is one who has a connection with the company that is expected to put him in possession of unpublished price sensitive information. **Immediate relatives and other categories of persons specified above are also presumed to be connected persons but such a presumption is a deeming legal fiction and is rebuttable.** This definition is also intended to bring into its ambit persons **who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of the company's operations.** It is intended to bring within its ambit those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of any connection that would put them in possession of unpublished price sensitive information.

recognised or authorised by the Board of a regulatory body; or  
(vi) is a relative of any of the aforementioned persons;  
(vii) Is a banker of the company.  
(viii) relatives of the connected person; or  
(ix) is a concern, firm, trust, Hindu undivided family, company or association of persons wherein any of the connected persons mentioned in sub-clause (i) of clause (c), of this regulation or any of the persons mentioned in sub-clause (vi), (vii) or (viii) of this clause have more than 10 per cent of the holding or interest

Under the new law, every 'connected person' under the Regulations is an insider.<sup>232</sup> The qualifying test of whether or not a person would fall within the definition of a 'connected person' is if a person who is or has during the six months prior to the concerned act been associated with the company, directly or indirectly, in any capacity including:

1. by reason of frequent communication with its officers; or
2. by being in a contractual, fiduciary or employment relationship; or
3. by being a director, officer or an employee of the company; or
4. holds any position including a professional or business relationship between himself and the company whether temporary or permanent that allows such person, directly or indirectly, access to UPSI or is reasonably expected to allow such access.<sup>233</sup>

The new regulations saw a shift from a largely position based definition to an association based one, which was much wider. Whilst under the old regime, it was only people who occupied official positions in the company, that were covered by the prohibition of Regulation 3, the new regulations have widened the scope of the definition of an 'insider', and have given legislative legitimacy to the term of 'constructive insiders' developed in American jurisprudence, most notably in the landmark case of *Dirks v. SEC.*<sup>234</sup> These 'constructive insiders' include investment bankers, advisors and others who often receive confidential information while providing services to the issuer acquiring the direct fiduciary duties of the true insider and thus are termed so.

The new definition has been given a very wide connotation and now includes people connected on the grounds of being in a contractual, fiduciary or employment relationship which gives rise to the reasonable expectation that he/she might have access to UPSI. Besides directors, employees and other deemed categories, covered under previous legislations, now even people who are not engaged with the company on a formal basis, but are in constant communication with the employees and officers of the company are insiders. This flexibility has enabled the SEBI to regulate a broader community of people, like consultants and external advisors, in contrast to the powers it was granted under the previous legislations, which stipulated the existence of a formal designation or professional business relationship as a requisite for such regulation. Again, it has incorporated into the statute and broadened, the concept of 'constructive insiders', which are people by either virtue of providing

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<sup>232</sup> Regulation 2(1)(g), PIT Regulations, 2015

<sup>233</sup> Regulation 2(d), PIT Regulations, 2015

<sup>234</sup> 463 US 646 (1983)

services to the company or discharging their statutory obligations may gain access to the unpublished price sensitive information which the company expects to remain confidential.

Some relief was provided to the corporate world, as the ambit of the deemed category of 'relatives' was narrowed down to immediate relatives.<sup>235</sup> Further it is only limited to those who are financially dependent on the concerned insider/connected person or who consult them on matters such as trading in financial securities.<sup>236</sup>

### **INCLUSION OF PUBLIC SERVANTS**

In spite of the Sodhi Committee's Report which recommends an explicit inclusion of public servants, the regulations have kept mum about it. Public servants often, in the course of discharge of duties come across information that may be UPSI. For example, a judge who has heard arguments in a complex tax proceedings the outcome of which would be materially adverse or materially positive to the price of securities of a company would be a —connected person|| until he pronounces the order. Another example will make it clear. A public servant who is actively involved in formulating policy on any matter that could result in a material impact on the price discovery for securities of listed companies – say, pricing policy for a natural resource, or the cap on foreign investment in a specific sector, would be a connected person in the eyes of the regulations.<sup>237</sup> Companies file their advance tax payments, they make advance tax payments. They file Foreign Investment Promotion Board (FIPB) application for new projects. There are public servants and SEBI officials in case of many other transactions, may become privy to unpublished price sensitive information They can still said to be covered by the second clause of the definition which includes almost everyone who is the recipient of such UPSI.

#### **CONNECTED PERSON- ACCESS TO UPSI OF SAME COMPANY OR ANY OTHER COMPANY**

Connected person of a company is not only reasonably expected to have access to the unpublished price sensitive information of 'the same company' but also, of any other company it might have dealings with. In the SEBI order against V K Kaul <sup>238</sup> the court refused to accept the contention that a connected person of 'the company' could only be reasonably expected to have unpublished price sensitive information, and hence could only be an insider of 'same company'. It thus held that the

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<sup>235</sup> Regulation 2(d)(ii)(a) PIT Regulations, 2015

<sup>236</sup> Regulation 2(f) PIT Regulations, 2015

<sup>237</sup> Report of the High Level Committee to review the SEBI (Prohibition of Insider Trading) Regulations, 1992 under the Chairmanship of N. K. Sodhi, *Securities and Exchange Board of India*, December 7<sup>th</sup>, 2013

<sup>238</sup> ORDER NO.ID-6/OCPL/VK/AO/DRK/AKS/EAD-3/301/67-11

such a connected person of one company can become an insider of another company if they have had access to, or have received, or can reasonably be expected to have access to or received UPSI of 'any other company'. It is important to note the language of Regulation 2(e) (i) of the PIT Regulations 1992, according to which a person is an insider, if he is connected with 'the' company and is reasonably expected to have access to UPSI in respect of securities of '[a]' company. The use of words 'the company' in one place and 'a company' in the other implies that the UPSI need not be of the same company which he is connected or with which he is deemed to be connected. The fact that the same difference was actually brought about by an amendment dated February 20, 2002 indicates that such placing was deliberate and a conscious act on part of the drafters, and substantiate the drawing an inference of such an implication.

#### PRESUMPTIONS IN CASE OF A CONNECED PERSON AND OTHER INSIDERS:

In India, the insider trading law is based on the possession view as opposed to the "use" view. The "use" view says that the person should abstain from trading only when he is using the inside information as the basis for trade.<sup>239</sup> The "possession" view argues that the person who is in possession of the insider information is prohibited from trading based on the fact that he is in possession of the information alone, even if the information is not the basis for the trade.<sup>240</sup> This view suffers from a glaring problem – it is a presumption that any person who is in the possession of UPSI is bound to trade on the basis of that knowledge. This is counteracted in the new law by making this a rebuttable presumption.

Under the 1992 regulations, a literal interpretation of the provisions favoured the imposition of a strict liability which makes the trading in securities illegal merely because the person was in possession of such information. However, this would perpetuate injustice if innocent traders, who deal in the securities meet some kind of contingency, were not just prosecuted but also held guilty of insider trading.

Judicial pronouncements tried to strike a balance between the apparent need of a kind of strict liability for insider trading and safeguarding the innocent traders who entered into such transactions in good faith. In *Rajiv Gandhi and Others v. SEBI*<sup>241</sup> the SAT held that the trade should have been motivated by such unpublished price sensitive information in possession of the insider. The

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<sup>239</sup>Fordham Law Review, *See also* Steven Amchen et al. *Securities Fraud*, 39 AM. CRI. L. REV. 1037, 1053 (2002)

<sup>240</sup> *id*

<sup>241</sup> Appeal No. 50/2007, SAT Order dated 09.05.2008

information should have been the factor or circumstance inducing the insider to trade in the securities of the company. However, the court also opined that if an insider trades or deals in the securities of a listed or proposed to be listed company, he shall be presumed to have done it on the basis of the unpublished price sensitive information. The burden of proof was thus put on the defendant because the facts necessary to establish the contrary were within the knowledge of the insider. Thus the presumption was a rebuttable one, and the onus was on the insider to show that he did not trade in the securities on the basis of the unpublished price sensitive information, but on some other basis. The SAT upheld the above view in its subsequent judgments as well.<sup>242</sup> This would also help level the playing field between persons in possession of UPSI and other investors in the market, while allowing market participants to freely deal in securities.

More recently in a short order of the Securities Appellate Tribunal (SAT) in the case of Reliance Petro Investments Limited (RPL) SEBI came to the conclusion that RPL was a deemed connected person (and therefore an insider) with reference to IPCL and that it was “reasonably expected to have access to Unpublished Price Sensitive Information (UPSI)”. On this count, the adjudicating officer imposed a penalty. On appeal, SAT quashed and set aside the adjudicating officer’s order and restored it for adjudicating in the light of SAT’s observations. This case involved trading by RPL in the shares of Indian Petrochemicals Corporation Limited (IPCL). However, in the present case, SAT found that RPL had placed on record various documents and made submissions to rebut the presumption. It also found that the adjudicating officer proceeded merely on the basis of the presumption without having regard to the evidence to the contrary. Hence, the order was set aside.

Although from a legal standpoint this is a simple and straightforward evidentiary issue, it highlights the difficulties in insider trading actions. In the recent reforms pertaining to SEBI’s regulations, some of these issues have been taken on board. While all of these aspects were left open to interpretation in the 1992 Regulations, the SEBI (Prohibition of Insider Trading) Regulations, 2015 explicitly deal with the issue in the legislative note appended to Regulation 4(1)<sup>243</sup>. The note defines the spirit of the

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<sup>242</sup> *Chandrakala v. SEBI*, Appeal No. 209 of 2011, Order dated 31.01.2012; Against Manoj Gaur, ORDER NO. PG/TT/ AO-01- 03/2012

<sup>243</sup> **NOTE:** *When a person who has traded in securities has been in possession of unpublished price sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession. The reasons for which he trades or the purposes to which he applies the proceeds of the transactions are not intended to be relevant for determining whether a person has violated the regulation. He traded when in possession of unpublished price sensitive information is what would need to be demonstrated at the outset to bring a charge. Once this is established, it would be open to the insider to prove his innocence by demonstrating the circumstances mentioned in the proviso, failing which he would have violated the prohibition.*

Regulations to move closer to a strict liability test by stating that the trades of an insider will be presumed to be motivated by the knowledge and awareness of the UPSI that he is possession of. The legislative notes further state that reasons for which such a person trades or the purposes to which he applies the proceeds of the transactions are not intended to be relevant for determining whether a person has violated the regulation.<sup>244</sup>

### PART III - UNPUBLISHED PRICE SENSITIVE INFORMATION (UPSI)

Price Sensitive Information can be defined as any information which is not known but, if known, could either way affect the scrip of the company.<sup>245</sup> The definition of Unpublished Price Sensitive Information under the 2015 Regulations has undergone substantial change.

SEBI (PIT) Regulations, 2015	SEBI (PIT) Regulations, 1992
<p>2 (n) "<u>unpublished price sensitive information</u>" means any information, <b>relating to a company or its securities, directly or indirectly</b>, that is <b>not generally available which upon becoming generally available, is likely to materially affect the price of the securities</b> and shall, ordinarily including but not restricted to, information relating to the following: -</p> <ul style="list-style-type: none"> <li>(i) financial results</li> <li>(ii) dividends</li> <li>(iii) change in capital structure</li> <li>(iv) mergers, de-mergers, acquisitions delisting, disposals and expansion of business and such other transactions</li> </ul>	<p>2 (ha) "<u>price sensitive information</u>" means any information which relates <b>directly or indirectly to a company</b> and which <b>if published is likely to materially affect the price of securities of company.</b></p> <p>Explanation.—The following shall be deemed to be price sensitive information :— (i) periodical financial results of the company (ii) intended declaration of dividends (both interim and final) (iii) issue of securities or buy-back of securities (iv) any major expansion plans or execution of new projects (v) amalgamation, mergers or takeovers</p>

<sup>244</sup>Salient features of the Regulations, *Nishith Desai and Associates* access at: [http://www.nishithdesai.com/fileadmin/user\\_upload/pdfs/NDA%20Hotline/Regulatory\\_Hotline/Salient\\_Features\\_of\\_the\\_Regulations.pdf](http://www.nishithdesai.com/fileadmin/user_upload/pdfs/NDA%20Hotline/Regulatory_Hotline/Salient_Features_of_the_Regulations.pdf)

<sup>245</sup> *Rajiv B. Gandhi and Others v. SEBI*, Appeal No. 50/2007, SAT Order dated 09.05.2008; *Supreme Court dismissed appeal in CA No. 5302/2008 vide order dated 11.09.2008*



<p>(v) changes in key managerial personnel</p> <p>(vi) material events in accordance with the listing agreement.</p> <p><b><i>NOTE:</i></b> It is intended that information relating to a company or securities, that is <b>not generally available would be unpublished price sensitive information if it is likely to materially affect the price upon coming into the public domain.</b> The types of matters that would ordinarily give rise to unpublished price sensitive information have been <b>listed above to give illustrative guidance</b> of unpublished price sensitive information.</p>	<p>(vi) disposal of the whole or substantial part of the undertaking</p> <p>(vii) and significant changes in policies, plans or operations of the company</p> <p>2 (k) "<u>unpublished</u>" means information which is <b>not published by the company or its agents and is not specific in nature.</b></p> <p>Explanation.—Speculative reports in print or electronic media shall not be considered as published information.</p>
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### WHAT CONSTITUTES UPSI

Under PIT Regulations, 1992, to qualify as Price Sensitive Information it had to be,

- a. directly or indirectly related to the Company
- b. When published, it should materially affect the price of the securities in the market.

The 1992 Regulations were ambiguous as to whether UPSI would also be in reference to securities. This ambiguity has been removed by the 2015 Regulations. According to the new regulations, Information would qualify as UPSI if,

- a. It is related to the Company or Securities
- b. It is directly or indirectly related to the above 2
- c. Though not generally available right now, but on becoming generally available would materially affect the price of securities in the market.

Therefore, under the new Regulations, UPSI also covers securities. This implies that UPSI would also relate to change in capital structure, delisting, etc. however, units of mutual funds is not included in the ambit of securities.

SAT has clarified many times, that to decide what constitutes UPSI it would be essential to look into the nature of the information, the extent of it, timing etc.<sup>246</sup>. The nature of price sensitive information changes from industry to industry.<sup>247</sup> What would qualify as PSI in the manufacturing sector would not be PSI in the investment sector. In the case of *Anil Harish v. SEBI*<sup>248</sup>, SAT concluded that, whether information amounts to UPSI depends on the facts and circumstance of each case. Price of shares for the purposes of acquisition of substantial shareholding of a company has been held to be PSI.<sup>249</sup> Information regarding the declaration of dividend and the failure of a proposed deal has also been held to be PSI.<sup>250</sup> Additionally, it is sufficient to prove that the information *may* affect the price and not that it *must*.<sup>251</sup>

### GENERALLY AVAILABLE INFORMATION

The 1992 Regulations defined Price Sensitive Information and Unpublished separately. These two have been combined under the new regulations and only the definition for Unpublished Price Sensitive Information is given. In fact, the new regulations have in a way done away with the concept of “unpublished”, replacing it instead with the term “*generally available information*”.

PIT Regulations 2015 stipulates that if the information is generally available it would qualify as published information. This is a stark change from the old law which required PSI to be printed by the company or its agents in print or electronic media (speculative reports not being considered) and be specific in nature with an objective to make it known to the investing public for the information to qualify as published.<sup>252</sup>

SEBI has given a definition for “Generally available information”<sup>253</sup> under the new act. It means information that is available to the public on non-discriminatory basis. This implies that the information can come from any source other than the company and does not necessarily need to be

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<sup>246</sup> Insider Trading Regulations – A primer, July 2013 *Nishith Desai and Associates*

<sup>247</sup> *Gujarat NRE Mineral Resources Ltd v. SEBI*, Appeal no. 207 of 2010 decided on 18.11.2011; A.O. Order No. PB/AO/117-120/2010, *In the matter of FCGL Industries Limited*, dated 29.10.2010

<sup>248</sup> Appeal no. 217 of 2011 Date of Decision 22.06.2012

<sup>249</sup> *S. Ramesh and S. Padmalata Asis Bhaumik v. SEBI* [2005] 59SCL 521 (SAT)

<sup>250</sup> *Kemef's Specialties Pvt. Ltd. v. SEBI* – Appeal no. 54/2011, SAT order dated 21.07.2011

<sup>251</sup> SEBI Order No WTM/MSS/ISD/18/2009, *In the matter of KLG Capital Services Limited*, dated 22.09.2009. SAT, in appeal, has remanded the matter in *Praveen Mahnot v SEBI*, Appeal No. 191/2009, SAT Order dated 21.10.2010; A.O. Order No. SKV/SA/AO-01/2010, *In respect of K.K. Maheshwari and another*, dated 03.06.2010

<sup>252</sup> Adjudication Order dated February 28, 2011 in the matter of Mr. *Naval Choudhary*; and Adjudication order dated February 28, 2011 in the matter of Mr. *Neeraj Jain*

<sup>253</sup> Regulations 2(1)(e), PIT Regulations, 2015

published and specific in nature as was required by the 1992 regulations. The legislative note to this definition states explicitly what constitutes generally available, and if the information is published on the website of a stock exchange then it is considered generally available. As long as the information can be accessed by any person without breaching a law the information would qualify as generally available. But situations may arise when SEBI or SAT may need to determine whether some information is available on a non-discriminatory basis. This must be treated as a question of fact to be answered adopting the standard of reasonable man.<sup>254</sup> In the case of *Anil Harish v. SEBI*<sup>255</sup>, the appellant was able to overturn the order orders of insider trading passed against them by SEBI by proving that the information was generally known to the market as the tenders were drawn and awarded by Government departments which followed transparency norms.

Additionally, 6 categories of UPSI have been given in the regulation but the legislative note states that these are merely illustrative in nature. The new regulations bring into account the order of SAT in *Hindustan Dorr Oliver Ltd. v. SEBI*<sup>256</sup> in which it had clarified that the list contained in the explanation clause of UPSI was not exhaustive in nature but was in fact much wider.

#### **ANALYSIS**

The new law in the author's opinion is more clear, precise and in line with global standards. For example, in the US the Courts do not make distinction between information about a Company's assets or earning power and Market information (often referred to as outside information) which is information that affects the market for a company's security<sup>257</sup> The new regulations has adopted the same policy.

By clearly specifying that securities are also included it has removed the ambiguity in that aspect and including "generally available information" into the ambit has made it easier to determine what would qualify as UPSI. In the author's opinion it would now be easier to prove that information was published as the explicit requirement of the information being published by the company or its agents in a specific nature has been done away with. This would in turn facilitate in disposing off cases quickly as it is now "*easier to crystallize and appreciate what Unpublished Price Sensitive*

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<sup>254</sup>Salient features of SEBI (PIT) Regulations, 2015 and Comparative Analysis with previous Regulations...Contributed by CA Rajan Gada and CA Neha Gada

<sup>255</sup> Appeal no. 217 of 2011 Date of Decision 22.06.2012

<sup>256</sup> Appeal No 107 of 2011, decided on 19.10.2011

<sup>257</sup> United States v. *Chiarella*, 588 F.2d 1358, 1365 (2d Cir. 1978)

*Information is.*<sup>258</sup> Additionally, disclosures of the same has been made mandatory so as to eliminate any privilege that another person might have. The new concept of “pre trading plans” have been provided for insiders who possess UPSI all year round.<sup>259</sup> The last change in the new regulations, i.e. the 6 categories given are merely illustrative in nature has widened the scope of what UPSI may be as now it is not a requirement that UPSI must relate to only the categories mentioned in the Regulation. However, the definition given by SEBI is exclusionary in nature, even though the list appended includes certain specific matters it is illustrative in nature which leaves room for judicial interpretation

The changes brought about in the new law are for the benefit of both the investor and those accused of insider trading. For the investors it is advantageous as UPSI has been clearly defined and its scope has been widened. Now, it would be harder for the insiders to bend the law. For those accused of insider trading, clear definition of UPSI is advantageous to them too as it would be easier to establish that they were trading on information that was generally known to the public even though there was no official communication from the company thereby showing that the investors were not really in a disadvantageous position.

#### **PART IV – DEFENCES UNDER THE 1992 REGULATIONS AND 2015 REGULATIONS**

Under the new regulations, it will be an offence to –

1. Merely disclose UPSI
2. Trade in securities when in the possession of UPSI
3. Procuring UPSI
4. Causing an insider to disclose UPSI.

SEBI (PIT) Regulations, 2015	SEBI (PIT) Regulations, 1992
(3) Notwithstanding anything contained in this regulation, an <b>unpublished price sensitive information may be</b>	3B. (1) In a <b>proceeding against a company</b> in respect of regulation 3A, it shall be a <b>defence to prove</b> that it entered into a

<sup>258</sup> Legislative Note to Regulations 2(1)(e), PIT Regulations, 2015

<sup>259</sup> SEBI Insider Trading Regulations – Key changes and analysis *Normura Research Institute*

**communicated, provided, allowed access to or procured**, in connection with a transaction that would:-

(i) **entail an obligation to make an open offer under the takeover regulations** where the board of directors of the company is of informed opinion that the proposed transaction is in the **best interests of the company**;

**NOTE:** It is intended to acknowledge the necessity of communicating, providing, allowing access to or procuring UPSI for **substantial transactions** such as takeovers, mergers and acquisitions involving trading in securities and change of control to assess a potential investment. In an open offer under the takeover regulations, not only would the same price be made available to all shareholders of the company but also all information necessary to enable an informed divestment or retention decision by the public shareholders is required to be made available to all shareholders in the letter of offer under those regulations.

(ii) **not attract the obligation to make an open offer** under the takeover regulations but where the board of directors of the company is of informed opinion that the **proposed transaction is in the best interests of the company** and the information that constitute unpublished price sensitive information is disseminated to be

transaction in the securities of a listed company when the unpublished price sensitive information was in the possession of an officer or employee of the company, if

(a) the **decision to enter into the transaction** or agreement was **taken on its behalf by a person or persons other than that officer or employee**; and

(b) such company has put in place such **systems and procedures** which demarcate the activities of the company in such a way that the **person who enters into transaction in securities on behalf of the company cannot have access to information which is in possession of other officer or employee of the company**; and

(c) it had in **operation at that time, arrangements** that could reasonably be expected to ensure that the **information was not communicated to the person or persons who made the decision and that no advice with respect to the transactions or agreement was given to that person or any of those persons by that officer or employee**; and

(d) the information was not so communicated and no such advice was so given.

made generally available at least two trading days prior to the proposed transaction being effected in such form as the board of directors may determine.

**NOTE:** It is intended to permit communicating, providing, allowing access to or procuring UPSI also in transactions that do not entail an open offer obligation under the takeover regulations if it is in the best interests of the company. The board of directors, however, would cause public disclosures of such unpublished price sensitive information well before the proposed transaction to rule out any information asymmetry in the market.

(4) For **purposes of sub-regulation (3), the board of directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties** and such parties shall keep information so received confidential, except for the purpose of sub-regulation (3), and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information.

4(1) No insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information

(2) In a proceeding against a company in respect of regulation 3A which is in possession of unpublished price sensitive information, it **shall be defence to prove that acquisition of shares of a listed company was as per the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.**

**Provided that the insider may prove his innocence** by demonstrating the circumstances including the following : -

- (i) **the transaction is an off-market inter-se transfer between promoters who were in possession of the same unpublished price sensitive information** without being in breach of regulation 3 and both parties had made a conscious and informed trade decision
- (ii) in the case of non-individual insiders:
  - 
  - (a) **the individuals who were in possession** of such unpublished price sensitive information **were different from the individuals taking trading decisions and such decision-making individuals were not in possession of such unpublished price sensitive information when they took the decision to trade;** and
  - (b) **appropriate and adequate arrangements** were in place to ensure that these regulations are not violated and **no unpublished price sensitive information was communicated by the individuals possessing the information to the individuals taking trading decisions** and there is no evidence of

such arrangements having been breached

- (iii) the trades were **pursuant to a trading plan set up in accordance with regulation 5.**

***NOTE:*** When a person who has traded in securities has been in **possession of unpublished price sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession.** The reasons for which he trades or the purposes to which he applies the proceeds of the transactions are not intended to be relevant for determining whether a person has violated the regulation. He traded when in possession of unpublished price sensitive information is what would need to be demonstrated at the outset to bring a charge. Once this is established, it would be open to the insider to prove his innocence by demonstrating the circumstances mentioned in the proviso, failing which he would have violated the prohibition

The 1992 Regulations provided defences to only companies dealing in securities of another company while in possession of UPSI in certain situations. The defences that were offered to companies were that of Chinese wall and proving that acquisition of shares were as per the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. Under the 2015 Regulations the defences are offered to **any insider** who has traded in securities while in the possession of UPSI.



In given cases, certain circumstances which can be demonstrated by an insider to prove his innocence are:

- UPSI exchanged in furtherance of open offer under Takeover Regulations
- UPSI communicated, etc. when in the best interests of the company
- Inter-se, off market transactions between promoters who have made a conscious and informed trade
- Chinese walls
- Trading plans<sup>260</sup>

This change in the 2015 Regulations is a substantial one and can prove to be very positive as this provides for genuine defences to legitimate commercial transactions or where no harm to the market would result.

Let's discuss these defences one by one.

#### **DISCLOSURE IN FURTHERANCE OF DUE DILIGENCE**

Regulation 3(1) of the new law allows for Communication of UPSI in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. The terms "furtherance of legitimate purposes", "performance of duties" or "discharge of legal obligations" have not been defined in the New Insider Trading Regulations, however, the notes appended to the regulations state that it is intended for organizations to develop best practices based on need-to-know principles for treatment of UPSI and to enable persons in possession of UPSI to carry out their legitimate duties. These words have replaced "in the ordinary course of business".

Regulation 3(3) explicitly permits the communication of UPSI for purposes of due diligence in connection with an open offer transaction under the Takeover Regulations and Regulation 3(4) when no open offer has been made. However, the Board of Directors of the company must be of the informed opinion that this communication is in best interests of the Company. A distinction has been made between investments resulting in open offer and in other cases where no open offer is attracted.

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<sup>260</sup> Key aspects SEBI PIT Regulations, 2015 – *Pantomath Advisory Services*

Prior to 2015, there was no such explicit provision that allowed for disclosure of UPSI in furtherance of due diligence operations. However, SEBI has recognized the practical realities of a commercial transaction that would require an investor to acquire necessary non-public information of the target not for the purpose of insider trading but to assess the merits of a particular transaction. No investor would be ready to infuse substantial funds for a large period of time in a target without sound knowledge of the Company's financial and legal standing. This knowledge could sometimes be information that only the insiders are privy to.

Under the old law, a plain reading of the regulation would suggest that divulging such information would be a technical breach. As a result of this, parties are forced to conduct a limited due diligence or merely rely on market information available about the Company. This predictably does not facilitate an investor friendly climate. This new addition to the Regulations is a welcome change as it is in line with the global practices. Now, communication of UPSI in furtherance of a contemplated transaction is permitted in specific circumstances. Additionally, this disclosure in furtherance of investment transactions is largely deemed harmless as a mandatory takeover offer would be made to all shareholders uniformly at a minimum price to be determined under the takeover regulations and therefore such disclosure of selective information to the acquirer would not materially jeopardize the interests of the other shareholders.<sup>261</sup> The New Insider Trading Regulations also require the parties receiving UPSI as part of their due diligence to sign confidentiality agreements and agree not to trade in the securities of the listed company while in possession of UPSI i.e. to enter into a standstill arrangement.<sup>262</sup>

The second type of situation where communication of UPSI would be allowed would be in cases where there is no obligation to allow an open offer but the Board of Directors of the company is of the informed opinion that such a transaction would be in the best interests of the company. An additional condition is imposed in such a situation, i.e. the due diligence findings which would qualify as UPSI needs to be made generally available at least 2 trading days to the effective date of the transaction. But, this additional conditions could give rise to some regulatory problems in the market. It is not clear yet how markets would deal with the disclosure of such information and if it would lead

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<sup>261</sup> Overhauling the Insider Trading Regulations: Part 2 *Indian CorpLaw Blog* posted on Sunday, December 22<sup>nd</sup>, 2013, access at [http://indiakorplaw.blogspot.sg/2013/12/overhauling-insider-trading-regulations\\_22.html](http://indiakorplaw.blogspot.sg/2013/12/overhauling-insider-trading-regulations_22.html)

<sup>262</sup> Due Diligence in M&A Transactions - Impact of New SEBI Insider Trading Regulations, *Legal Era News Network* posted on Thursday, 15<sup>th</sup> October, 2015 access at <http://www.legalera.in/legal-articles/item/17703-due-diligence-in-m-a-transactions-impact-of-new-sebi-insider-trading-regulations.html>

to some sort of speculative trading or other unfair practices. This aspect would have to be carefully considered both from a regulatory point of view and from perspective of the intended transaction, when parties have to consider how to disclose specific information. But the legislative note appended to the Regulation must be noted which stipulates that the board of directors could cause public disclosures of such unpublished price sensitive information well before the proposed transaction to rule out any information asymmetry in the market.

This change brought about by the new law may be a necessity but it needs to be closely monitored as it has much scope for abuse. Providing due diligence to investor ahead of a potential transaction is fraught with perils as the case of U.S. Hedge Fund Manager David Einhorn shows.<sup>263</sup> SEBI would need to provide additional guidance in matters such as the manner of providing UPSI, the form of disclosure, etc. to ensure that the regulations facilitate legitimate transactions.<sup>264</sup>

### **TRANSACTIONS BETWEEN PROMOTERS**

The 1992 Regulations only provided defences for non-individual entities that that took part in insider trading activities. The 2015 Regulations provide for the promoters to undertake amongst themselves conscious and informed trade in off market transactions. However, when the promoters are in possession of such UPSI they must not be in violation of Regulation 3.

### **CHINESE WALL**

Under the 1992 Regulations, Regulations 3B provided for the defence of Chinese wall. The term Chinese wall first originated in the US<sup>265</sup>. It is a metaphor used to describe a Company's internal rules and procedures designed to prevent insider trading and manage conflicts of interest. It attempts to prevent insider trading by preventing the flow of material, non-public information. The term originated as a means to describe a method to "wall in" information obtained from one department and prevent the inside information from being disseminated throughout the firm.<sup>266</sup> It offers many advantages - The purpose of the Chinese wall is to contain information within a department and allow other departments to act freely without the fear of contamination<sup>267</sup>.

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<sup>263</sup> Access at <http://www.fsa.gov.uk/pubs/decisions/dn-einhorn-greenlight.pdf>

<sup>264</sup> Ravi, Aparna, Insider Trading and the risks of due diligence access, *Indian Corp Law Blog* access at: <http://indiacorplaw.blogspot.in/search/label/Insider%20Trading?updated-max=2015-09-12T08:03:00%2B05:30&max-results=20&start=4&by-date=false>,

<sup>265</sup> *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933 (1968)

<sup>266</sup> Marc I. Steinberg & John Fletcher, *Compliance Programs for Insider Trading*, 47 SMU L. Rev 1783 (1994)

<sup>267</sup> FERRARA, *Fordham Journal of Corporate and Financial law*

In Indian law, this defence, under the 1992 Regulations is for companies. It means persons having UPSI are different from those taking a decision to deal in securities and adequately demarcating systems and procedures exist to prevent exchange of information.<sup>268</sup> Under this, the organization/firm shall adopt a Chinese wall policy which separates those areas of the organization / firm which routinely have access to confidential information, from those areas which deal with sale / marketing investment advice or other departments providing support services.<sup>269</sup> The firm may also warrant physical separation of the parties possessing UPSI and those trading. The firms are expected to put in place appropriate and adequate measures wall in the information. There has been no change with regard to this defence under the new Regulations and it has been retained as it is.

### **TRADING PLAN**

Trading plan is a new introduction under then 2015 Regulations. It explicitly recognizes the right of persons who may perpetually be in possession of UPSI and their right to trade in freely tradeable securities. Such persons are required to formulate a trading plan pursuant to Regulation 5. This Regulation has made it possible to draw a clear distinction between when trading in securities is permitted for an insider and when the trading constitutes as insider trading which is not permitted. Regulation 5 prescribes the following conditions to prevent abuse of the mechanism:

1. Trading plans shall not entail trading for a reasonable period around declaration of financial results;
2. Trading plan shall not entail trading for at least 12 months since the date of decision to trade;
3. There shall not be any overlap with another trading plan already in existence;
4. Trading plan that entail trading in securities for market abuse is prohibited;
5. Trading plans must set out nature of trade, value of securities or the number of securities to be invested or divested, specific dates and time etc.;
6. The compliance officer is entitled to review the trading plan and seek express undertakings that may be necessary for such assessment/monitoring and notify the stock exchanges on which the securities are listed, once the trading plans are approved;
7. Once approved trading plans shall be irrevocable and the insider shall mandatorily implement the plan within the scope of the trading plan, without any deviation;

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<sup>268</sup> Agarwal and Baby on SEBI ACT, *Taxxman*

<sup>269</sup> Insider Trading Regulations – A primer, July 2013 *Nishith Desai and Associates*

8. Commencement of the trading plan will be required to be deferred in a situation where the insider is in possession of UPSI at the time of formulation of the plan has not become generally available at the time of commencement of the plan.<sup>270</sup>

The logic behind a trading plan appears to be that once a trading plan is established, then it will not matter if the insider comes in possession of the UPSI as the decision to trade has already been taken. Further, trading plan cannot be cancelled and it shall be mandatorily implemented otherwise it would constitute a violation of the provision.

The concept of trading plan is a novel idea in Indian securities jurisprudence and seems to have been introduced by SEBI on an experimental basis. However, this could prove to supply clarity in cases where parties have adopted the argument before SEBI or SAT that trades were carried out as part of their regular investment / divestment plans not just in the company concerned but more generally in respect of their other investments. This has often operated persuasively to suggest that the insiders were not trading on the basis of UPSI. The trading plan mechanism will now formalize such an arrangement by imposing more objective conditions. It remains to be seen, however, whether the trading plan will be utilised effectively, and more importantly that it will not be subject to abuses. As the Committee notes in its report, the experience from other jurisdictions where the concept is prevalent has not been without controversies<sup>271</sup>

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<sup>270</sup> Salient features of the new regulations , *Nishith Desai and Associates*

<sup>271</sup> Overhauling the Insider Trading Regulations Part 3,  
<http://indiacorplaw.blogspot.in/search/label/Insider%20Trading?updated-max=2014-08-01T12:28:00%2B05:30&max-results=20&start=13&by-date=false>

## **INTELLECTUAL PROPERTY RIGHTS: A SNAG IN ENSURING PUBLIC HEALTH AFFECTING MANGEMENT**

**ANSHIKA SHUKLA<sup>272</sup>**

### **ABSTRACT**

Maintenance of public health has been a priority for any country, when it comes to management. With the passage of time and with technological advancement there has been increased threat to the public health which has been deteriorating day by day. There have been many reasons traced behind this but one field which always remains latent is intellectual property rights. In recent years, these rights have also emerged as one of the major factor affecting public health. Grant of patent rights is the pinpoint issue which makes the pharmaceutical products costly and then they become unaffordable at existing rates, by the developing countries, which then prefer alternative options rather than taking patented medicines.

To deal with this issue, TRIPS agreement was worked out in 1994 which was given with the objective of providing countries with minimum set of standards to maintain a balance between intellectual property rights and public health. Article 2.1 and 9.1 are the major provisions dealing with this. It also gives exception to protect the public health illustrated in Article 27.2, 27.3(a), 27.3(b). It also provides for settlement of disputes, but with changing conditions and advancement taking place TRIPS agreement became inefficient to deal with all the discrepancies coming up. To address this issue Doha declaration came into scene which was negotiated to provide developing countries with certain flexibilities and provided them with the option of compulsory licensing and parallel importation which has been dealt in paragraph 4, 5, 6 and 7 of the declaration.

But, at a later stage even Doha declaration was proved to be an inappropriate approach which failed to meet all the demands. Therefore, after this intergovernmental organizations came into play which was formed with the collective efforts of WHO members, NGOs and pharmaceutical industries which gave the resolution WHA 59.24 and WHA 61.21 to deal with this dilemmatic situation.

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<sup>272</sup> Year II, Damodaran Sanjivayya National Law University, Visakhapatnam (A.P.)

It is thus suggested the need of a concrete legislation to deal with the issue of IPR and public health should be met with. The issues and efforts taken by TRIPS agreement, Doha declaration and intergovernmental organizations are discussed in the paper.

## INTRODUCTION

*“My ideas of a better ordered world is one in which medical discoveries would be free of patents and there would be no profiteering from life or death”*

*-by Indira Gandhi*

This is one of the very beautiful quotes given by Indira Gandhi, focusing on importance of public health over intellectual property rights. A human mind is full of creations and there is no human mind that is devoid of this art of creating and inventing new things, and these inventions are shaped in the form of artistic designs, literary designs which usually includes sculptures, films, computer programs, names, symbols, images. People wish to protect their work and get exclusive rights on their creations created by them because these inventions are created by them with a lot of hard labor. Thus, this was the time when intellectual property rights came into force and intellectual property rights refers to the rights which mainly focused on protecting invention of the people and creations of their minds.

The intellectual property rights has been bifurcated into five categories which includes Copyright, Trademarks, Patents, Industrial design and geographical indications, Various laws has also been provided to protect the rights of the people under the different categories. Copyrights are those rights which an author usually exercises over his literary and artistic works which includes paintings, music, books and many more things, Trademarks is a mark which is assigned to the goods and which usually helps in differentiating the goods or services of a particular enterprise to that of the goods or services of the other enterprises, Patents are the set of rights which are imposed by the government upon an inventor who in exchange promises to disclose the detailed information relating to the invention, industrial designs refers to the protection to the aesthetic aspects of an article or a product and geographical indications are the signs which helps in denoting or identifying and which have specific geographic origin and has some distinctive qualities.

So, these were the certain intellectual property rights which need to be protected. There have been many problems and issues which have been encountered in this area in the particular arena. One of the major problems arising is the health related issues which has become the global concern owing

to the reason that it severely affects the management system of different countries. Over times, the conflict has been in respect to intellectual property rights over the pharmaceutical rights in the developing countries. The government has been facing a fundamental predicament in this matter because the country's ability to overcome poverty and health related problems increasing at an increasing rate has become obsolete and has been sabotaged due to increased economic and technological advancement. But, it has become difficult for developing countries to overcome the contagious diseases like HIV AIDS due to unavailability of proper medication.

Many organizational efforts have been taken, much legislation have been worked out to curb down this problem. Organizations like WTO, TRIPS has come up with innovative solutions, which have contributed their helping hand in protecting public health and devising a solution that would not affect the management system of the countries to a great extent.

#### **WHERE ACTUALLY THREAT TO PUBLIC HEALTH ARISES?**

With the technological advancement in the present era, the issues related to health have been at a unbridled increase and patent rights have evolved as one of the major problems in this area. The sole purpose of the patents for which it is used, has been exploited and this exploitation has been done from the grass root level itself. When the rights of the patents are granted to the inventor in exchange of providing the detailed information regarding the product, then the government makes the use and exploits the information to stimulate the further research, development and use it mostly in commercialization done on the same lines, and this is done so that formation of a new improved product can take place with advanced processes and techniques.

But, this has also landed the inventor into a problem because the grant of exclusive rights by the government gives the inventor the autonomy to charge the high price and impose the pricing policies above the normal competitive prices and this helps the inventor in taking advance preventive action against the potential competitors in the market. When a particular medicine to treat or cure a particular disease is released in the market, then usually the substitutes to those medicines are limited in the market and are sometimes unavailable. And as a result taking advantage of this situation the supplier may charge higher prices which may create their monopoly, apart from this also the medicines becomes unaffordable by the government in developing countries which in turn



fails to meet the requirement to ensure proper public health and is unable to provide quality treatment to the public in their country.<sup>273</sup>

So, this is how public health is affected due to intellectual property rights mainly narrowing down to patent rights. These patents on the pharmaceutical and medicinal drugs have an adverse effect on the countries which has affected the countries both industrially as well as economically. It also had the catastrophic effect on the least developed countries which hampered their ability to formulate appropriate policies relating to the public health which would enable their citizens suffering from poor health to access medicines and treat their ailment because pharmaceutical patents has resulted in increase in the cost of life-saving drugs which has put them out of the reach of low earning people comprising of the majority part of the population. Many drugs which are new to the market are usually similar to the unique medicines that are available in the market to treat a particular disease, but the problem here arises is that those medicines reflecting similar characteristics gives a minor treatment and does not have a long lasting affect that can cure the disease and so, the medicines proves not to be much effective and efficient.<sup>274</sup>

With the advancement taking place day by day, a new problem has been encountered by the developed countries, which were largely dependent upon the inventions, innovations and investments made in medicines by them and thus, seek to protect their interest. It has been contended by the industries in the developed countries that they have been deprived of their valuable property rights by the firms in the developing countries, who in turn are copying the inventions created by them without their permission. This problem has been mainly encountered with the pharmaceuticals products. These demands has been mainly evident when made by the research based pharmaceutical industries including Japan, United Nations and Europe which are the central forces which desired the need of Intellectual property rights.<sup>275</sup>

After the continuous efforts and scrutinization, the need of the developed countries has been now met with and has been provided the pharmaceuticals production and industries with the patent protection along with ensuring various flexibilities to the developing countries including provisions allowing for compulsory licensing, limited exceptions to patent rights and parallel importation, which

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<sup>273</sup> International Institute for sustainable development, TRIPS and public health ( December 9, 2015)  
[http://www.iisd.org/pdf/2003/investment\\_sdc\\_dec\\_2003\\_9.pdf](http://www.iisd.org/pdf/2003/investment_sdc_dec_2003_9.pdf)

<sup>274</sup> World Trade Organization on the declaration on the TRIPS agreement and public health, November 2001,  
WT/MIN(01)/DEC/2

<sup>275</sup> International Institute for sustainable development, TRIPS and public health ( December 9, 2015)  
[http://www.iisd.org/pdf/2003/investment\\_sdc\\_dec\\_2003\\_9.pdf](http://www.iisd.org/pdf/2003/investment_sdc_dec_2003_9.pdf)

are the major flexibilities provided to the developing countries. To meet all these needs WTO gave TRIPS agreement which carved out the provision keeping in mind the desires of the developed as well as developing countries, and also to maintain a balance between the intellectual property rights and public health, so, that exploitation of public health can be avoided.

### **TRIPS AND PUBLIC HEALTH**

There was a need of an legislation that would provide set of rules and regulations and that would also meet the requirements of the both developed as well as the developing nations and to give effect to these requirements, TRIPS (Trade related aspects of Intellectual Property rights) agreement was given. It was an initiative by World Trade Organization, which was negotiated at the Uruguay round, which took place on 1994. TRIPS is an agreement which is an international agreement given with the objective of giving minimum set of standards to govern and provide protection to Intellectual property rights and implement those uniform standards on the member nations to maintain international economic relations. Thus, it is of utmost importance to look which all areas are covered by the TRIPS agreement, which can be explored by knowing the features of the agreement. There are three major features of the agreement including:

- **Set of standards:** The most essential feature of the TRIPS agreement is to provide the Minimum set of standards for the member nations. The agreement consists of a subject matter that is to be protected, and it also provides the duration till which the protection will be provided and the rights will be conferred. The agreement includes various major conventions like Paris convention, Berne convention and many more whose provisions are made obligatory on the member nations to the agreement. Article 2.1 and 9.1 are the main provisions dealing with this.
- **Enforcement of provisions of agreement:** There are a set of provisions in the agreement which deals with the enforcement of the agreement and provides that the domestic procedures and remedies used by the member nations are mandatorily applicable on them which will help in better governance in an improved manner. But, agreement also provides for enforcement of the major IPR provisions which are the general provisions. Besides this the agreement also provides for special provisions that deals with border issues and provides

for border measures and also gives procedures and remedies relating to the same. It also provides for administrative and civil procedures and remedies.<sup>276</sup>

- **Settlement of Disputes:** The third basic feature of the agreement is to provide for dispute settlement. There may some dispute that take place between the WTO member nations in following the obligations laid down by TRIPS agreement and thus, dispute may arise while following the procedures, which is then dealt by the provisions of TRIPS agreement because it also aims at dispute settlement between the member nations of WTO.

So, these were the certain features of TRIPS agreement, but it is important to look into other provisions and to look into how these provisions are helpful in maintaining a balance between public health and Intellectual property rights. These provisions provides for protection of public health but there are certain provisions which provides for discrepancies and are threat to public health, and these are mainly relating to the patents. These provisions are enumerated below:

**Article 27.2** which is illustrative of the exceptions provides the exception to the inventions that are damaging or are contrary to public health, morality and public order and these inventions includes those ones which are dangerous to human, animal or plant life or health or which are severely affecting the environment. The exception provides that such an invention must be prevented which is a necessary condition for the protection of pubic and animal health and also to maintain a public order.

**Article 27.3(a)** provides another exception that for the purpose of protection of humans or animals, the member will be excluded from patentability diagnostic, therapeautic and surgical methods that are used in the treatment of humans or animals, that would be detrimental to their health.

**Article 27.3(b)** provides the third exception which provides that plants and animals that are used in the production processes can be excluded by the member nations if any country is excluding the plant species from protection of the patent and it must provide and create a system of *Sui Generis* action in order to protect plant varieties.

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<sup>276</sup> International Institute for sustainable development, TRIPS and public health ( December 9, 2015)  
[http://www.iisd.org/pdf/2003/investment\\_sdc\\_dec\\_2003\\_9.pdf](http://www.iisd.org/pdf/2003/investment_sdc_dec_2003_9.pdf)

**Article 28** is illustrative of the exclusive rights that must be conferred by the product patent and these rights must include that are relating to the making, offer for sale, using, selling and import of those products. It can be manifested from the provision that it necessitate the patent owners that they should be conferred with the right to assign, transfer. But, this provision is in contrary to public health and will also lead to the exploitation of the invention of the patent owners. If the process and the rights to assign and transfer are given by the patent owner then that may be misused by the other party and they would be use by them to make new creations and inventions that may have ill effect on the health of the public.

**Article 29.1** manifests that the member nations must require that the information relating to the invention and the manner in which the invention is to be carried out must be disclosed by applicant of a patent, this may again lead to the situation of the exploitation of the patent owners which in turn may again lead to harmful effects to the health of the public. For eg: if the patent owner of a medicine used in curing HIV AIDS, if discloses the method or the manner used in invention then that may be misused by some other person and may have negative effect on the health of the person.<sup>277</sup>

Therefore, where the exceptions are in favor of protecting public health whereas other provisions are contrary to the protection to the public health which is a setback of TRIPS agreement and is needed to be man oeuvre upon, thus, amendment must be made in effect to this. Apart from this there were certain alternatives which were given by the developing countries that focused on providing the medicines that would treat the people at cheaper rates that would also protect the patent owners and various other forms of exploitations, the negotiations given by the developing countries included:

1. **Price Negotiation:** The generic producers of the developing countries try to negotiate with the original patent holders to provide the medicines at affordable rates and at better prices. Also, the original patent holders gets ready to negotiate prices and provide essential medicines at discounting rates like antiretrovirals which is used to treat HIV AIDS. So, no problem is encountered as such in availing this option.
2. **Buying Generic:** This option is available with the consumers who can purchase the generic or the medicines which are off-patent. If most of the important medicines are not sold under the patent then it is accessible to people at affordable prices and is also made available in the market at a lower prices.

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<sup>277</sup> Vishwas H Devaiah, *TRIPS and public health* ( December 12, 2015) <http://infochangeindia.org/trade-a-development/intellectual-property-rights/trips-and-public-health.html>

3. **Compulsory Licensing:** Compulsory licensing has emerged as one of the major option because it authorizes a person who is not the holder of the patent to make use of the patent without the consent of the patent holder. This option is provided by Article 31 of the TRIPS agreement which permits the grant of compulsory licensing for fulfillment of any purpose subject to the condition that remuneration will be given for the same to the patent holder.
4. **Parallel Importation:** The importation of the pharmaceutical product from the country where it was originally manufactured to another country without the consent of the holder of the patent. This increase the access to the medicines by the people at a lower price which are affordable by the public at large.

But, there were many political and economic problems which were encountered after the TRIPS agreement came into force which also became genesis for Doha Declaration on TRIPS agreement and thus, it is necessary to be acknowledged with political and economic tensions that pursued Doha declaration.

#### **GENESIS OF DOHA DECLARATION**

The TRIPS agreement which was given to deal with the problem of public health and IPR failed to address the issue and was proved to be insufficient devise to deal with this issue. It provided a partial solution which took into consideration only few aspects including the problems of the originator multinational pharmaceutical companies and the problems of their home country governments which was a setback of the TRIPS agreement. It mainly focused on the patent protection in the developing countries rather than focusing on public health as a pivotal force of concern. But, from the originator multinationals point of view the TRIPS agreement served public health interest more properly which override the interest of the patent owners; the two sides were having the contradictory views.

The political tensions became perceptible in few countries which was evident when an action was taken against the adoption of Medicines and Related substances Control Amendment Act 1997 by the government of Nelson Mandela in South Africa, at the country level. The provisions in the Amendment act were mainly concerned with parallel importation and generic substitution and price controls which was inconsistent with the obligation of the TRIPS agreement. This event was the major reason that triggered the need of Doha Declaration because this emerged as a matter of concern for many developing countries and for related and affected NGOs. There was a need of

changing the existing rules given in TRIPS agreement because many countries with very powerful government misrepresented the agreement which was mutilating public health at a great stretch.

Besides the political reasons there were many other reasons, and the issue of patents continued to exist. This becomes an issue when a new medicine is given to treat a disease and that medicine is completely unique and efficient in its own manner, and these medicines usually do not have substitutes, and even if they have substitutes or alternatives then those substitutes are not equally efficient and effective to that extent to which these unique medicines are. In addition to this all these medicines are not available to all the countries because of which the developing countries continue to remain be at a disadvantageous position. The new patented machines are out of reach of many persons which forms the majority part of the population and the new medicines which are produced were more developed and patented because they are more technologically improved than the existing medicines. In some cases the production and supplying costs are so high that they are not affordable by the countries. There are some generic industries that usually make supply of off-patent medicines because of the unaffordable prices of the patented medicines which are then majority of the population are been deprived of, for example- India.

The options given by the TRIPS agreement are not always useful because there have been muddled up situations with compulsory licensing which becomes highlighted when the government of a country do not make use of the same owing to the threat of economic tensions that would be created if there is any retaliation from the country in which the originator pharmaceuticals companies are based on. The similar situation came into light in Thailand where the government issued a license for the medicines used for the treatment of HIV AIDS and this action of Thailand was found objectionable by the European Union, who objected the same because they were having some political interests. So, therefore it is evident that even the flexibilities provided by the TRIPS agreement to the developing countries were not completely flexible.

Apart from this, in present times given scarce resources, the countries who are at the developing stage and also the least developed countries are not at a stage where they can spend all the given prices and resources on supplying of a medicine at a generic rate and thus, it would be unfair and impractical for a country to invest all the resources in making all the generic medicines available to the public at higher prices because the developing countries has to allocate resources optimally and the distribution has to made to each sector, equally. Limitations of a budget have always been a barrier and this also creates pressure on originator multinational pharmaceutical companies. The countries has adopted various price control strategies which has emerged as an alternative of the

option of compulsory licensing which serves the purpose at par with compulsory licensing i.e. ensuring the supply of medicines at a decreased price rates. This practice has been usually followed in European countries.<sup>278</sup>

To deal with these numerous problems and to curb the political tensions Doha Declaration was given. But, even after various efforts taken with help of TRIPS agreement and Doha Declaration the political tension still continue to persist in the same manner as it was before the enforcement of TRIPS agreement. Various countries seeking a relief to their problems approached (WTO) World Trade Organization. The year 2001 has been a remarkable owing to reason that TRIPS council for the first time convened to address the issues of forming a link between the public health and TRIPS agreement and then came up with a negotiation in the form of Doha Declaration.

### **DOHA DECLARATION**

As it has been observed earlier that Doha Declaration was the aftermath of the collective efforts of WTO members and was given with the objective of giving clarity of the obligations that are to be followed, given by TRIPS agreement. The declaration acknowledges the public health crisis to be of great gravity and consider it to be an issue of concern on which national emergency can be declared and this is because of epidemic diseases like HIV AIDS, tuberculosis, malaria and many more such other diseases. There are three major aspects of the Doha declaration dealing with:

- The interpretation of TRIPS agreement in order to promote public health.
- Provisions that deal with flexibilities provided by TRIPS agreement and confirm those flexibilities and affirming the sovereignty of members of WTO.
- To deal with provisions relating to compulsory licensing with the countries having limited manufacturing ability or no manufacturing ability.

Mainly Doha declaration provides that WTO members has right to take action to protect public health but besides this they must confirm to the obligations laid down by the TRIPS agreement and also aim at promoting access to medicines by majority of the population. The three fold aspect given has been dealt in Paragraph 4, 5, 6 and 7 of the Declaration.<sup>279</sup>

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<sup>278</sup> Carlos M. Correa, *Implications of the Doha declaration on the TRIPS agreement and public health*, Buenos aires WHO/EDM/PAR/2002.3

<sup>279</sup> Amir Attran, *The Doha declaration on the TRIPS agreement and public health, access to pharmaceuticals, and options under WTO law* ( December 10, 2015)  
<http://graduateinstitute.ch/files/live/sites/iheid/files/shared/summer/GHD%202011%20Summer%20Course/Attran%202002%20DOHA.pdf>

Paragraph 4, 5 of the declaration illustrates that the members to the agreement will have the right to avail the option of compulsory licensing not only on the ground of national emergency but also in other situations. It also states that it will be the sovereign rights of the members to waive the negotiations done with the patent holder and they will have the right to determine that when the situation is existing in which the rights can be waived and can be waived in non- commercial use made by the public. One of the basic rights provided in paragraph 5 in the declaration to providing the countries with the “exhaustion of rights” which means that after the initial sale of the product is finished the rights of the patent holder internationally is exhausted which further means that he will not be having any right of either approving or blocking or intervening with the process of parallel importation. This is major positive step taken by the Doha Declaration which will help in promoting public health without any monopoly of patent holders which usually created an obstruction in taking steps towards the protection of public health.

Paragraph 6 talks about certain negotiations made when a particular problem was encountered. Article 31(f) of the TRIPS agreement required that as of 1 January 2005 the option of compulsory licensing shall be predominantly available for local markets whereas the WTO member nations i.e. the countries which are developing countries will have to have pharmaceutical product protection to avail this option and after 1 January 2005 the TRIPS agreement allowed the option of compulsory licensing only for those countries which have capacity to manufacture medicines and deprived those from availing the option those who have limited manufacturing capacity or no manufacturing capacity. For a long period of time this remained a debatable topic and remained a controversy, but after the deep discussion a solution was chalked out in which developed countries proposed the idea that measures should be taken by developing countries to prevent the re-export of a product and also there must a packaging done on the medicines to ensure that the products are not re- exported. But, at the end the solution adapted to this problem was that developing countries must be allowed to import the medicines at the time of national emergencies because at that time there is a large threat that there may be situation of epidemic in the country.<sup>280</sup>

It can be observed that the TRIPS agreement was inefficient in tackling the problem of compulsory licensing and public health and was also discriminatory in providing with the options, it focused more on developed countries rather than focusing on developing countries which were the need of the hour. This issue was addressed by Doha declaration to a great extent.

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<sup>280</sup> Vishwas H Devaiah, *TRIPS and public health* ( December 12, 2015) <http://infochangeindia.org/trade-a-development/intellectual-property-rights/trips-and-public-health.html>



Paragraph 7 is demonstrative of flexibilities to be provided to the least developed countries. Doha declaration has granted the special flexibilities apart from the flexibilities granted by the TRIPS agreements to the least developed countries.<sup>281</sup> The flexibility granted is that the least developed countries do not need to adopt and enforce the patent and data protection until January 2016, which has granted relief to the least developed countries to a great extent to ensure proper treatment to diseases suffered by public at a large scale, make necessary medicines available to treat diseases like HIV AIDS, tuberculosis etc. to all the least developed nations.

So, these were certain alterations and additions that were brought by the Doha Declaration to rectify the existing problem in the TRIPS agreement which have been discussed earlier. But, later on there were certain discrepancies encountered in Doha Declaration. Some of the discrepancies have been discussed below.

Doha Declaration failed to define the term 'public health' which was the main issue of concern and renders the issue less focused, and this was the major drawback of Doha declaration, this makes it open for any kind of interpretation and gives the pharmaceutical companies and industrial companies great autonomy to interpret the term "public health" according to their convenience.

Also it carries the very casual attitude towards the various problems that are being faced by the developing countries and does not provide any help in promoting public health and protect them from the diseases like AIDS, malaria, tuberculosis and such other diseases. The declaration deals with only specific diseases and provides the option like compulsory licensing and parallel importation for certain specific diseases like AIDS, tuberculosis and does not takes into consideration other diseases and sometimes the diseases which are epidemic in other countries are not recognized by the Doha declaration which negates the objective of Doha declaration which cripples its ability to ensure proper public health.

Another setback of Doha declaration was that, the member countries of WHO i.e. the countries which are developing can make use of the option of compulsory licensing only when there is a situation of national emergency i.e. only if there is a situation of health crisis that affect the public at large. The option cannot be availed otherwise, that is when there is some other disease rather than being an epidemic disease. Apart from this it can provide a basic solution to the problem of high prices by

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<sup>281</sup> Amir Attran, *The Doha declaration on the TRIPS agreement and public health, access to pharmaceuticals, and options under WTO law* ( December 12, 2015)  
<http://graduateinstitute.ch/files/live/sites/iheid/files/shared/summer/GHD%202011%20Summer%20Course/Attaran%202002%20DOHA.pdf>

reducing the prices which it fails to provide, besides providing option of compulsory licensing and parallel importation which can be availed by limited countries and cannot be accessed by all of them.

Thus, these are certain defects in Doha declaration which cannot be rendered unattended. There is a need of further amendments to the declaration and more focus should be given in defining the term “public health” at first place and then providing the options of compulsory licensing and parallel importation by providing it to other countries as well by expanding its scope.

### **INTERGOVERNMENT ORGANIZATIONAL EFFORTS**

Due to increased problems of intellectual property rights and public health which raised question concerning human rights gained hype worldwide and as a response to this, many organizations and non- governmental organization came up to together to form a union and trace out a solution and take initiatives towards impediment of this problem. This intergovernmental set up was initiated with the collective efforts of World Health Organization members, pharmaceutical industries, non-governmental organizations and intergovernmental organization during the year 2006 – 2008 and this intergovernmental organization was adopted by 59<sup>th</sup> World Health Organization by the way of adopting the resolution WHA 59.24 given on public health, health research, innovation and intellectual property rights. The major aim of the intergovernmental organization was to formulate an action plan in furtherance of a global strategy and to provide a framework that would efficiently address the problem of diseases that are affecting the developing countries disproportionately which can be done by providing medicines to treat these diseases like HIV AIDS, tuberculosis and also other diseases and also protecting them under intellectual property rights by the way of various bilateral and multilateral agreements.<sup>282</sup>

After the formation, the intergovernmental organizations met in three sessions between December 2006 and April 2008 in Geneva to discuss the problem and chalk out a solution by giving a final negotiable text. There were two major resolutions which were adopted in these three sessions. The prominent objective of adopting these resolutions were that the member nations of WHO can take certain measures inter alia to protect the members of their respective nation and can also contribute in aiding other nations with proper medication to treat the nationals of their countries.

The two resolutions adopted were resolution WHA 59.24 and WHA 61.21. To adopt resolution WHA 59.24 more than 100 members states of WHO and other persons related with public health,

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<sup>282</sup> Lisa Forman, *The intergovernmental working group on public health, innovation and intellectual property*, ( December 17, 2015) <http://www.ohchr.org/Documents/Issues/Development/RTDBook/PartIIIChapter22.pdf>

innovation and intellectual property rights met in Geneva in three sessions, first session being held in December 2006, second sessions being held in November 2007 and third session being held in May 2008. The countries worked together and gave a written submission which was to give the text confirming to negotiable terms apart from this, stakeholders also gave various inputs that can be used to deal with the problem.

After the deep consultations and extensive discussions which took place among the member nations and the stakeholders, in May 2008 the resolution WHA 61.21 was adopted by World Health Assembly which included a global strategy that would be followed in order to overcome the problem relating to public health and intellectual property rights.

**Resolution WHA 61.21** the major contribution of intergovernmental organizations is basically a proposal which give suggestions concerning the role that should be played by WHO in bringing a co-ordination between public health and intellectual property rights. The intergovernmental organizations developed a strategy which was to be adopted by the member nations, which was specifically designed to encourage innovative thoughts besides ensuring accessibility of medicines at affordable rates and this would divert the path from market driven research to need driven research that would target the diseases that are affecting the developing countries disproportionately. The strategy given was as amalgamation of eight elements and its structurization was guided by the set of principles that have been agreed upon and established by the member nations.<sup>283</sup>

Thus, it can be concluded that intergovernmental organization is a successful attempt of the WHO to deal with the problem which emphasized on dealing with these problems with the help of an global strategy and by adopting an action plan.

## CONCLUSION

After all the study made it can be concluded that TRIPS agreement and Doha declaration plays a significant role in bringing out the balance between the public health and intellectual property rights. It was TRIPS agreement which first provided developing countries with option of compulsory

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<sup>283</sup> Lisa Forman, *The intergovernmental working group on public health, innovation and intellectual property*, (December 17, 2015) <http://www.ohchr.org/Documents/Issues/Development/RTDBook/PartIIIChapter22.pdf>

licensing, parallel importation to make them available with medicines to treat diseases like HIV AIDS, tuberculosis, accessible at affordable rates. And these provisions were made more concrete by Doha declaration which also cured the defects found in TRIPS agreement.

Apart from this, intergovernmental initiatives cannot be overlooked, which gave two important resolutions to deal with the problem and to maintain harmony between the management of different countries. But, after the analysis and observations made it can be said that there is a need of a proper legislation which would deal with and focus mainly on maintaining a balance between public health and intellectual property rights, which is the world lacking of and which will also ensure efficient working of the administration. Also various options provided by the TRIPS agreement must be made more flexible besides ensuring right of the patent holder and these provisions must be enforced without any discrepancies.

## **REFORMS IN INDIAN ARBITRATION LAWS IN 2015 – AN ANALYSIS FOR THE STAKEHOLDERS INVOLVED**

**ANANT MERATHIA<sup>284</sup>**

### **ABSTRACT**

This Paper analyses the reforms in the Indian arbitration regime with the Arbitration & Conciliation (Amendment) Act, 2015 (“Amended Act”). The Arbitration & Conciliation (Amendment) Ordinance, 2015 (“Ordinance”) was brought into effect on 23<sup>rd</sup> October 2015 as the Parliament was not in session. Consequently the Bill was introduced in Lok Sabha on 3<sup>rd</sup> December 2015 and passed on 17<sup>th</sup> December 2015 by the Lok Sabha and on 23<sup>rd</sup> December 2015 in the Rajya Sabha to give birth to the Arbitration & Conciliation (Amendment) Act, 2015 which came into effect from 1st January 2016.

This paper covers the key amendments which were proposed by the 246<sup>th</sup> Law Commission Report and those accepted by the Ministry in bringing about the amendments to the existing Act of 1996. These include important changes such as the jurisdiction of Indian Courts once again being conferred in international commercial arbitrations, a message to the global investors that only High Courts in India shall deal with issues relating to international commercial arbitrations, the widening of the powers of arbitral tribunals at par with Indian Courts and in fact the limiting the scope of interference of Courts, efforts to create a balance in pre-arbitral judicial intervention. Furthermore, the paper covers the refreshing amendments relating to appointment of arbitrators and the importance being given to competence, neutrality & independence of arbitrators in future arbitrations in India, positive developments to speed up the arbitral process in India, amendments with respects to costs & interest to be awarded to parties by an arbitral tribunal and the factors to be considered for the same, narrowing down of the scope of challenge of arbitral awards and the issue of fraud which has not been covered in the Amended Act in spite of being recommended by the Law Commission Report.

### **INTRODUCTION – ECONOMIC GROWTH & THE INDIAN ARBITRATION REGIME**

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World economy has seen a major transformation in the last three decades. Trade and business has evolved and become easier and more accessible thanks to advancement in technology and spirited entrepreneurship in growing economies. Right from the brick and mortar style of doing business in a defined boundary, today the same is done on the online platform and businesses in true sense have become global and have no boundaries anymore. Not just the companies but business leaders are also becoming global citizens with their presence in many countries and geographic locations.

It is obvious that India being a country with tremendous potential is bound to be a part of this change. India was poised to be an economic powerhouse as per the studies conducted a couple of decades ago. While things may not have totally gone in the directions as they should ideally have, India has progressed and has a significant place and role in world trade and business in the 21<sup>st</sup> century. There has been a huge influx of foreign companies and businesses that have setup shop in India in one form or another. Thus it is important that the legal system of India needs to be developed and updated to cater to the needs of these global businesses.

Given the fact that the conventional litigation system through courts in India was time consuming, arbitration as a mechanism of dispute resolution was a ray of hope for commercial disputes in India. However, while the Indian Arbitration Act, 1940 was in place, jurists often commented that it had too many lacunae and was not helping India catch up with the changes required by the business environment and especially ones after liberalization. Though it was the first major consolidated arbitration legislation in India, it failed to deal with key issues such as enforcement of foreign awards leading to enactment of Arbitration (Protocol and Convention) Act, 1937 to deal with Geneva Convention Awards and the Foreign Awards (Recognition and Enforcement) Act, 1961 to deal with New York Convention Awards; thus there being multiple legislations on inter-connected issues at the same time.

The Courts in India lamented over the working of the 1940 Act. In the case of *Guru Nanak Foundation v Rattan Singh*<sup>285</sup>, the Supreme Court observed:

*“Interminable, time consuming, complex and expensive Court procedures impelled jurists to search for an alternative Forum, less formal, more effective and speedy for resolution of disputes, avoiding procedural claptrap and this led them to Arbitration Act, 1940 (“Act” for short). However, the*

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<sup>285</sup> (1981) 4 SCC 634

*way in which the proceedings under the Act are conducted and without exception challenged in Courts, has made Lawyers laugh and legal philosophers weep..”<sup>286</sup>*

The problems faced with the 1940 Act became more challenging after liberalization of the Indian economy in 1991. The economy had opened up to foreign investors and they required a stable business environment and a strong commitment to the rule of law which was lacking in India<sup>287</sup>. Therefore an updated and upgraded arbitration regime became the need of the hour in early 1990's. The Indian Government in order to address the problems faced with the 1940 Act, enacted the Indian Arbitration and Conciliation Act, 1996 (the “Act” or the “1996 Act”) which came into force on 22.08.1996 after promulgating it as an ordinance earlier. The 1996 Act was based on the UNCITRAL model law and it continues to be the arbitration law in force in India till date. The 1996 Act repealed all three earlier laws (the 1937 Act, the 1940 Act and the 1967 Act and applied to (i) domestic arbitrations; (ii) enforcement of foreign awards; and (iii) conciliations<sup>288</sup>. While the 1996 Act was an improvement over the 1940 Act, over time the need developed to incorporate changes for remedying the problems faced in the arbitration regime in India even under this statute. While arbitration had always been offered as an alternative dispute resolution mechanism in India for faster disposal of cases at lower costs, the same only became a myth or a paradox as neither of these two really happened. Arbitration kept getting lengthier as a process and expensive due to the high fees charged by arbitrators and counsels.

The arbitration scenario in India became a subject of debates and discussions in the past decade. There was criticism on several aspects of arbitration in India right from the manner in which the proceedings were conducted especially in ad-hoc arbitrations, the delays at par with the conventional courts systems, the exorbitant costs to parties, judicial interference at several stages, challenges with respect to interim orders obtained by parties in courts, difficulties in enforcement of awards and finally the challenge procedure of the award which would typically review the issues on merits and thus convert the process of arbitration into just another civil court litigation involving layers of appeals and thus inordinate delays. In fact, even the 246<sup>th</sup> Law Commission Report on the proposed amendments to the 1996 Act itself observed that “*Delays are inherent in the arbitration process, and*

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<sup>286</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

<sup>287</sup> Ibid

<sup>288</sup> Part I of the 1996 Act titled ‘Arbitration’ is general in nature. Part II deals with ‘Enforcement of Certain Foreign Awards’. Chapter I of Part II deals with New York Convention Awards and Chapter II deals with Geneva Convention Awards. Part III of the 1996 Act deals with Conciliation. Part IV of the 1996 Act deals with supplementary provisions

*costs of arbitration can be tremendous. Even though courts play a pivotal role in giving finality to certain issues which arise before, after and even during an arbitration, there exists a serious threat of arbitration related litigation getting caught up in the huge list of pending cases before the courts. After the award, a challenge under section 34 makes the award inexecutable and such petitions remain pending for several years. The object of quick alternative disputes resolution frequently stands frustrated”<sup>289</sup>.*

To overcome and address these issues, several committees and panels were setup from time to time but nothing concrete emerged and recommendations to Governments remained as recommendations probably due to the lack of political will. Finally, the Ministry of Law and Justice issued a Consultation Paper on April 08, 2010 inviting suggestions/comments from eminent lawyers, judges, industry members, institutions and various other sections of the government and other stakeholders. After receiving many written responses these were collated and studied in detail. The Ministry of Law and Justice thereafter held National Conferences in major cities in India, inviting suggestions on the Consultation Paper from various significant quarters including lawyers, judges, industry, arbitration institutions and the public at large. Subsequent to that, taking into account the comments and suggestions received in writing and expressed orally in the National Conferences and discussions held thereafter, the Ministry prepared draft proposals and subsequently a ‘Draft Note for the Cabinet’.

Thereafter the Ministry of Law and Justice requested the Law Commission to undertake a study of the amendment proposed to the Act in the ‘Draft Note for the Cabinet’. Accordingly the present reference came to the 246<sup>th</sup> Law Commission. The Law Commission set up an expert committee to study the proposed amendments and make suggestions accordingly. The Committee comprised of several eminent persons from the legal field. After much exchange of notes, suggestions, deliberations and discussions with experts in arbitration and in-depth study of the issues involved, the Law Commission headed by Retired Justice Mr A.P.Shah released the 246<sup>th</sup> Report on proposed amendments to the arbitration law in India<sup>290</sup>.

There were several suggestions and recommendations made in this report. The said report came out in August 2014. The proposed amendments to the Act were intended to facilitate and encourage

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<sup>289</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

<sup>290</sup> Ibid



Alternative Dispute Mechanism, especially arbitration, for settlement of disputes in a more user-friendly, cost effective and expeditious disposal of cases since India is showing commitments to improve its legal framework to obviate in disposal of cases. Moreover, India had been ranked at 178 out of 189 nations in the world in contract enforcement, and thus the Government deemed that this was high time that urgent steps were taken to facilitate quick enforcement of contracts, easy recovery of monetary claims, award of just compensation for damages suffered, reduce the pendency of cases in courts and hasten the process of dispute resolution through arbitration, so as to encourage investment and economic activity<sup>291</sup>.

However, as Parliament was not in session and immediate steps were required to be taken to make necessary amendments to the Arbitration and Conciliation Act, 1996 to attract foreign investment by projecting India as an investor friendly country having a sound legal framework, the President was pleased to promulgate the "Arbitration and Conciliation (Amendment) Ordinance, 2015" (hereinafter referred to as "Ordinance") on 23 October, 2015. Consequently, The Arbitration and Conciliation (Amendment) Bill, 2015 (hereinafter referred to as "Bill") was introduced in Lok Sabha on 3<sup>rd</sup> December, 2015 by the Minister for Law and Justice, Mr. D.V. Sadananda Gowda and was passed on 17<sup>th</sup> December 2015 by a voice vote in Lok Sabha, and on the last day of the winter session being 23<sup>rd</sup> December in the Rajya Sabha. Finally the Bill received the assent of the President on the 31<sup>st</sup> December, 2015 and the "The Arbitration And Conciliation (Amendment) Act, 2015 (Act No. 3 of 2016)" (hereinafter referred to as "Amended Act") came into effect from 1<sup>st</sup> January 2016<sup>292</sup>.

We shall examine the key observations of the Law Commission Report, its recommendations and the amendments brought in by this Ordinance and subsequently the Amended Act based on the said Report and; whether these would help the arbitration scenario in India move towards global standards; given that the present Indian Government is trying to project India as a business friendly nation and wants to promote the country as an arbitration hub as well.

#### **A. JURISDICTION OF INDIAN COURTS ONCE AGAIN CONFERRED IN INTERNATIONAL COMMERCIAL ARBITRATIONS**

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<sup>291</sup> The Arbitration and Conciliation (Amendment) Bill, 2015, Bill No 252 of 2015; Statement of Objects and Reasons

<sup>292</sup> The Arbitration and Conciliation (Amendment) Act, 2015, Act No 3 of 2016 (31<sup>st</sup> December 2015)

The Law Commission Report makes a major distinction between the UNCITRAL Model Law and the 1996 Act of India wherein Article 1(2) of the UNCITRAL Model Law provides: "The provisions of this Law, except articles 8, 9, 35 and 36, apply only if the place of arbitration is in the territory of this State." However, Section 2(2) of the Arbitration and Conciliation Act, 1996 contained in Part I of the Act, states that "This Part shall apply where the place of arbitration is in India." This posed a question before the Supreme Court of India in the landmark cases *Bhatia International vs. Interbulk Trading SA* (hereinafter called "Bhatia")<sup>293</sup>, and in *Bharat Aluminum and Co. vs. Kaiser Aluminium and Co.* (hereinafter called "BALCO")<sup>294</sup>; whether the exclusion of the word "only" from the Indian statute gave rise to the implication that Part I of the Act would apply even in some situations where the arbitration was conducted outside India?

The Supreme Court in *Bhatia*, held that Part I mandatorily applied to all arbitrations held in India. In addition, Part I applied to arbitrations conducted outside India unless it was expressly or impliedly excluded. While *Bhatia* was a case arising out of section 9, the same principle was extended by the Supreme Court to sections 11 and 34 as well<sup>295</sup>. Thus as a result of these judicial pronouncements, Indian Courts became competent over time to provide interim reliefs pending arbitration, appoint arbitrators and set aside arbitral awards even if the arbitration was conducted outside India thus making the threshold of judicial intervention by Indian Courts very low in arbitrations held outside India. These powers existed unless Part I was expressly or impliedly excluded. Further, an implied exclusion was construed not on the basis of conflict of laws principles but in an ad-hoc manner. However this position was overruled in the *BALCO* case<sup>296</sup>.

The Supreme Court in *BALCO* decided that Parts I and II of the Act are mutually exclusive of each other. The Court held that the intention of Parliament was that the Act is territorial in nature and sections 9 and 34 would apply only when the seat of arbitration is in India. It was held in this landmark judgment that the seat is the "centre of gravity" of arbitration, and even where two foreign

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<sup>293</sup> (2002) 4 SCC 105

<sup>294</sup> (2012) 9 SCC 552

<sup>295</sup> In the cases of *Venture Global v Satyam Computer*, (2008) 4 SCC 190; *Intel Technical Services v W.S. Atkins*, (2008) 10 SCC 308; *Citation Infowares Ltd v Equinox Corporation*, (2009) 7 SCC 220; *Dozco India v Doosan Infrastructure*, (2011) 6 SCC 179; *Videocon Industries v Union of India*, (2011) 6 SCC 161

<sup>296</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

parties arbitrate in India, Part I would apply and, by virtue of section 2(7), the award would be a “domestic award”.

The Supreme Court in BALCO recognized the “seat” of arbitration to be the juridical seat; however, in line with international practice, it was observed that the arbitral hearings may take place at a location other than the seat of arbitration. The distinction between “seat” and “venue” was, therefore, recognized. In such a scenario, only if the seat was determined to be India, Part I would be applicable. If the seat was foreign, Part I would be inapplicable. The decision in BALCO was expressly given prospective effect and applied to arbitration agreements executed after the date of the said judgment<sup>297</sup>.

However, while the decision in BALCO was a step in the right direction and would reduce judicial intervention in foreign arbitrations, the Commission felt that there were a few problematic areas left unaddressed. For example in a situation where the assets of a party are located in India, and there is a likelihood that the party will dissipate its assets in the near future, the other party will lack an efficacious remedy if the seat of the arbitration is abroad. Neither will the obtaining of an interim order from a foreign court or arbitral tribunal be effective to enforce due to its failure to qualify as a “judgment” or “decree”<sup>298</sup>; nor can contempt proceedings provide a practical remedy to the party seeking to enforce the interim relief obtained by it. Thus this would lead to situations wherein a foreign party would obtain an arbitral award in its favour only to realize that the entity against which it has to enforce the award has been stripped of its assets and has been converted into a shell company<sup>299</sup>.

Thus upon contemplation and deliberations on situations as mentioned hereinabove and other practical difficulties; and in order to address them, the Amended Act has once again given Indian Courts jurisdiction over international commercial arbitrations even with seat of arbitration outside India with respect to provisions for interim reliefs granted by Courts (Sec 9), assistance that can be taken from Courts by arbitral tribunals for purposes of evidence (Sec 27) and in appeals against orders of a courts in Section 8 applications (Sec 37(1)(a)) and appeals to Supreme Courts against certain orders (Sec 37(3)).

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<sup>297</sup> Bharat Aluminum and Co. vs. Kaiser Aluminium and Co; (2012) 9 SCC 552

<sup>298</sup> For the purposes of sections 13 and 44A of the Code of Civil Procedure, 1908 ( which provide a mechanism for enforcing foreign judgments)

<sup>299</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

While on one hand this can be seen as a clarification that the other provisions of Part I of the Act are not applicable to international commercial arbitrations; on the other, this once again brings in the interference of Indian courts in international commercial arbitrations, though in a limited manner. It would only be settled over time with pronouncements of the courts of India whether these limited provisions are actually progressive or having a counter-productive effect on international commercial arbitrations with seat of arbitration outside India. The author believes that these will be positive provided that the judicial pronouncements in coming years should not expand the scope of applicability of Part I of the Act to other provisions and thus dilute it back to the Bhatia era in arbitrations with “seat” outside India.

#### **B. HIGH COURTS TO DEAL WITH ISSUES RELATING TO INTERNATIONAL COMMERCIAL ARBITRATIONS – A POSITIVE MESSAGE TO GLOBAL BUSINESS COMMUNITY**

The Law Commission in its Report has stated that there was an urgent need of upgrading the judicial system in India especially in the context of international commercial arbitrations and investments treaty arbitrations wherein not only complex issues are involved, the stakes are high; and the reputation of the country’s judicial system is exposed to the global business community. In this background, the Commission recommended that in the case of international commercial arbitrations, where there is a significant foreign element to the transaction and at least one of the parties is foreign, the relevant “Court” which is competent to entertain proceedings arising out of the arbitration agreement, should be the High Court, even where such a High Court does not exercise ordinary original jurisdiction.

The Amended Act has incorporated this recommendation and made it specific and clear that the definition of “Court” in the context of a domestic arbitration would be District court or High Court; however the same in the context of an international commercial arbitration would be only a High Court. These clarifications are provided vide amendments in Section 2(e) of the Act. There have been amendments in Sections 47<sup>300</sup> and 56<sup>301</sup> of the 1996 Act as well to define “Court” as only the High Court as these are provisions under Part II relating to enforcement of awards under the New York and Geneva Conventions. The intent here is that awards of international commercial arbitration should only be enforced through High Courts and not any courts inferior to them presumably for the reason that the High Courts would be more educated and sensitive of enforcements of foreign awards

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<sup>300</sup> This provision under Part II relates to enforcement of awards under the New York Convention

<sup>301</sup> This provision under Part II relates to enforcement of awards under the Geneva Convention

vis-à-vis civil courts at district level. Moreover enforcement procedure would be more accessible for a foreign party in a High Court than in a lower court in India.

The rationale of the Law Commission to recommend and for the Amended Act to incorporate this amendment is that litigations relating to international commercial arbitrations will be heard expeditiously and by commercially oriented judges at the High Court level. The Law Commission report noted that the award of the Arbitral Tribunal in *White Industries Australia Ltd. v the Republic of India*<sup>302</sup>, serves as a reminder to the Government to urgently implement reforms to the judicial system in order to avoid substantial potential liabilities that might accrue from the delays presently inherent in the system<sup>303</sup>.

### C. INTERIM MEASURES – POWERS OF COURTS NARROWER & TRIBUNAL'S WIDER

The arbitral tribunal has powers to grant interim measures of protection under Section 17 of the Act, unless the parties have excluded such power by agreement. Though this is an important provision, its effectiveness is compromised given the lack of any suitable statutory mechanism for the enforcement of such interim orders of the arbitral tribunal in India. The judicial pronouncements starting with *Sundaram Finance Ltd v. NEPC India Ltd.*<sup>304</sup> have consistently held that though section 17 gives the arbitral tribunal the power to pass orders, the same cannot be enforced as orders of a court and therefore only section 9 gives the court powers to pass interim orders during the arbitration proceedings. Once again in a major decision in *M.D. Army Welfare Housing Organisation v. Sumangal Services Pvt. Ltd.*<sup>305</sup>, the Court had held that under section 17, no power is conferred on the arbitral tribunal to enforce its order nor does it provide for judicial enforcement thereof<sup>306</sup>.

The Delhi High Court made a sincere attempt to find a solution to this problem by its pronouncement in *Sri Krishan v. Anand*<sup>307</sup>, wherein it held that any person failing to comply with the order of the arbitral tribunal under section 17 would be deemed to be "making any other default" or "guilty of any contempt to the arbitral tribunal during the conduct of the proceedings" under section 27(5) of Act. Further, it devised that remedy of the aggrieved party would then be to apply to the arbitral

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<sup>302</sup> UNCITRAL, Final Award (November 30, 2011)

<sup>303</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

<sup>304</sup> (1999) 2 SCC 479

<sup>305</sup> (2004) 9 SCC 619

<sup>306</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

<sup>307</sup> (2009) 3 Arb LR 447 (Del)

tribunal for making a representation to the Court to mete out appropriate punishment. Once such a representation is received by the Court from the arbitral tribunal, the Court would be competent to deal with such party in default as if it is in contempt of an order of the Court, i.e., either under the provisions of the Contempt of Courts Act or under the relevant provisions<sup>308</sup> of Code of Civil Procedure, 1908<sup>309</sup>.

The Law Commission after much deliberation on this issue arrived at a conclusion that it is important to provide teeth to the interim orders of the arbitral tribunal as well as to provide for their enforcement in line with the 2006 amendments to Article 17 of the UNCITRAL Model Law. The Commission also concluded that the route observed in the Delhi High Court judgment in *Sri Krishan v. Anand* is not a complete solution as it was a lengthy and circuitous way to enforce the interim protection obtained. Therefore, major amendments have been provided to section 17 of the 1996 Act which would give teeth to the orders of the Arbitral Tribunal and the same would be statutorily enforceable in the same manner as the Orders of a Court<sup>310</sup>.

In the above background, it is important to note that the provisions of Section 9 of the Act with respect to interim measures and protection was being over used and it wouldn't be out of place to say "misused" as a pressure tactic even before the arbitrations proceedings commenced and parties that obtained ex-parte interim orders under this provision would consciously not commence the arbitration proceedings thus in a way misusing the powers given under this section. The present amendment has dealt with this issue by setting a time frame of ninety days for commencing the arbitration proceedings from the date of any such order; and secondly has made the provision loud and clear that the courts shall not entertain such applications under Section 9 unless the Courts find that the circumstances that exist may not be remedied by the provisions under Section 17 wherein the arbitral tribunal can provide the same wide interim protection.

The amendments proposed under the new Section 17 make it virtually at par with the powers of the Courts under Section 9 of the Act. All interim measures that the courts have been granting over the years have been equally bestowed to the tribunal and these interim orders made by the tribunal would be enforceable as though an order of the Court under the Code of Civil Procedure, 1908. The legislative intent of the Amended Act is very clear that the intervention of courts has to be minimized

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<sup>308</sup> Order 39 Rule 2A of the Code of Civil Procedure, 1908

<sup>309</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

<sup>310</sup> Ibid

and the tribunal and its powers shall be on par with that of courts giving it the sanctity of a court order and allow proper enforcement.

#### **D. JUDICIARY & ARBITRATION – A BALANCE IN PRE-ARBITRAL JUDICIAL INTERVENTION & A MESSAGE TO INDIAN COURTS TO ADOPT A PRO-ARBITRATION APPROACH**

Judicial intervention in arbitral proceedings prior to the commencement of the arbitration per se is in itself a significant issue that needed to be addressed in the present reforms. The three major interventions at the pre-arbitral stage include Court intervention under sections 8, 9 and 11 in Part I and Section 45 in Part II of the Act. Sections 8, 45 and 11 deal with “reference to arbitration” and “appointment of the tribunal” which affect the very constitution of the tribunal and functioning of the arbitral proceedings. Their operation has a direct and significant impact on the “conduct” of arbitrations. Section 9, however being solely for the purpose of securing interim relief, although having the potential to affect the rights of parties, does not affect the “conduct” of the arbitration in the same way as the other provisions. The Commission has examined the working of these provisions in this context and has proposed certain amendments<sup>311</sup>.

The key question that arose before the Supreme Court in *SBP v Patel Engineering*<sup>312</sup> was upon *scope* and *nature* of permissible pre-arbitral judicial intervention, in the context of section 11 of the Act and whether the powers under this section was a “judicial” or an “administrative” power. The Supreme Court held that the power to appoint an arbitrator under section 11 is a “judicial” power. The underlying issues in this judgment, relating to the scope of intervention, were subsequently clarified in *National Insurance Co. Ltd. v Boghara Polyfab Pvt. Ltd.*<sup>313</sup>, where the Supreme Court laid down three categories of issues to be decided upon thus bringing in clarity on this aspect. The Commission was of the view that, in this context, the same test regarding *scope* and *nature* of judicial intervention, as applicable in the context of section 11, should also apply to sections 8 and 45 of the Act. The Supreme Court in *Shin Etsu Chemicals Co. Ltd. v Aksh Optifibre*<sup>314</sup>, (in the context of section 45 of the Act and parameter of intervention), ruled in favour of looking at the issues/controversy only *prima facie*. The

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<sup>311</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

<sup>312</sup> (2005) 8 SCC 618

<sup>313</sup> (2009) 1 SCC 267

<sup>314</sup> (2005) 7 SCC 234

Commission in this background has recommended amendments to sections 8 and 11 of the 1996 Act<sup>315</sup>.

The Law Commission in its Report has recommended major amendments to Section 8 of the Act; however the Amended Act has incorporated only a part of these; however having a significant impact on the applicability of the Section. The Report recommends a very basic and low threshold for a judicial authority to refer a matter before it to arbitration. A judicial authority shall refer a matter before it to arbitration provided it finds that *prima facie* a valid arbitration agreement exists.

The amendments in Section 8 of the law make provisions for referring a matter to arbitration that is before a judicial authority when one party claims that the dispute is to be governed by arbitration. The same has to be done irrespective of any decision by the Supreme Court or any other court unless the judicial authority finds that *prima facie* no valid arbitration agreement exists. This is a proposed amendment in 8(1) of the Act and while a minor amendment on the face of it; this would go a long mile in several civil and corporate disputes wherein parties try to wriggle out of arbitration and prolong the matter in a civil court. This amendment is a shot in the arm of the civil courts and judicial authorities to refer the matter to arbitration and thus a step towards saving time and costs for the parties.

Another supportive proviso that has been added in Section 8 in the Amended Act is to help a party making a reference of a dispute to arbitration before a civil court which for some reason does not have the original arbitration agreement. If the original or a certified copy of the agreement is retained by the other party, the referring party may make an application before the court with a copy of the agreement calling upon the other party to produce the original or its certified copy before the court. This proviso fills in a procedural lacunae often faced by parties wherein the party retaining the original agreement tried avoiding arbitration.

In fact the Amended Act also brings in an appeal provision under Section 37 against an order of a court refusing to refer the parties to arbitration under Section 8 of the Act. Thus the courts would be mindful when an application under Section 8 of the Act is before them and shall have a pro-arbitration approach to avoid appeals against their orders.

The *scope* of the judicial intervention is only restricted to situations where the Court/Judicial Authority finds that the arbitration agreement does not exist or is null and void. In so far as the *nature*

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<sup>315</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996



of intervention is concerned, the Commission recommends a limited prima facie satisfaction for the Court/Judicial Authority to see if an arbitration agreement exists and not beyond that. Thus if the Court/Judicial Authority is of a prima facie view that an arbitration agreement exists, then it shall refer the dispute to arbitration, and leave the existence of the arbitration agreement to be finally determined by the arbitral tribunal. While the Commission had recommended the orders under Section 8 and 11 to be non-appealable<sup>316</sup>, Section 37 allows appeals against orders of Section 8<sup>317</sup>.

#### **E. APPOINTMENT OF ARBITRATORS – COMPETENCE, NEUTRALITY & INDEPENDENCE STRESSED UPON**

Section 11 provides for the appointment of arbitrators under the Act. The Commission realizing the time lost in pre-arbitration litigation such as Section 11 applications of appointment of arbitrators, has recommended in its Report an amendment whereby the powers of appointment of arbitrators being vested in the “Chief Justice” shall now be vested to the “High Court” and the “Supreme Court” respectively. It has thus been clarified that delegation of the power of “appointment” (as opposed to a finding regarding the existence/nullity of the arbitration agreement) shall not be regarded as a judicial act. This would rationalize the law and provide greater incentive for the High Court and/or Supreme Court to delegate the power of appointment (being a non-judicial act) to specialized, external persons or institutions. The Commission has further recommended an amendment to remove the scope of appeal against orders of High Court or Supreme Court in Section 11 applications.

A key amendment here is the introduction of Sub-section (6A) to Section 11 which limits the scope of examination by the court before which the said application is made to the limited issue of existence of an arbitration agreement alone and nothing beyond that. Further, provisions are added in Sub-Section (8) to Section 11 whereby the court appointing the arbitrator shall seek certain disclosures in writing from the prospective arbitrator. These disclosures are dealt more elaborately in the new Section 12(1) which has strict norms for ensuring that the arbitrators appointed by courts have the highest degree of impartiality and independence. Another significant amendment brought in is the time frame whereby the court shall make an endeavor to dispose of such applications under Section 11 within sixty days from the date of service on the other side.

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<sup>316</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

<sup>317</sup> Amendment in Section 37(1)(a) of the Amended Act

A connected and extremely important issue is that of neutrality of the arbitrator. There can be no two views that any judicial or quasi-judicial process including arbitration must be in accordance with principles of natural justice. Thus, in the context of arbitration, neutrality of arbitrators, viz. their independence and impartiality, is critical to the entire process. The 1996 Act has been worded in such a manner giving wide connotation to neutrality. The test of neutrality is not whether given the circumstances, there is any *actual* bias; but, whether the circumstances in question give rise to any *justifiable apprehensions* of bias. Thus the threshold for bias is at a basic level and slightest apprehension can trigger Section 12(3) of the Act.

However the concept of neutrality, impartiality and independence of arbitrators in India has been compromised to a large extent in Government contracts awarding tenders, contracts from Public Sector Undertakings, etc. wherein usually an employee or a person associated with the said Company is nominated as arbitrator in the contract with the private party. The Supreme Court of India has consistently held that (See *Executive Engineer, Irrigation Division, Puri v. Gangaram Chhapolia*<sup>318</sup>; *Secretary to Government Transport Department, Madras v. Munusamy Mudaliar*<sup>319</sup>; *International Authority of India v. K.D.Bali and Anr*<sup>320</sup>; *S.Rajan v. State of Kerala*<sup>321</sup>; *M/s. Indian Drugs & Pharmaceuticals v. M/s. Indo-Swiss Synthetics Germ Manufacturing Co. Ltd.*<sup>322</sup>; *Union of India v. M.P.Gupta*<sup>323</sup>; *Ace Pipeline Contract Pvt. Ltd. v. Bharat Petroleum Corporation Ltd.*<sup>324</sup>) that arbitration agreements in government contracts which provide for arbitration by a serving employee of the department, are valid and enforceable.

The Supreme Court, in *Indian Oil Corp. Ltd. v. Raja Transport (P) Ltd.*<sup>325</sup>, carved out a minor exception in situations when the arbitrator “*was the controlling or dealing authority in regard to the subject contract or if he is a direct subordinate (as contrasted from an officer of an inferior rank in some other department) to the officer whose decision is the subject matter of the dispute*”, and this exception was used by the Supreme Court in *Denel Propreitory Ltd. v. Govt. of India, Ministry of Defence*<sup>326</sup> and *Bipromasz Bipron Trading SA v. Bharat Electronics Ltd.*<sup>327</sup>, to appoint an independent arbitrator under

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<sup>318</sup> 1984 (3) SCC 627

<sup>319</sup> 1988 (Supp) SCC 651

<sup>320</sup> 1988 (2) SCC 360

<sup>321</sup> 1992 (3) SCC 608

<sup>322</sup> 1996 (1) SCC 54

<sup>323</sup> (2004) 10 SCC 504

<sup>324</sup> 2007 (5) SCC 304

<sup>325</sup> 2009 8 SCC 520

<sup>326</sup> AIR 2012 SC 817

<sup>327</sup> (2012) 6 SCC 384

section 11; however this was considered very narrow and is not enough as a proper benchmark of neutrality and independence of an arbitrator by the Law Commission<sup>328</sup>.

The Supreme Court of India has tilted towards binding nature of contracts over procedural fairness which needed a review. Principles of impartiality and independence are supreme and have to be borne at every stage of the proceedings especially at the time of constitution of the tribunal as that would pave the way ahead for a fair conduct of proceedings. Even if party autonomy allows them to agree prior to the disputes in a manner which is in discord with principles of neutrality, the same needs to be addressed once the disputes have arisen. Certain minimum levels of independence and impartiality are required of the arbitral process regardless of the parties' apparent agreement. A reasonable law thus cannot permit appointment of an arbitrator who is himself a party to the dispute, or who is employed by (or similarly dependent on) one party, even if this is what the parties agreed. The Commission is of the view that the concept of party autonomy cannot be stretched to a point where it negates the very basis of having impartial and independent adjudicators for resolution of disputes. In fact, when the party appointing an adjudicator is the State, the duty to appoint an impartial and independent adjudicator is much more onerous – and the right to natural justice cannot be said to have been waived only on the basis of a “prior” agreement between the parties at the time of the contract and before arising of the disputes. To address this concern, amendments at large have been recommended in the Law Commission Report and the Amended Act adopts most of them as is evident from amendments in sections 11 and 12 of the Act<sup>329</sup>.

The Commission has proposed the requirement of having specific disclosures by the arbitrator, at the stage of his possible appointment, regarding existence of any relationship or interest of any kind which is likely to give rise to justifiable doubts. The Commission has proposed the incorporation of a Schedule drawn from the Red and Orange lists of the IBA Guidelines on Conflicts of Interest in International Arbitration, and which would be treated as a “guide” to determine whether circumstances exist which give rise to such justifiable doubts. In addition to this, another schedule has been proposed to be added in the Report and adopted by the Amended Act which incorporates categories from the Red list of the IBA Guidelines, whereby the person proposed to be appointed as an arbitrator shall be *ineligible* to be so appointed, *notwithstanding any prior agreement* to the

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<sup>328</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

<sup>329</sup> Ibid

contrary<sup>330</sup>.

The Law Commission Report has respected party autonomy and in certain situations, parties have been allowed to waive even the categories of ineligibility as set in the proposed Fifth Schedule such as family arbitrations, etc., despite the existence of objective “justifiable doubts” regarding his independence and impartiality. To deal with such situations, the Commission has proposed the proviso to section 12 (5), where parties may, *subsequent to disputes having arisen between them*, waive the applicability of the proposed section 12 (5) by an express agreement in writing. However, in all other cases, the general rule in the proposed section 12 (5) must be followed. The Commission has also stressed that the High Court or its designate should give “due regard” to the contents of the disclosure made by a potential arbitrator under Section 12(1) of the Act in appointing the arbitrator<sup>331</sup>.

In the above background, as per the amendments, a prospective arbitrator has to disclose in writing if he or she has had any relation of any kind with either parties, counsels, etc. that may give rise to doubts of the impartiality or independence of the said person. The two new schedules introduced in the Amended Act namely Schedule V and VII containing an exhaustive list of grounds which would act as a guideline in determining if there is any such possible conflict or relationship.

This provision would minimize if not eliminate one-sided arbitrations whereby typically a senior personnel or official of the company which is more powerful amongst the parties to the arbitration agreement is usually appointed as an arbitrator. This was common practice in building and engineering contracts, stock market contracts, etc. Public sector undertakings in India in most of their contracts would typically have their employee, a senior official designation named as an arbitrator. While the other side may be unhappy with this, it would be helpless as the courts in India have held that a party having signed a contract with eyes wide open could not dispute the appointment of the arbitrator under it later.

Another helpful amendment has been brought in Section 14 giving a provision for substituting the arbitrator when he becomes unable to perform his functions. The present version of the Act merely identified the problem but didn't provide a solution or an option to overcome that which the amendment does, thus making the arbitral process progressive.

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<sup>330</sup> Ibid

<sup>331</sup> Ibid

A key area of concern area in arbitrations in India especially ad-hoc arbitrations are the high costs associated with it – including the arbitrary and disproportionate fixation of fees by several arbitrators. The road to arbitration becoming a cost effective dispute resolution mechanism in India requires a rationalization of the fee structures for arbitrations. This issue was commented upon by the Supreme Court in *Union of India v. Singh Builders Syndicate*<sup>332</sup> wherein the court observed:

*“There is no doubt a prevalent opinion that the cost of arbitration becomes very high in many cases where retired Judges are arbitrators. The large number of sittings and charging of very high fees per sitting, with several add-ons, without any ceiling, have many a time resulted in the cost of arbitration approaching or even exceeding the amount involved in the dispute or the amount of the award. When an arbitrator is appointed by a court without indicating fees, either both parties or at least one party is at a disadvantage. Firstly, the parties feel constrained to agree to whatever fees is suggested by the arbitrator, even if it is high or beyond their capacity. Secondly, if a high fee is claimed by the arbitrator and one party agrees to pay such fee, the other party, who is unable to afford such fee or reluctant to pay such high fee, is put to an embarrassing position. He will not be in a position to express his reservation or objection to the high fee, owing to an apprehension that refusal by him to agree for the fee suggested by the arbitrator, may prejudice his case or create a bias in favour of the other party who readily agreed to pay the high fee.”*

The Commission has as a solution to this problem recommended a model schedule of fees and has empowered the High Court to frame appropriate rules for fixation of fees for arbitrators and for which purpose it may take the said model schedule of fees into account. The model schedule of fees is based on the fee schedule set by the successfully functioning Delhi High Court International Arbitration Centre. The Commission has further suggested that this schedule of fees would require regular updating, and must be reviewed every 3-4 years to ensure that they continue to stay realistic. Finally the Commission has clarified that the schedule of fee recommended by it is applicable only to ad-hoc domestic arbitrations and not to international commercial arbitrations as they involve foreign parties who might have different values and standards for fees for arbitrators; and they are also not applicable to institutional arbitrations in India as they might have their own schedule of fees; and in both cases greater deference must be accorded to party autonomy<sup>333</sup>.

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<sup>332</sup> (2009) 4 SCC 523

<sup>333</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

The issue of fees payable to arbitrators appointed by Courts is addressed for the first time by introducing a proposed fourth schedule in the Amended Act giving a fee structure based on the quantum of dispute amount. This is a welcome change to the Indian arbitration scenario as ad-hoc arbitrations in India are more popular than institutional ones and since the issue of fees is seen as a sensitive subject, the same is not discussed with the tribunal or arbitrators before commencement of proceedings. There are times when parties are uncomfortable with the fee structures set by the tribunal but are unable to raise this issue. Also, fee slabs based on the quantum of the claim would deter parties from raising frivolous claims and counterclaims of astronomical sums.

#### **F. SPEEDING UP THE ARBITRAL PROCESS**

The Law Commission in its Report has observed that in spite of numerous provisions in the 1996 Act aimed at ensuring proper conduct of arbitral proceedings, the experience of arbitrating in India has been largely unsatisfactory for all stakeholders. Arbitration proceedings are held in the similar manner as Court proceedings with procedural formalities similar to conventional court proceedings. This has led to arbitration proceedings going on for years and the entire idea of a cost effective and fast method of dispute resolution is defeated.

Moreover, ad-hoc arbitrations are really expensive with “per sitting” fees of arbitrators, dates spread over long periods, proceedings continuing for years resulting in increase in costs and denial of justice. The Law Commission in its Report has stated that this entire scenario must undergo a change. To begin with, arbitrators must avoid purely formal sittings. The Commission highlights the legal position taken by the Delhi High Court that delay in passing an award can lead to such an award getting set aside in *Oil India Ltd v Essar Oil Ltd*.<sup>334</sup>; *Union of India v Niko Resources Ltd*.<sup>335</sup>; and *Peak Chemical Corporation Inc v NALCO*<sup>336</sup>. These decisions should act as a reminder to all arbitrators to hear and decide matters expeditiously, and within a reasonable period of time. The Commission has also recommended use of technology, like tele-conferencing, video-conferencing etc., to replace the need for purely formal sittings and thereby aid in a smoother and more efficient conduct of arbitral proceedings<sup>337</sup>.

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<sup>334</sup> OMP No 416/2004 dt 17.8.2012, Delhi High Court

<sup>335</sup> OMP No 192/2010 dt 2.7.2012, Delhi High Court

<sup>336</sup> OMP 160/2005 No dt 7.2.2012, Delhi High Court

<sup>337</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

In the above background, the Commission has proposed several amendments and most of these have been incorporated by the Amended Act thus giving a major push to the manner in which arbitration proceedings are conducted in India. This Amended Act has made a genuine effort to address a major challenge that the arbitral processes in India is facing which is inordinate delay in completing the arbitration proceedings due to frequent adjournments and conducting of the proceedings like a civil court. A minor amendment in the form of a proviso to Section 24 (1) of the Act reflects this. Intent is clear that the arbitral tribunal shall as far as possible hold oral hearings for evidence or arguments as the case may be on a day-to-day basis and not grant adjournments unless a fair case is made out for the same. Further, there is a provision for the tribunal to impose costs on the party seeking unreasonable adjournments.

While these amendments may not change the entire scenario overnight, effects will be hopefully felt in the near future and the manner in which arbitrations shall be conducted. Even institutional and court annexed arbitration rules as and when are framed or amended to incorporate similar provisions shall take a cue from these for a setting up a faster process.

A similar minor amendment in Section 25(b) of the Act empowers the tribunal to forfeit the right of a respondent in filing of the statement of defense when the respondent fails to do so. As per the present section, the tribunal could at best proceed with the arbitral proceedings and as a matter of practice, it is often seen that parties consciously do not appear for a major part of the proceedings and show up at a later stage stating that they were either not aware of the proceedings or did not get notice. Tribunals in India generally go on the basis of equity and thus tend to grant an opportunity to the respondent to file its statement of defence even at a belated stage. In this process, the party that has been attending the proceedings from the beginning suffers and the process is also delayed overall. Thus this amendment would help seal the issue at the appropriate stage once in for all.

Another major and refreshing change which has been introduced through Section 29(A) is the provision to complete the arbitration proceedings within a period of twelve months of entering reference. This period can be extended by another six months by the consent of the parties and any extension beyond that can only be made by the Courts. The Courts in granting any such extension would examine the reason for the delay and justification for the extension sought. Here lies a problem that since the mandate of the tribunal in the arbitral proceedings terminates at the end of this twelve or eighteen month period; the Respondent typically would delay the proceedings and cross the time limit thus landing up in the Courts for extension and delaying the matter there as Indian Courts are inundated with backlog of cases. The onus would be on courts to hear such applications for further

extension within a reasonable time frame so that the arbitration proceedings see a practical conclusion; else this provision proposed will only add to the problems though it appears pro-arbitration on the face of it. However, the same has to be seen in the background of the overall Indian litigation scenario.

As per the Amended Act, Courts now have the powers to penalize the tribunal by reduction of its fee and to penalize the parties by imposing actual or exemplary costs on them. In addition to this, to incentivize faster adjudication of arbitration matters, the tribunals shall be entitled to additional fees as the parties may agree if they complete the arbitral process within six months of entering reference. This at least makes the entire process appear very commercial and may not go well with certain arbitrators.

The Courts have also been empowered to substitute one or all the arbitrators and the substituted arbitrators shall continue the proceedings from the stage already reached and it would not mean a fresh start once again. It would be apt here to make a reference to the provisions under Section 12 of the Amended Act wherein a prospective arbitrator is required to make a disclosure about his or her availability of time and whether he or she would be able to complete the arbitration proceeding within the period of twelve months. This would make the said arbitrator once appointed, accountable towards the court and the parties before it.

The Amended Act for the first time in India has introduced the concept of fast track arbitration in Section 29(B). As per this provision, if the parties to an agreement decide to adopt the procedure of fast track arbitration, the same shall be conducted on the basis of written pleadings, documents and submissions. This would be different from the usual proceedings as there would not be oral hearings and if there are any, the technical formalities can be dispensed with for the sake of expeditious progress of the matter and that the award can be rendered within six months of entering of reference by the parties. This format of arbitration is ideal for smaller disputes which are mainly based on documents. It would be highly beneficial for parties saving them time and costs.

On the aspect of early disposal of challenge proceedings of an award, the Commission has in its Report observed that challenges to arbitration awards under sections 34 and 48 are similarly kept pending for many years. In this context, the Commission has recommended amendments in sections 34 and 48 which would require that an application under those sections shall be disposed off expeditiously and in any event within a period of one year from the date of service of notice. While the Amended Act has brought in a change of this nature vide an amendment to Section 34 (challenge of domestic



award), the same has not been reflected in the provision for enforcement of foreign awards under Section 48<sup>338</sup>.

#### **G. AMENDMENTS WITH RESPECTS TO COSTS & INTEREST TO BE AWARDED TO PARTIES**

Costs are an important element of concern for any party to litigation and the same applies to parties in arbitrations too. In fact costs in arbitration has several components such as arbitrator's fees and expenses, institutional fees and expenses, fees and expenses in relation to lawyers, witnesses, venue, hearings etc. which makes it an expensive affair. The Law Commission in its report has put forth the concept that allocation of costs should be done in a manner reflecting the parties' success and failure in the arbitration. This logic is followed by the principle that the losing party pays costs; which the Commission believes shall also act as a deterrent against frivolous conduct and furthers compliance with contractual obligations. Therefore it has recommended comprehensive reforms in the costs regime which was proposed as Section 6A but incorporated as Section 31A in the Amended Act. This new regime is in spirit of the decision of the Supreme Court in Salem Advocate Bar Association v Union of India<sup>339</sup>, and the Commission has expressed hope in its report that the judges and arbitrators would take advantage of these provisions, and explain the "rules of the game" to the parties early in the litigation so as to avoid frivolous and meritless litigation/arbitration<sup>340</sup>.

An important provision introduced in the new regime under proposed Section 31A is that while awarding costs, "conduct of the parties" shall also be a factor that the tribunal could take into account amongst other factors and also "if a reasonable offer to settle the dispute was refused by another party". From a practice view point, these provisions are immensely significant while they may appear a general guideline prime facie. In arbitrations, more often than not, parties tend to delay or drag proceedings when it suits them by seeking adjournments and raising technical pleas whenever possible thus not showing great conduct.

Moreover, it's a psychological satisfaction for a party to make an unrealistic claim or counterclaim of an astronomical sum especially for damages since they know that no court fee or stamp duty is accordingly levied. Moreover, since the arbitral tribunal's fee is decided in the first sitting usually, the claimant or respondent wants to maximize its' chances even if it is at the cost of making an

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<sup>338</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

<sup>339</sup> AIR 2005 SC 3353

<sup>340</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

unreasonable claim of a large sum of money. These issues would be addressed over time when the parties become aware that their conduct during the proceedings would be factored in when the costs are being awarded.

Also at times, when one party actually comes up with a proposal to settle the dispute, the other party is totally reluctant to accept the same. Even reasonable settlement proposals are rejected many a times due to unrealistic expectations of award of compensation or damages from the tribunal or at times even ego. It is time that the Indian arbitration scenario gives weightage to these factors now incorporated in the amendments and at least give a clear message to the parties that their conduct is being observed throughout the proceedings.

The Law Commission has also highlighted the contrary judicial pronouncements with respect to awarding of interest under the 1996 Act. The Supreme Court in *Renusagar Power Co Ltd v. General Electric*<sup>341</sup>, held that awarding compound interest was not a violation of public policy of India with a justification the same was awarded in order to put the injured party in the same economic position it would have been in if the contract had been duly performed. The Supreme Court then in *State of Haryana v. L. Arora & Co.*<sup>342</sup>, held that section 31(7) makes no reference to payment of compound interest. The decision in Arora's case was seen as being contrary to the statutory scheme of the Act and against decisions of the Supreme Court in *ONGC v. M.C. Clelland Engineers S.A*<sup>343</sup>, and *UP Cooperative Federation Ltd v. Three Circles*<sup>344</sup>. The Supreme Court, in *Hyder Consulting (U.K.) v. Governor of Orissa*<sup>345</sup> has referred this issue for determination to a three judge bench as it was leading to conflicting opinions. The Law Commission has recommended amendments to section 31 to clarify the scope of powers of the arbitral tribunal to award compound interest, as well as to rationalize the rate at which default interest ought to be awarded and move away from the existing rate of 18% to a market based determination in line with commercial realities. While the latter recommendation of moving to a realistic interest rate regime has been incorporated by the Amended Act; the issue of awarding compound interest and for what period it has to be awarded has not been incorporated.

The Amended Act introduces under Section 31 a concept of interest to be calculated at 2% above the current rate of interest prevalent on the date of the award and this current rate of interest is inferred

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<sup>341</sup> 1994 Supp (1) SCC 644

<sup>342</sup> (2010) 3 SCC 690

<sup>343</sup> (1999) (4) SCC 327

<sup>344</sup> (2009) 10 SCC 374

<sup>345</sup> (2013) 2 SCC 719

from the Interest Act, 1978. There is a departure from the existing provision of providing 18% interest per annum from the date of award to the date of payment.

#### **H. LIMITING THE SCOPE OF CHALLENGING AN AWARD**

The provisions for setting aside and enforcements of awards post arbitrations proceedings in India under the 1996 Act was more or less the same for awards arising out of domestic and international commercial arbitrations. The languages of Section 34 dealing with setting aside a domestic award and a domestic award resulting from an international commercial arbitration; and that of section 48 dealing with conditions for enforcement of foreign awards are on similar lines. This led to problems and the Commission in its report highlighted the present levels of judicial intervention in both in India. The Commission has made a clear distinction between domestic and foreign awards in this context and accordingly made recommendations.

The Law Commission has recommended the addition of section 34 (2A) to deal with purely domestic awards, which may now also be set aside by the Court if the Court finds that such award is vitiated by “patent illegality appearing on the face of the award.” In order to provide a balance and to avoid excessive intervention, it is clarified in the proposed *proviso* to the proposed section 34 (2A) that such “an award shall not be set aside merely on the ground of an erroneous application of the law or by re-appreciating evidence.” This would negate the unintended consequences of the decision of the Supreme Court in *ONGC vs. Saw Pipes Ltd*<sup>346</sup>, which, although was made in the context of a purely domestic award, was extended equally to both awards arising out of international commercial arbitrations as well as foreign awards leading to a wide misuse and weak regime of enforcement of foreign awards in India.

Another amendment has been proposed to section 28(3) solely to remove the basis for the decision of the Supreme Court in *Saw Pipes* case and in order that any contravention of a term of the contract by the tribunal should not *ipso jure* result in rendering the award becoming capable of being set aside.

Even though the Supreme Court in *Shri Lal Mahal v Progetto Grano Spa*<sup>347</sup>, has held that the expansive construction accorded to the term “public policy” in *Saw Pipes* cannot apply to the use of the same term “public policy of India” in section 48(2)(b), the recommendations of the Commission go a step further and are intended to ensure that the legitimacy of court intervention to address patent

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<sup>346</sup> (2003) 5 SCC 705

<sup>347</sup> (2014) 2 SCC 433

illegalities in purely domestic awards is directly recognized by the addition of section 34 (2A) to the Act and is distinguished from foreign awards.

In this context, the Commission has further recommended the restriction of the scope of “public policy” in both sections 34 and 48 to bring the definition in line with that propounded by the Supreme Court in *Renusagar Power Plant Co Ltd v General Electric Co*<sup>348</sup>, and the Commission has proposed a stricter provision whereby, an award can be set aside on public policy grounds *only* if it is opposed to the “fundamental policy of Indian law” or it is in conflict with “most basic notions of morality or justice”; whereby the reference to “interests of India” has been excluded to avoid the potential of interpretational misuse especially in the context of awards arising out of international commercial arbitrations. These amendments have been incorporated in the Amended Act and thus the scope of review to set aside an award has been made objective and narrower<sup>349</sup>.

The Amended Act is progressive on this much criticized issue of challenging of arbitral awards in India. Judicial pronouncements have over the years expanded the grounds for challenging an arbitral award under the term “public policy”. The amendments in Section 34 of the Act restrain the present wide interpretation in setting aside domestic arbitral awards. Scope of conflict with public policy has been narrowed down to an award being induced by fraud or corruption, in conflict with fundamental policy of Indian law and basic notions of morality or justice as proposed in the Law Commission Report.

The Amended Act on the lines of the Law Commission’s Report’s observations further clarifies that a test whether an award is in conflict with fundamental policy of Indian law will not entail a review on the merits of the dispute and thus limits the re-appreciation of merits of the dispute at this stage; a problem which was plaguing the Indian arbitration scenario. There is further clarification that even when a challenge is made and the court finds that the award is vitiated by patent illegality on the face of the award, this would not entitle the courts to set aside an award on the ground of erroneous application of law or by re-appreciation of evidence.

Another positive amendment is the necessity to give prior notice to the other party in case of a challenge under Section 34, thus eliminating the possibility of moving ex-parte and obtaining a stay. Finally the legislature has fixed a time frame of one year for Courts to expeditiously dispose of such

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<sup>348</sup> AIR 1994 SC 860

<sup>349</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

applications. Thus once again the legislative intent is made clear that the provisions under Section 34 for challenge of arbitral awards should be limited and even if there is a merit based challenge before the courts, the same shall not allow re-agitation of facts on merits and moreover the courts shall make endeavors to dispose these at the earliest.

The Amended Act has brought in similar changes in Sections 48 and 57 of the Act which are relevant to international commercial arbitration thus limiting the scope of challenge to foreign awards. Section 48 deals with the enforcement of awards under the New York Convention and Section 57 deals with enforcement of awards under the Geneva Convention.

Another welcome change in the Amended Act is that an application under Section 34 of the Act would not automatically effect a stay on the award and the courts shall while granting a stay shall have due regard as they would in the case of a money decree as per the provisions of the Code of Civil Procedure, 1908 which could also mean depositing of money by the unsuccessful party which has filed the challenge.

As per the provisions of Section 36 of the 1996 Act, the pendency of a section 34 (to set aside an arbitral award) petition renders an arbitral award unenforceable. The Supreme Court, in *National Aluminum Co. Ltd. v. Pressteel & Fabrications*<sup>350</sup>, held that by virtue of section 36, it was impermissible to pass an Order directing the losing party to deposit any part of the award into Court. The Bombay High Court in *Afcons Infrastructure Limited v. The Board of Trustees, Port of Mumbai*<sup>351</sup> applied the same principle to the powers of a Court under section 9 of the Act as well; thus confirming that an admission of a section 34 petition, therefore, virtually paralyzes the process for the winning party/award creditor. The Supreme Court in *National Aluminium Co Ltd's case* criticized the situation and observed that the practice of automatic suspension of the execution of the award, the moment an application challenging the said award is filed under section 34 of the Act leaving no discretion with the court to put the parties on terms, defeated the very objective of the alternate dispute resolution system to which arbitration belongs. To address this major problem, the Commission has recommended important amendments to section 36 of the Act, which provide that the award will not become unenforceable merely upon the making of an application under section 34<sup>352</sup>.

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<sup>350</sup> (2004) 1 SCC 540

<sup>351</sup> 2014 (1) Arb LR 512 (Bom)

<sup>352</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act, 1996

This is a much required amendment to the Act as unsuccessful parties in Indian arbitration over the last decade or so would merely file a challenge under section 34 and the award would be stayed as a matter of practice. Thus the successful party in spite of having a favorable award was unable to enforce the same. This amendment along with others under Section 34 will hopefully discourage and reduce the appeals and challenges of arbitral awards.

## **I. ARBITRABILITY OF FRAUD – A KEY ISSUE NOT ADDRESSED**

The Law Commission report addressed an often litigated issue of “arbitrability of fraud” which has seen conflicting and diverse judicial pronouncements; and recommended amendments in Section 16 of the Act to include a provision to state that the arbitral tribunal shall have the power to make an award or give a ruling notwithstanding that the dispute before it involves a serious question of law, complicated questions of fact or allegations of fraud, corruption etc. However the same was not included in the Ordinance and hence in the Amended Act proposing the amendments.

Some major pronouncements on this subject started with *Radhakrishnan v. Maestro Engineers*<sup>353</sup>, wherein the Supreme Court held that an issue of fraud is not arbitrable. This decision was based on the decision of the three judge bench of the Supreme Court in *Abdul Qadir v. Madhav Prabhakar*<sup>354</sup>. This was followed by the Supreme Court’s decision in *Bharat Rasiklal v. Gautam Rasiklal*<sup>355</sup>, wherein the Court observed that when fraud is of such a nature that it vitiates the arbitration agreement, it is for the Court to decide on the validity of the arbitration agreement by determining the issue of fraud.

There have in parallel been the more pro-arbitration line of judgments such as *Ivory Properties and Hotels Private Ltd v Nusli Neville Wadia*<sup>356</sup> and *CS Ravishankar v. CK Ravishankar*<sup>357</sup> wherein the Courts distinguished between a serious issue of fraud and a mere allegation of fraud and the former has been held to be not arbitrable. The Supreme Court in *Meguin GMBH v. Nandan Petrochem Ltd.*<sup>358</sup> proceeded ahead and appointed an arbitrator in a Section 11 application even though issues of fraud were involved. However the most recent judgment has been that of the Supreme Court in *Swiss*

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<sup>353</sup> 2010 1 SCC 72

<sup>354</sup> AIR 1962 SC 406

<sup>355</sup> (2012) 2 SCC 144

<sup>356</sup> 2011 (2) Arb LR 479 (Bom)

<sup>357</sup> 2011 (6) Kar LJ 417

<sup>358</sup> 2007 (5) R.A.J 239 (SC)

*Timing Ltd v Organising Committee*,<sup>359</sup> wherein it has been held that the law laid down in *Radhakrishnan v. Maestro Engineers* was not good law<sup>360</sup>.

While the Law Commission had recommended insertion of a subsection (7) in Section 16 to address the challenges relating to arbitrability of fraud often raised before tribunals by giving the tribunal express powers to make an award or give a ruling notwithstanding that the dispute before it involves allegations of fraud; the Amended Act has decided to skip the proposed amendment and thus leaving this issue open and unaddressed which will continue to have an adverse effect on arbitration proceedings as there have been conflicting judicial pronouncements in the past before the *Swiss Timing Ltd v Organising Committee* decision.

## CONCLUSION

The Commission had proposed to insert a new section 85-A to the Act, to clarify the scope of operation of each of the amendments with respect to pending arbitrations/proceedings. As a general rule, the Commission has suggested that the amendments will operate prospectively, except in certain cases as set out in section 85-A or otherwise set out in the amendment itself such as those with respect to Costs, second proviso in Section 24 with respect to conduct of prompt proceedings. However this section had not been incorporated in the Ordinance and there was some confusion and ambiguity over the prospective operability of some of the provisions especially those where judicial intervention is possible. A clarification on this has been provided by the Ministry of Law & Justice by inserting Section 25A to the Bill which clarifies that the amendments would not apply to arbitrations commenced before 23.10.2015 unless otherwise agreed to between the parties.

On an overall basis, the Amended Act has several progressive and required amendments. The Indian arbitration regime has been through phases of evolution and development wherein the law was first updated and brought on lines with UNCITRAL model law in 1996. However with court pronouncements and interpretations over the years including the amendments in the Model Law made in 2006, the system had been overwhelmed with several challenges which almost made the Indian arbitration scenario a ridiculed one or a laughing stock in the international arbitration community. The Amended Act and its amendments bring with them a sense of hope for all the stakeholders right from businesses/litigants/parties, counsels, arbitrators and an overall positive

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<sup>359</sup> Arbitration Petition No. 34/2013 dated 28.05.2014

<sup>360</sup> Law Commission of India, Report No.246, August, 2014 - Amendments to the Arbitration and Conciliation Act 1996

message to the international and domestic business community that the Indian Government is not just pro-arbitration but keen on an effective and efficient arbitration regime.

It would be pertinent to also highlight here that while legislative changes can only be starting point to improve the arbitration regime in India, attitude of various stakeholders is key and unless that also changes and moves progressively to bring it in line with international standards, the expected results would only remain a dream. Thus while the Government has done its part to bring in the reforms, it is now for us, the stakeholders to do our best keeping the spirit and legislative intent in mind and move India to a place of pride in the field of arbitration.

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6. Justice R S Bachawat, *Law of Arbitration & Conciliation*, (Fifth Edition, 2010), LexisNexis Butterworths Wadhwa
7. P C Markanda, *Law Relating to Arbitration & Conciliation* (Seventh Edition, 2009), LexisNexis Butterworths Wadhwa



## **PATH DEPENDENCE AND CORPORATE GOVERNANCE: THE INDIAN MODEL**

**IRENE ABRAHAM<sup>361</sup>**

### **1. INTRODUCTION**

To accommodate the essence of corporate governance in a single definition is a tedious task, owing to the lack of a universal framework that is widely accepted, and the voluminous literature available on the topic. Paul Wolfonitz, President of the World Bank was able to capture its crux when he described corporate governance as the “promotion of corporate fairness, transparency and accountability.”<sup>362</sup> This is an extensive yet inclusive description of corporate governance because the fundamental principle contained is to encourage corporate fairness that can be accounted for by promoting transparency in decision making and other functional aspects.

This paper is an attempt to trace the evolution of the existing corporate governance structure in India and determine the trajectory it has followed over the years. The paper evaluates the influence of path dependency in the corporate governance phenomenon in the country. Section 1 introduces the concepts of corporate governance and path dependency, both of which have its origin in western academic circles. Thus its evolution in India can only be understood if perceived from the western view point first. Thus, Section 2 deals with the evolution of the corporate governance in the west. The 2008 recession and its implications are looked into, followed by a detailed analysis of the Enron scam. It can be rightly assumed that the Enron scam brought out the necessity of having a strong corporate governance code for the first time. The WorldCom scam and the Parmalat scam in Italy are also addressed. Section 3 deals with the evolution of corporate governance in India. Gandhi’s trusteeship philosophy contained the essence of corporate governance though the structural framework was established only in the 1990s. Clause 49 of the Listing Agreement which serves as the most superior legal framework for corporate governance standards is examined in this section. The Harshad Mehta scam and the Satyam scam are analysed in detail and its path dependence on the regulation of the existing corporate governance code is also inspected. The Infosys example serves as an ideal example

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<sup>362</sup> K. Aggarwal, *Indian Corporate Laws*, First Edition, Galgotia Publications Pvt Ltd., 2006, Page 483

of corporate governance implementation. Infosys has also been inspected from the path dependency context to assign it as reference for subsequent regulatory frameworks.

### *1.1 Corporate Governance*

Globalization is on the rise and multinational companies whose functioning has spread across multiple continents need incredibly large working capital for its sustenance. At a time when banks are increasingly disappointing people with low interest rates and the angst of sudden recessions, joint stock companies are an appropriate setting for people to safely invest their funds in. The idea of corporate governance is to ensure this sense of security that people trust their investments with, especially when they don't have direct access to the direction making. Big companies need such investments to increase their capital and hence it is important for the stakeholders to know that their financial interests are secured in order to incentivize them to invest further. This objective of the corporate governance phenomena is to develop a functioning balance between the profit maximization goals and the interests of the stakeholders, internal and external by allowing transparency and accountability. Traditionally, corporations or companies were driven only by the incentive to maximize profits and minimize expenses incurred. And this traditional perspective only sought to protect the interests of the shareholders and prominent providers of capital. Then dawned the realization that the company requires the support of more than the shareholders, investor's insecurities, consumer's demands, worker's rights, and even environmental concerns had to be addressed in the long run. Thus there was a shift from the shareholder centric approach to one that was more inclusive of the stake holder's issues too<sup>363</sup>.

### *1.2 Path Dependency*

Path Dependency is an important concept both in economics and law, making it an indispensable concept in the law and economics discourse too. The economic understanding of path dependency is that equilibrium allocation in the present is always dependent on historical patterns. Neo classical theory of economics focused on the rationale that market forces attain equilibrium purely by rational means of market forces such as demand for the product, supply of the product, output pricing etc. It was based on an objective perspective where the ends were achieved only by looking at those external factors that had a direct influence on the achieved ends. Path dependence evolved as an

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<sup>363</sup>Jean Jacques du Plessis, James McConvill, MirkoBagaric, *Principles of Contemporary Corporate Governance*, First Edition, Cambridge University Press, 2005, Page 4

alternative to this neo-classical school of thought<sup>364</sup>. Path dependency addresses the circumstances in which the ends were achieved, it analyses the history of not just the ends but also the means through which the ends were achieved. It affords considerable significance to the history and evolution of a process or event or decision making. The concept of Path Dependence was developed by a Stanford economist by the name Brian Arthur. Its application on corporate institutions and the study of evolution of corporate governance based on path dependency was taken up by Michael Klausner and Marcel Kahan<sup>365</sup>. Path dependency argues that historical, ideological and behavioural settings matter because they set the path upon which institutions are formed<sup>366</sup>. Path dependence takes into consideration not only our present position, but also our past position while determining our future position. It is based on the underlying principle that history matters.

Path dependency derives its functionality from two sources. It can either be structure driven or rule driven. Corporate structures that exist today are borne after making modifications and innovations to structures that existed previously. Thus, the nature of the present structures is always dependant on the structures that existed when the economic system first emerged. This is what is known as structure driven form of path dependency. It gives these structures and identity and it gives those incentives and the power to impede the changes in them. Corporate rules which affect corporate structures are themselves dependant on corporate structures that existed when the economy was first established. Initial structures can affect existing structures and also the interest group politics that will determine the rules and the extent to which it is applicable.<sup>367</sup>

A legal analogy to the concept path dependency is the reference of precedents to adjudge present cases. The method of approaching precedential decisions and applying similar reasoning to present situations is the exact core principle of path dependency. Thus, it is evident that path dependency has considerable significance in the legal field too.<sup>368</sup>

In this paper, path dependency is observed from the perspective of the application of corporate governance principles in various corporate institutions in India. The period from 1992 to 2009

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<sup>364</sup>Ronald J. Mann, Curtis J. Milhaupt, *F.Hodge O' Neal Corporate and Securities Law Symposium: Path Dependence and Comparative Corporate Governance*, WASHINGTON UNIVERSITY LAW QUARTERLY, VOL 74, NO 2 (1996)

<sup>365</sup>*Id.*

<sup>366</sup> Marcel Kahan, Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, WASHINGTON UNIVERSITY LAW REVIEW, VOL 74, ISSUE NO 2, Jan (1996)

<sup>367</sup>Lucian AryeBebchuk, Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, STANFORD LAW REVIEW, NOV (1999)

<sup>368</sup>*Supra* Note[3]

witness the collapse of a number of corporate firms due to lack of sufficient corporate governance standards and its enforcement. Thus the regulatory authority takes this into consideration and crafts a corporate governance code with the intention of ensuring that all the corporate loopholes that were exploited previously are tightened and not subjugated in the future. This is the first instance of path dependency that is looked at.

Secondly, a case study of Infosys depicts how progressive its corporate governance structure is and the paper recommends that future codes be drafted with the Infosys code as the reference. Thus, the Infosys example of corporate governance implementation will serve as the path upon which future mechanisms can depend on. This is the second instance of path dependence in the paper.

## **2. THE EVOLUTION OF CORPORATE GOVERNANCE IN THE WEST**

### *2.1 2008 Recession*

The 2008 recession is often regarded as the most serious financial crisis of the global age after the Great Depression of the 1930s.<sup>369</sup>

The financial crisis that commenced by mid-2008 was an important indicator of the efficiency of the existing corporate governance structures. It was clear that the wall-street crisis was having a major impact on financial institutions and banks in many countries. Financial institutions in the US (e.g. Citibank, Merrill Lynch) and Europe (UBS, Credit Suisse, RBS, HBOS, Barclays, Fortis, Société Générale) were continuing to raise a significant volume of additional capital to finance, diluting in a number of cases existing shareholders' funds.<sup>370</sup> By the third quarter of 2008, many more companies collapsed and there was a generalized tumbling of the financial market and its constituents. Several banks failed and were unable to return the deposits to creditors and debtors, whereas some received government recapitalization depleting government funds. The global economic structure was severely scrambled. Towards the end of the year most investors and stakeholders had lost their confidence in the financial institutions. Thus, a demand was felt to have a steady and robust corporate governance structure in place to influence the people to once again invest their confidence and capital

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<sup>369</sup>Brian R Cheffins, *Did Corporate Governance 'Fail' during the 2008 Stock Market Meltdown? The Case of the S&P 50*, BUSINESS LAWYER, VOL.65, NO.1 (2009)

<sup>370</sup>Grant Kirkpatrick, *The Corporate Governance Lessons From the Financial Crisis*, FINANCIAL MARKETS TRENDS, VOL 1 (2009) Available at <http://www.oecd.org/finance/financial-markets/42229620.pdf> (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

in the economic market and ensure that there arise no more situations to abuse this trust. This is the most primal objective of having a corporate governance structure.

The post 2000 corporate environment relied heavily on corporate governance to ensure their continued sustenance in the market. Boards were expected to formulate clear and realistic strategies that were in accordance with the risk management efficiency of the company and to demand timely reports to evaluate the efficiency of the strategies that were implemented. Risk management and remuneration systems were also to be looked into and ensure that they comply with the company's objectives and risk appetite.<sup>371</sup> Many economists contemplate the financial crisis to have been a test to evaluate the functionality and efficiency of the existing corporate governance mechanisms. If the existing standards had the capacity to ensure that the firms were regulated with no loopholes for corruption or anti-competitiveness the crisis could have been managed effectively in most parts of the world. Unfortunately, the existing standards of corporate governance failed this test. The financial crisis could have been prevented or at least, its consequences minimized to a large extent, if there were stronger and more stringent corporate governance practices in place. Thus, the global financial crisis can be partly attributed to the failure and weakness of the existing corporate governance standards.

It is reasoned that the 2008 crisis can be attributed to the failure of corporate governance mechanisms for the following reasons.

- i. Risk management was not effectively conducted.
- ii. Remuneration and incentive system did not comply with long term interests
- iii. Unsatisfactory board practices
- iv. Lack of a universal accounting and regulatory scheme
- v. Lack of transparency

Efficient risk management structures require that all the information available internally and externally be considered to assess the risks that could be associated with the company in the future. These risks should be communicated to the board accurately without sugar-coating the possible defaults and drawbacks in a timely manner. Most of the times, companies falsify their reports on risk management and even financial statements to prevent the stakeholders and shareholders from comprehending the possible defaults in the near future. Prior to 2008, internal regulation and board regulation of the risk assessment and risk management was not effective. Even if the board accepted

and approved various strategies, they did not follow up to ensure that these strategies were being implemented at the grass root level. It is the duty of the board to oversee the risk management of the firm.

Remuneration and incentive systems have played a key role in influencing financial institutions sensitivity to shocks and causing the development of unsustainable balance sheet positions.<sup>372</sup> It is important that firms functions on a policy that discloses the factors on which remuneration scales are based on. Remuneration should be based on performance of the employee and should also comply with the firms risk appetite and its long term interests. Failure to ensure a healthy balance of remuneration and incentive system was another reason that led to corporate governance failure and the subsequent market failure in 2008. It is important that the remuneration package of the firm complies with the firm's long term goals and potential. Remuneration involves that of low level employees and high ranking executives and board members. Sometimes, the gratuity packages of exiting high ranking executives are not in sync with their performance. Such form of remuneration is synonymous with rewards for failure. Lack of universally accepted and recognized accounting system for valuation results in lack of adequate transparency and this result in misrepresented disclosure to shareholders.

This is how the lack of an effective corporate governance structure contributed to the collapse of the global markets in 2008. The United Nations Conference on Trade and Development published a report in the wake of the financial crisis which resonate similar views<sup>373</sup>. The report states that the failure of the financial market could partly be associated with that of poor corporate governance that is implicated through inferior risk management systems in most of the failed financial institutions. This consequence was descriptive narrated by Sahlman when he says<sup>374</sup>:

*"...many organizations suffered from a lethal combination of powerful, sometimes misguided incentives; inadequate control and risk management systems; misleading accounting; and, low quality human capital in terms of integrity and/or competence, all wrapped in a culture that failed to provide a sensible guide for managerial behaviour..."*

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<sup>372</sup>Grant Kirkpatrick, The Corporate Governance Lessons From the Financial Crisis, FINANCIAL MARKETS TRENDS, VOL 1 (2009) Available at <http://www.oecd.org/finance/financial-markets/42229620.pdf>

<sup>373</sup>Corporate Governance in the Wake of the Financial Crisis, United Nations Conference on Trade and Development. Available at [http://unctad.org/en/Docs/diaeed20102\\_en.pdf](http://unctad.org/en/Docs/diaeed20102_en.pdf) (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>374</sup> W.A Sahlman, *Management and the Financial Crisis (We Have Met the Enemy and He Is Us)*. Harvard Business School Working Paper No. 10-033. Available at: <http://www.hbs.edu/research/pdf/10-033.pdf> (Last accessed 07:00 AM 15<sup>th</sup> July 2015).

## 2.2 Enron Scam

Even though there existed certain elements and underlying principles of corporate governance and corporate social responsibility in various facets of Indian society and culture, corporate governance as it exists today is heavily borrowed from the west. Thus, it is necessary to understand the evolution of the corporate governance mechanism in the west particularly the United States to understand how the phenomenon by itself was born and how it expanded to the rest of the world.

Enron Corporation was an energy company founded in 1985 in Houston, Texas. Soon after, it developed into a leading company engaged in the dealing of electricity, natural gas, communication, pulp and paper, and had a strong international presence. Throughout the 1990s, Enron was vastly regarded as the most innovative company in the US with efficient risk management and regulative structures. Enron is an appropriate example to show that even a huge and powerful company can fall just as easily and quickly.

The Enron scandal is often regarded to be the largest bankruptcy in American history and is often cited to be the biggest audit failure too.<sup>375</sup> Along with Enron, its auditing firm, Arthur Anderson was also faced with corporate and criminal charges and was subsequently dissolved in a few years. Anderson failed in fulfilling its professional responsibilities towards Enron's financial statements and also failed to notify the board of directors of the conspiracy of which it had information of. Arthur Anderson was one of the five largest audit and accountancy partnerships in the world.<sup>376</sup>

Trouble began at Enron when its CEO Jeffrey Skilling convinced a few of his loyal executives to assist him in manoeuvring certain strange transactions that will enable them to utilize corporate loopholes, special purpose entities and poor financial reporting practices to falsify records and steal huge amounts of money from the accounts of failed projects and stash it away under the disguise of bad debts. Enron's Chief Financial Officer, Andrew Fastow was also a part of the scheme and he misled the Board of Directors from time to time and pressurized its auditing agency, Anderson to ignore these issues. However, the mishap was brought to public attention by October 2001. Shareholders slammed a \$40 billion law suit against Enron as soon as word got out. Main rival and competitor Dynegy offered to buy the company at a significantly low price. This deal did not break through. Finally, Enron filed for bankruptcy on Dec 2<sup>nd</sup>, 2001 under Chapter 11 of the United States Bankruptcy

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<sup>375</sup>William W. Bratton, *Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders? : Enron and the Dark Side of Shareholder Value*, TULANE LAW REVIEW, MAY 2002.

<sup>376</sup>Yuhao Li, *The Case Analysis of the Scandal of Enron*, INTERNATIONAL JOURNAL OF BUSINESS AND MANAGEMENT, VOL 5, NO. 10, OCTOBER 2010

Code. At the time, its assets were worth about \$63.4 billion making it the largest bankruptcy until then.

Enron's failure can also be attributed to various factors that could have been minimized or erased had it been for better corporate governance practices. Enron was involved in a broad range of illegal and illicit financial manoeuvres in order to enhance its financial reporting.<sup>377</sup> The Enron scam has immensely contributed to the reasons why there exists such a strict code of corporate governance today. The magnitude of the failure of Enron and the public deception it created is unmatched. Thus, it is very important that there exists effective systems to ensure that this is not repeated. The reasons leading to Enron's failure are enumerated below.

Enron did not have a practical system of remuneration for its employees. Theoretically, the system in place was intended to reward employees for the value that they bring to the firm. However, employees found this as an incentive to disregard qualitative expectations of cash flows to increase their short term employee ratings which has a direct effect on their performance review that in turn determines their bonuses. Thus, though on the surface it appeared that the employees were working progressively and bringing in profits, in fact the employees were not concerned whether the clients they approached were capable of fulfilling their obligations to work the cash flow cycle. Thus, the scheme of remuneration was unchecked and was damaging to the firm's long run interests<sup>378</sup>. Also, there came a point when the CEO believed that original thinking will be hampered if executives had to worry about costs. Thus, executive salaries were increased immoderately and by 1998, records showed that the amount spent on the salary, bonuses and stocks of the top 200 highest paid employees amounted to \$193 million. It rose to \$1.4 Billion in 2000<sup>379</sup>.

Enron's risk management systems were also heavily criticized. The Finance Committee and the Board of Directors lacked the required know how and expertise to fully comprehend the schemes and strategies that were brought to them by the management and executives. Thus, they didn't know what they were accepting and adopting all the time. Enron recklessly entered into numerous long term commitments without adequately considering the possibilities of fluctuations in the energy prices in the future. Thus it had to create a number of special purposes entities and derivatives to

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<sup>377</sup>David K. Millon, *Who Caused the Enron Debacle*, WASH AND LEE LAW REVIEW (2003) Accessible at: <http://scholarlycommons.law.wlu.edu/wlur/vol60/iss1/8>. (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>378</sup>Bala G. Dharan, William R. Bufkins, *Red Flags in Enron's Reporting of Revenues and Key Financial Measures*, SOCIAL SCIENCE RESEARCH NETWORK Accessible at : [www.ruf.rice.edu/~bala/files/dharan-bufkins\\_enron\\_red\\_flags.pdf](http://www.ruf.rice.edu/~bala/files/dharan-bufkins_enron_red_flags.pdf) (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>379</sup>Bethany Mclean, Peter Elkind, *The Smartest Guys in the Room*, First Edition, Portfolio Trade, 2003, Page 281



maintain a steady float in the market. This was a high risk move prone to easy failure because by this strategy Enron was now responsible for those risks associated with these transactions with the special purpose entities too. If the board of directors knew these implications, they would not have signed it forward<sup>380</sup>. Hence, the lack of expertise among board members is another reason that contributed to the failure of Enron.

Even though Enron was a public company, it had to subject itself to external sources of governance, market pressures, government regulations, private entity oversight etc. External governance standards require that once a long term contract was entered into, the amount at which the current assets will be sold in the future is assessed and shown in the current financial statements. Enron was known to manipulate these figures to forecast higher cash flows and low discount rates to attract investors. These projections were overly optimistic and inflated and inaccurate and ultimately led to its downfall.

Thus the Enron example teaches us that healthy corporate culture is important not just to maintain ethically strong principles but also for continued sustenance in the market. Defaults arising in a firm should be addressed in the correct manner as and when it arises and communicated to the board of directors immediately and accurately. Enron ensured that all their defaults were well hidden to save its reputation among shareholders. This finally led to its own destruction. The board of directors should exert better oversight and supervision of the management and implementation of schemes accepted by the board. Also, the constitution of the board should be undertaken carefully to ensure that it is filled in by directors who have sufficient knowledge about the market and expected market standards.<sup>381</sup>

### *2.3 WorldCom Scam*

Enron was the first in a series of corporate scams that highlighted the first half of the first decade of the 20<sup>th</sup> CE. It was followed by a number of declarations of bankruptcy by large corporates in different parts of the world. For the purpose of this paper, two such cases will be looked into.

WorldCom Inc. is a provider of long distance telephone communication services based in Mississippi. Around late 1990s, the Internet and its facilities were forecasted to boom exponentially and the telecom industry witnesses the entrance of many more competitors. Thus WorldCom saw a reduction

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<sup>380</sup>Robert Rosen, *Risk Management and Corporate Governance : The Case of Enron*, CONNECTICUT LAW REVIEW 35 (2003)

<sup>381</sup>David K. Millon, *Who Caused the Enron Debacle*, WASH AND LEE LAW REVIEW (2003) Accessible at: <http://scholarlycommons.law.wlu.edu/wlur/vol60/iss1/8> (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

in demand for telecom services but increased number of suppliers. The revenue generated fell short of expectations, number of impending bank debts were still on the rise, stock market value fell. In order to conceal this and save the reputation of the company, WorldCom engaged in certain fraudulent accounting practices. WorldCom filed for bankruptcy by 21<sup>st</sup> of July 2002 and confessed to overstating its earnings in 2001 and the first quarter of 2002 by more than 3.8 million dollars.<sup>382</sup>

#### *2.4 Parmalat in Europe*

The following year saw the bankruptcy of a major dairy firm based in Italy on the 24<sup>th</sup> of December, 2003. The Parmalat bankruptcy is often cited to be the European version of Enron. From 1990-2003, Parmalat borrowed millions of dollars from numerous banks worldwide such as Citigroup, JP Morgan, Deutsche Bank, Merrill Lynch, Morgan Stanley, Bank of America and many others. In early 2003, it failed to repay a 190 million bond that was due to Deutsche Bank. Upon inquiry, it was found that Parmalat had \$5.2 billion in its capital reserve in addition to the borrowed money. Parmalat was questioned as to why these reserves couldn't be utilized to pay back the debts. It was then found that these capital reserves shown in the financial statements did not actually exist and were fraudulent manipulation of accounting statements. The inquiry revealed a series of missing funds, complex off shore transactions, creation of special purpose entities, lack of internal control, corruption at the highest levels and fraudulent accounting that had gone unnoticed at Parmalat in the recent past. Parmalat survived as the symbol of the failure of corporate governance in Italy.

### **3. EVOLUTION OF CORPORATE GOVERNANCE IN INDIA**

Though Corporate Governance as a structured phenomenon was born only in the late 1990s, the essence has been in existence for longer than that and was fostered by The Company's Act 1956, Ministry of Company Affairs, Registrar of Companies, and SEBI<sup>383</sup>. The focal point of the Corporate Government structure is to protect the Stakeholders<sup>384</sup> – Investors, Customers, Employees, Government and Society at Large. In the Year 1998, the Confederation of Indian Industries (CII) published the first formal Regulatory Framework titled "Desirable Corporate Governance: A Code"<sup>385</sup>. The CII code contained a number of promising governance provisions. Few companies took up

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<sup>382</sup>Bob Lyke, CRS Report for Congress: The Accounting Scandal, Library of Congress Available at: [http://www.law.umaryland.edu/marshall/crsreports/crsdocuments/RS21253\\_08292002.pdf](http://www.law.umaryland.edu/marshall/crsreports/crsdocuments/RS21253_08292002.pdf) (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>383</sup>*Supra* Note [1] at 482

<sup>384</sup>*Id.*

<sup>385</sup>*Id.*

voluntary steps to implement these and various others didn't. However, it proved to be a positive step towards achieving a healthy and stable corporate environment in the country<sup>386</sup>. The CII Code was followed by the Kumarmangalam Birla Committee on Corporate Governance that came out in 1999. In 2002, the Naresh Chandra Committee Report on Corporate Audit and Governance was published. The Narayana Murthy Committee on Corporate Governance Report was constituted in the year 2003. The committee came out with its report in the year 2004.<sup>387</sup> The year 2004 is an important one in the evolution of the corporate governance structure in India because the National Foundation for Corporate governance, the first formal institution set up to oversee the state of corporate governance in the country was established<sup>388</sup>.

### *3.1 Gandhi Model of Trusteeship*

Even though Corporate Governance is still fresh of its western influence and in its nascent stages in India, the spirit of the phenomena has been in existence for a very long time. Gandhi's socialistic principle of "trusteeship" holds various underlying principles that are similar to the objectives of corporate governance. The concept of "trusteeship" was intended to serve as a philosophical foundation for business and provide a requisite moral guidance in the corporate market. The concept of "trusteeship" was intended to reduce the disparity between the rich and the poor. The wealthy in the society were expected to act as trustees for those portions of their wealth that were in excess and not being used by them. This portion should be held by the wealthy in his trust for the benefit of those who are poor and less fortunate. The idea was not to distribute wealth equally among everyone in the society. It was to ensure that everyone has a share of wealth proportional to their needs<sup>389</sup>.

Gandhi's philosophy of trusteeship is a very theoretical concept. It expects the wealthy to bear in mind the benevolence of the poor when involved in decision making. The pattern of wealth distribution, policies, procedures of corporate organization etc. need not be altered to implement trusteeship model. The only requirement is that the decision makers bear in mind that their decisions should be for the best interest of the society at large.

### *3.2 Clause 49 of the Listing Agreement*

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<sup>386</sup>AfraAfsharipour, *A Brief Overview of Corporate Governance Reforms in India*, DIRECTOR NOTES- THE CONFERENCE BOARD, No DN – 020, Dec (2010)

<sup>387</sup>*Supra* Note[1] at 486

<sup>388</sup> *Id.*

<sup>389</sup>C. Gopinath, *Trusteeship as a Moral Foundation for Business*, BUSINESS AND SOCIETY REVIEW 110 (3) Pp 331-334

The existing corporate governance framework in India is laid down under Clause 49 of the listing agreement that is contained in the guidelines issued by SEBI after constituting a Committee on Corporate Governance headed by R. Narayana Murthy.<sup>390</sup> Initially, Clause 49 came into operation in 2005. However, following the Satyam scandal, the provisions of the Clause were modified to lock existing loopholes that were known to be exploited by corporate and the amended Clause 49 came into force in 2010. A listing agreement is drafted by a stock exchange with a public company for whose shares the stock exchange has approved and given permission to be listed with it. The listing agreement should comply with the guidelines issued by SEBI. Clause 49 deals with a number of elements that are of supreme importance when it comes to enforcing corporate governance in India. These are enumerated below.<sup>391</sup>

1. Board of Directors: - There should be a balanced constitution of executive and non-executive directors. An executive director is one who is involved in the functioning of the company. A non-executive director is not involved in the day to day working of the company and is only entrusted with the task of corporate decision making on behalf of the company. An independent director would always be a non-executive director and is responsible for taking corporate decisions in an independent fashion with no personal or financial bias.
2. Audit Committee: - The Audit Committee shall have at least minimum three directors as members, two thirds of which shall consist of independent directors. All members are expected to be financially literate and at least one member should possess sufficient expertise in accounting and financial management.
3. Remuneration of Directors: - If the company desires to allocate stock options to non-executive directors, there should be in place a resolution dictating this and having already prescribed the maximum stock option that can be allocated to non-executive directors. Compensation of non-executive directors should always follow prior consent of the Board and the shareholders of the company.
4. Board Procedures: - There should be a periodic review of all recent and relevant laws issued that is pertinent to the functioning of the company. If there is noncompliance with any such law, the Board should be notified and appropriate steps should be taken immediately to rectify the non-compliance.
5. Management: - Periodic disclosures relating to material financial and commercial transactions should be made to the board. The senior management should also inform the board if there is a

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<sup>390</sup> SEBI guidelines on Corporate Governance Available at <http://www.sebi.gov.in/commreport/clause49.html> (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>391</sup> *Supra* Note [1] at 486

personal interest on behalf of any of the board members or the top executives that may have a potential conflict with the interest of the company at large.

6. Shareholders: - The shareholders should be given periodic updates about any new appointments or changes in the board. A Shareholders Grievances Committee headed by a non-executive director should also be constituted to ensure that all of the investor's grievances are adequately considered.

7. Miscellaneous Provisions: - If there is any deviation from the regular accounting practices that is prescribed, then this should be disclosed in the financial statements, along with the explanation as to why this deviation was adopted. The shareholding details on non-executive directors should be disclosed and made available on the company's website.

These are the existing laws that regulate the corporate governance structure in India. Before analysing its efficacy it is important to go through some of the most corporate scams in India and determine how corporate governance has evolved until this point.

### *3.3 Harshad Mehta Scam*

Harshad Mehta was a stockbroker who was involved in a major stock market scam in April 1992. It can be rightly argued that it is the Harshad Mehta scam that rang the bells for a strict and well-structured corporate governance framework in India. Harshad Mehta used Ready Forward (RF) deals to squeeze some capital from the banking system and invested it in his stocks to increase its value. This went unnoticed for years after a point at which it was brought to public attention and Mehta was slammed against with a number of suits.<sup>392</sup>

The next important downfall in the corporate market was the Ketan Parekh scam in which Parekh rigged the value of a number of stocks to abnormally high prices which was brought to public attention in a while when the stock market crashed abruptly in 2000.

The Harshad Mehta scam and the Ketan Parekh Scam are important events in the history of the corporate markets in India because these two downfalls played an important role in the development and regulation of corporate governance in India.

### *3.4 Satyam Scandal*

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<sup>392</sup>Rujitha TR, *Challenges to Corporate Governance: Issues and Concerns*, INTERNATIONAL JOURNAL OF MARKETING, FINANCIAL SERVICES AND MANAGEMENT RESEARCH, VOL 1, ISSUE 12, DECEMBER 2012

The Satyam scandal broke out in January 2009. In 2005, Satyam was ranked third in a Corporate Governance Survey by Global Institutional Investors.<sup>393</sup> Thus, it can be observed that even with appreciable corporate governance principles the fraudulent behaviour of individuals who caused the mishap couldn't be detected and stopped. This either indicates the lack of competence of the existing corporate governance structure, or the lack of its implementation or that there exists loopholes that are not yet brought within the purview of existing corporate governance mechanisms.

Satyam Computer Services was a publicly traded company listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) in India.<sup>394</sup> For years, Mr. Ramalingam Raju had been misappropriating financial statements to secure portions of the firm's capital for his own personal utilization. Over time, this created an obvious gap in the balance sheets and the 2008 recession worsened things for Raju. In order to cover the gap in the balance sheets, he manoeuvred a sale transaction between Satyam and two other corporate entities Maytas Infra Limited and Maytas Properties Limited, of which the Ramalingam family owned 30% of its shares<sup>395</sup>. The efforts for this transaction became futile as it was opposed to by shareholders and investors and there was an immediate drop in the value of Satyam shares in the stock markets. As a final attempt to cover his tracks, Raju created records of fictitious projects that Satyam had undertaken with fictitious clients. Thus, there showed an increase in the Sales but the Cash register showed no change. Also, there were records of ghost employees working on these projects. Thus, Satyam had to remunerate these employees which again created a gap in the balance sheets because cash was debited from Satyam funds without being debited to employee accounts. Thus, he overstated company revenue and declared cash holdings of approximately \$1.04 billion that did not exist anywhere.<sup>396</sup> Finally, in January 2009, He came out to the public and confessed of the fraud.

It is astonishing that Satyam auditors were able to sign off on its financial statements even after being required to adhere to standards prescribed by the Sarbanes-Oxley reforms.

### *3.5 Path Dependency in the Indian Context*

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<sup>393</sup>Sudhakar V. Balachandran, *Satyam Scandal*, FORBES Available at: [http://www.forbes.com/2009/01/07/satyam-raju-governance-oped-cx\\_sb\\_0107balachandran.html](http://www.forbes.com/2009/01/07/satyam-raju-governance-oped-cx_sb_0107balachandran.html) (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>394</sup>*Supra* Note [25]

<sup>395</sup>*Id.*

<sup>396</sup>*Supra* Note[32]

Following the Satyam scandal, there was a massive upheaval of the corporate governance structure in India. The present corporate governance structure in India is path dependant on the events surrounding the three major corporate scams that shook the faith of the Indian investors in the capital markets. In the case of Satyam, the independent directors on the board failed to stop the curb the proposal of buying the Maytas companies even with the possession of the knowledge that Mr Raju, a promoter owned up to 8% of the stocks and other institutional investors jointly owned around 45% of it. Thus, it is evident that these independent directors were in fact not acting independently and their decision making was influenced and biased. This is an instance of corporate governance failure. The independent directors hold the responsibility of ensuring that the decisions they make are unbiased and in the interest of the investors and stakeholders. The revised Clause 49 of the listing agreement has sought to achieve this independence for the independent directors. The Companies Act, 1956 was repealed and replaced by the Companies Act, 2013 that extended the mandates placed on independent directors of listed companies to those of other companies too. Thus, this is an example of how the regulatory authority depended on the historical trajectory of the lack of independence of the independent directors on the Satyam board to improvise the present framework<sup>397</sup>.

The Ministry of Corporate Affairs came out with certain guidelines in 2009 that was focused on detailing the importance of the independence of directors, financial obligations and responsibilities of auditors, need for a separation of the powers of the CEO and Chairman to ensure checks and balances, and limitations on the number of companies of which a person can serve as the director at once.<sup>398</sup>

Though the Companies Act, 2013 was already pending in the legislature before the Satyam scandal, numbers of provisions were included to strengthen corporate governance measures following the scam. The Act mandates that the role of the Auditor should be filled in by someone whose job profile is restricted to that of auditing and nothing else. He cannot function as a consultant or as promoter or as an executive as that would lead to a conflict of interests. He should remain as an auditor to the firm alone and cannot occupy any other position. At least one-third of the board should be constituted

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<sup>397</sup>Manpreet Kaur, *Corporate Governance in India: Case Study of Satyam*, INDIAN JOURNAL OF RESEARCH Vol No 2, Issue no 11 Nov (2013). Available at: [http://theglobaljournals.com/paripex/file.php?val=November\\_2013\\_1384850560\\_f4a34\\_08.pdf](http://theglobaljournals.com/paripex/file.php?val=November_2013_1384850560_f4a34_08.pdf) (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

<sup>398</sup>*Corporate Governance Voluntary Guidelines 2009*, Ministry of Corporate Affairs, Government of India,. Available at: [http://www.mca.gov.in/Ministry/latestnews/CG\\_Voluntary\\_Guidelines\\_2009\\_24dec2009.pdf](http://www.mca.gov.in/Ministry/latestnews/CG_Voluntary_Guidelines_2009_24dec2009.pdf) (Last accessed 07:00 AM 15<sup>th</sup> July 2015)

of independent directors and independent directors are barred from receiving stock options as remuneration. Additional provisions for disclosure were also enacted. Board of directors will also be subjected to a performance evaluation hereafter. The Registrar of Companies have to be mandatorily notified if there are any changes in the shareholding positions of the promoters and the top ten shareholders. Shareholders can now file class action suits against the company and its auditors.<sup>399</sup>

### *3.6 Infosys Example*

Infosys is lauded worldwide as a pioneer of corporate governance practices.<sup>400</sup> It was the first company to receive the National Award for Excellence in Corporate Governance in 2000. Infosys is recognized as a golden example in the corporate markets as a company that has gone an extra mile to ensure that it has taken adequate steps to ensure that all its functionalities and workings are within the prescribed corporate governance code of the country. Infosys was audited for corporate governance by Investment Information and Credit Rating Agency, and also by Credit Rating Information Services of India Ltd. It was also accredited with Corporate Governance Rating 1, and Governance and Value Creation Level 1. Infosys complies with the principle of “when in doubt, disclose”. This is a sound proof method of maintaining transparency and full disclosure. The Annual Report of Infosys descriptively narrates all the corporate governance related steps that the firm has undertaken to ensure full accountability and transparency. The firm also embodies a trusteeship model of possession wherein, the management acts as the trustees of the shareholder’s capital and not as its owner. This indicates the respect attributed to shareholders and their investments and the concern for their protection that is enforced by the firm. This is an example of healthy corporate governance practice. The firm has declared that it strives to satisfy the spirit of the law and not just the letter of the law.<sup>401</sup>

The firm complies with a number guidelines and codes issued with respect to corporate governance both nationally, and internationally. At the international level, it complies with the Euro shareholders Corporate Governance Guidelines, 2000, Recommendations of Conference Board Commission on Public Trusts and Private Enterprises in the United States, and the United Nations Global Compact Program. It also complies with the OECD principles on corporate governance that was first released

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<sup>399</sup> The Companies Act , 2013

<sup>400</sup>Tarun Khanna and Krishna G Palepu, *Globalization and convergence in corporate governance: evidence from Infosys and the Indian software industry*, JOURNAL OF INTERNATIONAL BUSINESS STUDIES, 35, NOV (2004)

<sup>401</sup>Infosys Annual Report 2014-2015, Accessible at: <http://www.infosys.com/investors/reports-filings/annual-report/annual/Documents/infosys-AR-15.pdf> (Last accessed 07:00 AM 15<sup>th</sup> July 2015)



in 1998 but revised in 2014. Nationally, it complies with the guidelines of the Narayana Murthy Committee on Corporate Governance constituted by SEBI.<sup>402</sup>

The Infosys Annual Report discloses the remuneration schemes of all its directors; promoters, independent directors and whole time directors. It contains information about their salaries, commission, stock options and the number of equity shares held by them. Attendance of directors during board meetings is also given. Seven out of its ten board members are independent directors going one step ahead of the existing mandatory requirement concerning the proportion of independent directors in a board.

Infosys is acclaimed to be a revolutionary institution when it comes to adhering to corporate governance principles are thus obvious. In addition to its compliance with nationally issued guidelines and statutory provisions, it adheres to international principles. It has also gone ahead of these guidelines to improvise corporate governance standards on its own.

The Infosys example is a satisfying one after the three scandalous scams that arose in the 2000s. Thus the future of corporate governance in India should be path dependent on the Infosys example. The mechanism with which Infosys has implemented the various mandates should be analysed and prescribed in laws so that other corporate institutions can also benefit from the model. The principle of path dependency lies in determining the future course of action dependent on the past course of action. Thus, in this regard, if the future course of action in the field of corporate governance is dependent on the Infosys example, it will serve the welfare interests of the society at large.

#### **4. CONCLUSION**

India is progressing on the right track in terms of corporate governance standards. However, there exists scope for improvement in terms of implementation and enforcement. Infosys is an extraordinary example of a company that has taken voluntary steps to include corporate governance mechanisms in its regular functioning. Other corporations require constant pressure and oversight in achieving the same standard. The onus is on the government to ensure that the codes of corporate governance standards are adhered to by one and all. The continued functioning of the capital markets is necessary for the well-being of the economy as a whole. Thus it is up to the government to ensure that the investors' trust and confidence in the equity markets are not disposed of recklessly. The interests of the shareholders have to be well maintained as the corporate cannot exist otherwise.

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<sup>402</sup>*Supra* Note [40]

While devising future mechanisms for corporate governance structures, reliance should be placed on previous examples. Negative examples like the Satyam scam and Harshad Mehta scam should be relied on to devise severe measures to ensure that these are not repeated again and positive examples such as Infosys should be relied on to seek better modes of implementation.

## RECRUITMENT: FINDING THE RIGHT PERSON FOR THE RIGHT JOB

MS. NAMRATA SHAH<sup>403</sup>

### ABSTRACT

*"Great vision without great people is irrelevant."* <sup>404</sup>

An optimistic process of searching for potential employees and encouraging them to apply for the jobs in an organisation is termed as recruitment. A high number of applications for a vacant position aids in filtering candidates so as to select an impeccable candidate.

Recruitment has to be timely and cost effective. The result of a good recruitment process has to be appointment of a best-qualified candidate (from within or outside of an organization) for a job opening, in a timely and cost effective manner. There are various stages in recruitment process like examining the requirements of a job, attracting applications for the available position, screening and selecting applicants, hiring, and introducing the new employee to the organizational system. According to Edwin B. Flippo, "Recruitment is the process of searching the candidates for employment and stimulating them to apply for jobs in the organisation"<sup>405</sup>.

The chronological cycle of recruitment involves and connects employers with job seekers. When reaching out for meeting the manpower requirements of an organisation both in their quantitative and qualitative aspects by attracting and confirming a supply of qualified personnel and selection of requisite manpower is the crux of recruitment. An effective recruitment and selection process reduces turnover. These practices match up the right person with the right job position. These also ensure that the right candidate is employed who is reliable and carries out the planned objectives for providing quality goods and services to the customer.

*Keywords:* Recruitment, selection, job, employment .

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<sup>404</sup> [http://www.chalre.com/hiring\\_managers/recruiting\\_quotes.htm](http://www.chalre.com/hiring_managers/recruiting_quotes.htm)

<sup>405</sup> Principles of Management & Administration By D. Chandra Bose (February 29, 2004)

## **INTRODUCTION**

The method of identifying the requirement for employment, describing the requirements of the job and the position holder, publicising the position and deciding on the most suitable person for the work is recruitment and selection. A business requires time to train new recruits to fill vacant positions or to meet skill shortages and also train existing employees to take new responsibilities; workforce planning allows a business the time to meet its future demands of staffing. Undertaking this course is one of the main points of management. The quality of employees determines the success of any organisation. Organisations must ensure they recruit employees that possess the correct skill and can add value to the business at a fair compensation that will not only reduce cost, retain existing employees but also attract new candidates. Personnel should hence be wisely selected, managed and retained, just like any other resource.

For any business, recruitment is an essential exercise and is very effective and pays well if done systematically. Recruiting staff is a very costly exercise. Every organisation needs to choose the right people for the job, train them well and treat them appropriately. If that's achieved then people not only produce good results but also tend to stay with the organisation longer. In such situations, the organisation's primary and continuing investment in them is well paid off. Right people are the key for organisational success coupled with all of the latest technology and the best physical resources.

## **IMPORTANCE OF RECRUITMENT**

There have to be choices of prospective deserving candidates for the management of the organisation to select from. This is done by recruitment which is preceding step to selection. Acceleration of an effective selection process is a key element of recruitment.

Attracting job applications of talented candidates is usually a key element in the recruitment process of an organization. This is put forth in a way that it motivates the maximum number of people to apply for the job. Best talent is attracted by designing and advertising a lucrative job description. This talent pool is then inspected so as to select one who fits best for employment.

Recruitment is an on-going activity. For the future human resources needs, Pro-active businesses attempt to develop a pool of competent applicants even though specific openings do not

exist. It's the manager that has to sight an anticipated vacancy or a regular exit and initiate the recruitment process by making a requisition request.

The present and future requirements of the business have to form the basis when planning for a recruitment process. The process has to be analysed from time to time. This analysis helps the HR department recruit the right person for the right job. There are times when recruitment takes place internally from the available talent pool within the business.

The traditional recruitment concept treats all job vacancies equally no matter the position or the severity or urgency of the vacant position. There is a need for a shift from the traditional concept of hiring equally to one that prioritizes each vacancy depending on criticality. A seamless equilibrium of workforce and work is essential to be retained in a company. The cost of hiring a candidate not suitable for the job or a deserving candidate that leaves the job can be costly for a business. Therefore, a job recruiter needs to ensure that only the most skilful and competent people should be selected for the jobs at a price the business can afford.

## **RECRUITMENT CYCLE**

A candidate with a mix of professional and social skills, depending on the requirement of the position, could be an asset for an organisation and should be looked for when analysing the candidate. The Job description has to be realistic and precise so as to make sure to the right candidate with the right attitude is chosen. Recruitment process involves a lot of money, time, efforts and resources starting from identification of potential candidates to training a new recruit. An ineffective recruitment process might result in imbalance or chaos in the project and loss of investment in the employee by the business. Every organisation has a recruitment policy which is a guideline on how the organisational recruitment and selection process must be practiced.

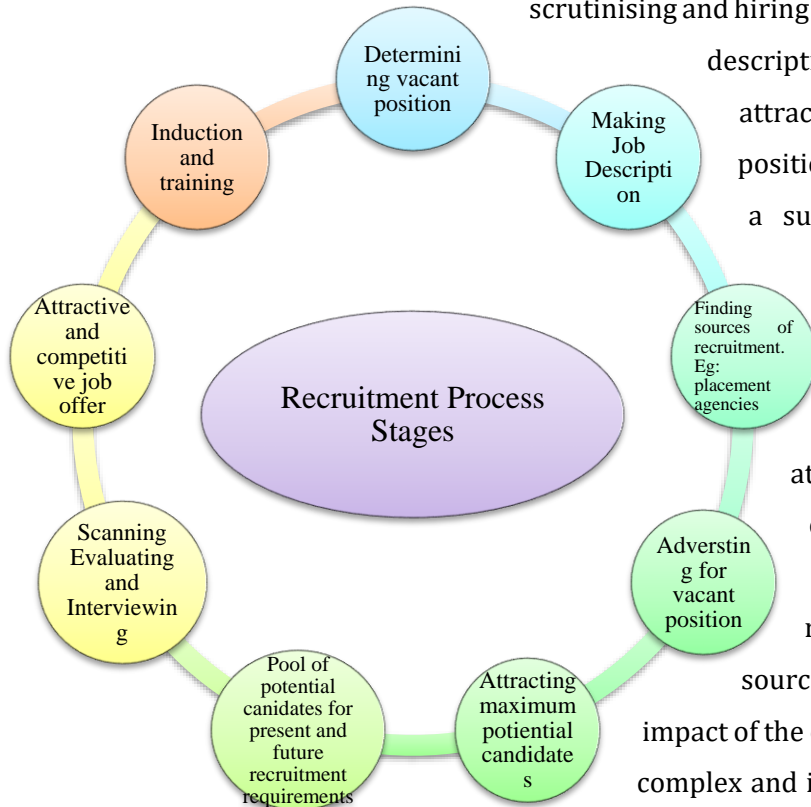
Dale Yoder, describes recruitment as the process to “discover the sources of manpower to meet the requirements of the staffing schedule and to employ effective measures for attracting that manpower in adequate numbers to facilitate effective selection of an efficient working force.”<sup>406</sup> The organisational values, philosophy and goals are aimed to be achieved by an unbiased and transparent

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<sup>406</sup>Recruitment: Meaning, Definition and Factors Affecting Recruitment, -  
<http://www.yourarticlelibrary.com/recruitment/recruitment-meaning-definition-and-factors-affecting-recruitment/35264/>

recruitment policy. Such a recruitment policy results in employment of the best applicant based solely on merit and best-fit principles.

The recruitment process is a value added human resource process which involves attracting, scrutinising and hiring new employees. This includes having a job



description, advertising for the position so as to attract candidates to apply for the vacant position and offering a competitive package for a successful new recruit. The recruitment

strategy of the organisation governs the recruitment process. HR of an organisation has to have a good reputation in the job market so as to

attract more applications. Satisfied employees are the best measure of a well operating organisation, weather recruited through external or internal

sources. A satisfied employee leaves a good impact of the organisation in the market. Recruitment is complex and involves a lot of processes hence its quite

difficult to define recruitment in simple terms.

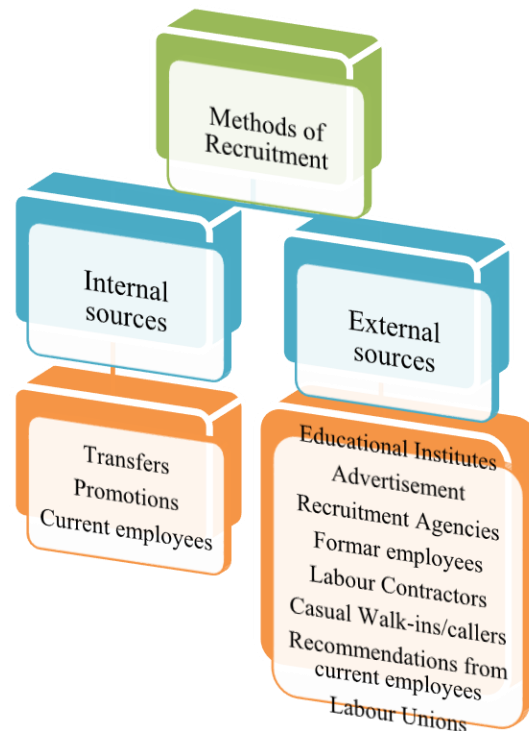
An effective operating organisation is identified by an effective recruitment and selection process. The decisions made in recruitment are important for obtaining the best possible person-to-job fit. For new recruits, the inclination to learn, adapt and capability to work as a part of a team is very essential as the company progresses and changes. Organisations can build a competitive advantage with a good recruitment process. Recruitment enriches and helps build a learning organisation. Identifying the right profile for the job is the responsibility of a HR recruiter. Hence, it is essential for organisations to have a skilled HR manager. With the right profile candidate for the job, internal recruitments and promotions from within it becomes much easier for the HR department to fill vacant positions within the organisation.

Recruitment Process Passes through the Following Stages:

## METHODS OF RECRUITMENT

Organisational growth depends essentially on a strong recruitment process. Finding and sourcing quality profiles for the organisation is a part of recruitment. It includes seeking profiles that are precisely apt for the role.

Organisations should have access to an available pool of talent at a single place and time during recruitment. Having a pool of worthy talent provides an organisation with abundant choice so as to select the best fit for existing or future use. Organisations can even assemble and use this information of available talent on a later date rather than striving to find the right one at the last minute.



## IN HOUSE/INTERNAL RECRUITING

Recruiting from within the organisation is internal recruitment. The method of internal recruitment is gaining popularity to move employees vertically or laterally within the organisation as it is cost effective and requires little or no training. It also nurtures faithfulness and equality amid team members. Although very effective, internal method of recruitment has its limitations and cannot be used to fill every vacancy within an organisation.

A new or recently vacated position within an organisation is advertised to existing employees as a means of internal recruitment. Internal recruitment concerns current employees while deciding on an available position. Better development and utilization of existing human resources in the organisation is provided through this method of recruitment.

### **EXTERNAL RECRUITING**

Diverse techniques are used to bring potential candidates from outside the organisation. Different candidates with dissimilar experiences in work are brought forward in this method. In case of special work-specific technical skills that cannot be filled internally by current employees, external sourcing method is used. Before advertising for an available position HR should know exactly what are the requirements of the job to choose the most suitable candidate. External sources of recruitment involve investing more time and money.

External source of recruitment comprises employing candidates externally for improved performance. External employees always are self-motivated, enthusiastic, are more innovative for new job position in new organisation, they work more actively to find business complications and fix it. External Recruitment is tougher and costlier but has a positive and progressive effect on organisation.

### **RECRUITMENT MISTAKES**

One of the most crucial parts of any organisation is recruitment of personnel. However, due to the nature of the work it may get monotonous at times. The key is to not lose focus, as mistakes can cause an employer both time and money; on the other hand to someone else it may be their bread and butter (their job). Companies need to encourage out of box thinking and training for key recruitment personnel on a regular basis; as doing the same task over and over can lead to boredom and de motivation resulting into an ineffective recruitment process. Some blunders that need to be watched for are:

- ✓ Placing an Ambiguous Ad in the Local Paper – This will give a very limited pool of candidates that fit in the job criteria. This may also target only the most desperate candidates.



- ✓ Encouraging over qualified candidates to apply – During desperate times any individual will take any given job at hand, however; within short time there will be a feeling of dissatisfaction in the employee and therefore not a long term solution for the organisation
- ✓ Participating in low-cost and unrelated recruitment fairs and events is akin to sticking to shallow waters as it won't achieve the desired purpose.
- ✓ Keeping the Candidate waiting for an update on possible short listing, poor follow ups – It is as much HR need as it is for the candidate. Mutual respect is very important
- ✓ Not looking in-house for talent – Yes it saves time and money, moreover; this (internal advancement) can be the best way to motivate in-house employees.
- ✓ Not involving key personnel in interview process – Departmental managers know their department and their business requirements the best.
- ✓ Snap judgement – Following the process with appropriate reasoning even if it is time consuming gives better results.
- ✓ Highlight Unrealistic Expectations – Job description should be genuine
- ✓ Looking for a clone - Expecting an exact identical individual may result in ignoring factors like creativity, potential and innovation.
- ✓ Not briefing the candidate about the company work culture and Job requirements – Induction is of utmost importance
- ✓ Unrealistic or No Recruitment strategies – Both long and short term plans have to be executed as per the business type.
- ✓ Relying on just one source repeatedly– Different sources have to be looked at for best recruitment results
- ✓ Desperation recruitment – Just recruiting someone due to urgency might result in low efficiency and attrition.
- ✓ Omitting Reference checks – Reference checks avoid any ambiguous spaces. It is always best to have everything clear and in inscription.
- ✓ Too much negotiation – Hagglng might be considered a healthy practice. Over doing it might result in de-motivation.

## CONCLUSION

The most profound HR process is recruitment. Recruitment methods have to be adapted as per changes in the job market. Organisations have to be flexible and innovative in order to learn and maximise timely. Recruitment has to be made smart. The company has to work on market image and goodwill in order to survive in the market and win the best talents for itself.

Recruitment policy should be established on definite values that ensure fair dealing and growing the probabilities of acquiring the best potential people for the organisation. The foundation of these principles should be equal conduct for all, selection according to merit, moral judgement making, procedural impartiality, and respect for diversity.

Recruitment can form the key element in organisational success. It gives organisation a competitive advantage in the market. The organisation has to choose the correct sources, methods to reach the right target group. The better the recruitment, the better the organisation's bottom-line such as productivity and financial performance and the higher the rate of satisfied employees resulting in increased goodwill of the organisation. Therefore, capitalising and investing in the process of a comprehensive and effective recruitment is the right strategy.

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## **ANALYSIS OF SECTION 34 OF THE ARBITRATION AND CONCILIATION ACT - SETTING ASIDE OF ARBITRAL AWARDS FOR GOOD GOVERNANCE**

**JUHI MATANI, ANSHUMAN KUMAR<sup>408</sup>**

### **ABSTRACT**

Mere good Governance is always superior to the good Government. For the promotion of society, the rule of Law and fundamental human rights, right to legitimate and accountable government are respected, which ensure a socially and economically equitable society and all are inherent with the concept of good governance. Good governance always depends upon its sovereign functions and it has to discharge many constitutional obligations and with this discharge of obligation, good governance is capable of deploying and enhancing the power of the State for the sustainable human development. It not only strengthens the institutions of Government but also civil society with the object of making governments more accountable, open and transparent as well as democratic and participatory.

In the new economic era, the boundaries of the nations are becoming redundant in the business world. The motive and goal of today's good governance is the allowing of free trade and commerce in the global world. As there has been increase in the trade and commerce, the number of commercial disputes is at peak. It is preferably an informal way, having speedy, cost effective and fair settlement of the disputes. It has now become the leader amongst the developing nations. Arbitration has now become the major instrument for the settlement of contractual obligations. Normally every commercial agreement contains an arbitration clause for the settlement of a disputes if arises. Alternative Dispute Resolution process enhances and preserves the personal and business relationships which might otherwise be damaged by the adversarial process. Arbitration process helps in resolving most of the domestic commercial disputes and it's a better regular legal process for all parties. The international arbitration cases can be better handled by the Arbitration process. As India has become a venue for the international arbitration cases because of which our law requires

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few interpretation. As there is always delay in the normal court proceedings, arbitration has undue advantage over it.

*Arbitration & Setting Aside: This paper discusses in detail Section 34 of the Arbitration and Conciliation Act, 1996, and tries to understand the basic object behind the interference of the court with the arbitration process since it is something that must have been discouraged and then there would be an end of the independence of the arbitration. The paper also deals with the finality of arbitral awards and also give gives direction that in what cases it may set aside as in cases of public policy.*

### **INTRODUCTION:**

From the beginning, India has been an arbitration friendly country, as arbitration was practiced even before the codified law came into force. The leaders of the communities and the elders of the families use to act as arbitrators in the pre-court period and also people use to obey the decision of those arbitrators. Only the interference of courts has been substantial and excessive, otherwise arbitration system is not new to India. The most effective step was to bring Arbitration Act, 1940, a comprehensive law covering all important aspects of arbitration. This Act also provides provisions, that the court can interfere into arbitration matters before and after the arbitral awards are passed.

The United Nations Commission on International Trade Law (UNCITRAL), a subsidiary body of the General assembly, in the year 1985, brought a model Arbitration law. This law is popularly known as UNCITRAL model law on International Commercial Arbitration which helped many countries to make improvements in their arbitration systems. The basic objective of the model was to convince the member states to adopt a uniform International Arbitration Law which further help the International Trade and Business in a wider way and it also helps the member states to have a proper uniform domestic arbitration law.

In the year 1985, the United Nations Commission on International Trade Law (UNCITRAL), a subsidiary body of the General Assembly brought a model 'Arbitration Law". It is popularly known as UNCITRAL model law on International Commercial Arbitration which helped many countries in the improvement of arbitration system. The objective of the said model Arbitration Law was to convince the member states to adopt a uniform International arbitration law which would further help the international trade and business in a wider way. The model also helped the member states to have a uniform domestic arbitration law. As per arbitration laws of many countries, the international arbitration which had seat of one country can treat that international award at par with the domestic arbitral awards to meet the purposes of challenges and enforcement.

For achieving a complete arbitration friendly atmosphere there is a basic need to first achieve a uniform domestic and international arbitration system. The General Assembly of United Nations dated on 11<sup>th</sup> December 1985, by its resolution recommended that all states must give due consideration to the model law on International Commercial Arbitration, by this way the uniformity of law of arbitral procedures and specific needs of international commercial arbitration practice can be achieved.

#### **ARBITRATION AND CONCILIATION ACT, 1996: A BREIF OVERVIEW:**

The recommendations of the United Nations were swiftly responded by India and it also understood the importance of adopting the Model law and also gaining the confidence of the foreign investors. So, for this sake, India enacted Arbitration and Conciliation act 1996 from the view of the above mentioned UNCITRAL model law of Arbitration.

The main intention of the Arbitration and Conciliation Act, 1996 are as follows:-

- (i) To observe the importance of having a uniform arbitration law all over the World wide.
- (ii) To reduce the interference of the courts into the arbitral proceedings.
- (iii) To solve Commercial disputes by arbitration.

#### **HISTORICAL VIEW:**

In ancient and medieval India, disputes were settled by referring it to a third person. If the any of the parties to the dispute was not with the decision given by the third person, he could refer to appeal to the Court of Law and to the King itself.<sup>409</sup>

In the Modern law of arbitration, regulations were framed by the East India Company whereby the courts were in a authority to refer the suits to arbitration. The first Indian Arbitration Act of 1899 which was based on the English Arbitration Act. Afterwards, Indian Arbitration Act of 1940 came and then finally the Arbitration and Conciliation Act, 1996 was enacted by Parliament based on the UNCITRAL Model Law on International Commercial Arbitration, 1985.<sup>410</sup> Section 30 of the Indian

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<sup>409</sup> P.C. Rao & W. Sheffield, *Alternative Dispute Resolution* (Delhi: Universal Law Publishing Co. Pvt. Ltd., 1997) at 33.

<sup>410</sup> K.D. Kerameus, "Waiver of Setting Aside Procedures in International Arbitration" 41(1) *The American Journal of Comparative Law* (1993), <http://links.jstor.org/sici>

Arbitration act, 1940 was enacted in the year 1996 with contained the broad grounds for setting aside an “Arbitral Award”. In contrast the Section 34(2) of the Act was sought to restrict the grounds for challenging an “award”. To prevent the arbitrators to go beyond their authority, procedures were provided to have check on the powers. But there is another school of thought which provides that the provision for setting aside of arbitral award should not be envisaged. The parties are required to stick to the judgment laid by the arbitration; however it’s unreasonable, but shall be considered as final judgment.

After passing final award court cannot reassess the evidence even if the error committed by arbitrator.<sup>411</sup>

The court does not have jurisdiction to substitute the conclusion on fact or law which it has passed.<sup>412</sup> The re-examination and reappraise of the evidence which had already been considered by the arbitrator cannot go for further appeal.<sup>413</sup> For the investigation of any misconduct in the decision passed by the arbitrator, Court may simply see the record done before the arbitrator but will never re-examine it.<sup>414</sup> It is further considered that the “Arbitrators” are judges of fact as well as law and also has jurisdiction and authority over decisions to pass them right or wrong. The award passed by the Arbitrators cannot be attacked if they have heard both the parties and had given decision fairly.<sup>415</sup> The decisions of them cannot be interfered by any of the court even if the decision is erroneous.<sup>416</sup> The court cannot examine and challenge the decision passed by the arbitrator, if the reasons are stated with decision. The forum which is decided by the parties has the power of appraisal of evidence. The ‘arbitral award’ is not open challenge on the grounds that it has given wrong conclusion or has failed in appreciating the facts and evidence of the case even if the award arbitrator failed to prove the oral and documentary evidence, recorded in the arbitral proceedings. It has been very clear that the parties who selected the arbitral tribunal as the sole and final judge of the dispute, the award decided by the arbitral tribunal shall be binding on the parties and they have no other option except

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<sup>411</sup>*Eastern and North East Frontier Railway Cooperative Bank Ltd. v. B. Guha & Co.* AIR 1986 Cal 146, *Uttar Pradesh State Electricity Board v. Sear sole Chemicals* (1995) 2 Arb LR 320, *National Electric Supply and Trading Corporation Pvt. Ltd. v. Punjab State AIR* 1963 Punj 56.

<sup>412</sup>*Francis Klein Pvt. Ltd v. Union of India* 1995 2 Arb LR 298.

<sup>413</sup>*State of Orissa v. R.N. Mishra* AIR 1984 Ori 42, *Swaran Singh v. University of Delhi* AIR 1994 Del 290, *Samyukt Namratav. Delhi Development Authority* 1986 2 Arb LR 48, *Sarabjit Singh v. State of Punjab* AIR 1985 P&H 179, *New Snow View Transport Pvt. Ltd* AIR 1994 NOC 311 (H.P.), *R.S. Builders v. Delhi Development Authority* AIR 1995 Del 10, *Shivlal Prasad v. Union of India* AIR 1975 MP 40.

<sup>414</sup>*JagdishChander v. Hind Vegetable Oils Corporation* AIR 1990 Del 204, *Eastern and North East Frontier Railway Cooperative Bank Ltd. v. B. Guha & Co.* AIR 1986 Cal 146.

<sup>415</sup>*Yeshwantrao Ganpatrao v. Dattarayao Ramachandranrao* AIR 1948 Nag 162 (DB).

<sup>416</sup>*Bharu Kure Jat v. Tara Lal* AIR 1962 Punj 173.

to bind themselves with the arbitral award and thus, the award passed by the arbitral tribunal cannot be set aside on the grounds of the erroneous facts/law. This concept is basically explained in Section 34 of the Arbitration and Conciliation Act.<sup>417</sup> The appraisal of evidence which the arbitrator laid down in the cases cannot be questioned or considered by the Court.<sup>418</sup> It is not the duty of the court to take up the task of being judge of evidence of arbitration cases, since it is never possible for the court to come with same conclusion as the arbitrator, although on the same facts, the court will come to totally different conclusion and then both the conclusion will have inconsistency to the parties. Only the Arbitrator has final say on evidence production and the court cannot interfere with the matters like document is important, which should be accepted and which evidence is necessary.<sup>419</sup> The decisions of the arbitrator cannot be challenged on the ground of inadequacy or impropriety or inadmissibility of evidence. Judicial misconduct by the arbitration can be challenged on the grounds, total absence of evidence or failure to consider any material documents or admission of parties for arriving final conclusion.<sup>420</sup> Court cannot interfere in the arbitration proceedings even if the arbitrator disregards principles of natural justice, being vicious in proceedings or radically wrong or also disregarding any fundamental rules of evidence.<sup>421</sup> The basic purpose of arbitration and adjudication shall be the alike; at last the price should always be paid to defeated litigants.<sup>422</sup> As soon as a judgment becomes final and no appeals provided, does it become a sacrosanct? The main argument of unequal treatment and partial subjugation is that arbitration is yet to be checked as an autonomous institution, independent and separate from judiciary. It has been somehow incorporated as cohesive system of the overall administration of justice and is tolerated by the State.<sup>423</sup> Setting aside of awards have given importance to judges and have played important role in the validity and enforceability of the arbitration.<sup>424</sup> In overall it has been argued that arbitration

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<sup>417</sup>*Laxmi Mathur v. Chief General Manager, MTNL* 2000 (2) Arb LR 684 (Bom).

<sup>418</sup>*Haji Ebrahim Kassim Cochinnwalla v. Northern Indian Oil Industries Ltd.* AIR 1951 Cal 230, *Life Insurance Corporation (LIC India) v. M.L. Dalmia & Co. Ltd.* AIR 1972 Cal 295, *Polo Singh & Co. v. Union of India* 1995 (2) Arb LR 303, *State of Punjab v. Amarnath Agarwal* 1993 103 Pun LR 1, *State of Rajasthan v. Puri Construction Co. Ltd.* 1994 6 SCC 485.

<sup>419</sup>*Shankarlal Majumdar v. State of West Bengal* AIR 1994 Cal 55.

<sup>420</sup>*West Bengal Industrial Infrastructure Development Corporation v. Star Engineering Co.* AIR 1987 Cal 126 (Arbitrator is the sole judge of the quality and sufficiency of evidence and the courts are not allowed to interfere) *Natwarlal Shamaldas & Co v. Minerals and Metals Trading Corporation India Ltd.* AIR 1982 Del 44, *Bungo Steel Furniture Pvt. Ltd. v. Union of India* AIR 1967 SC 378.

<sup>421</sup>*Des Raj & Sons v. Union of India* 1984 Arb LR 156, *Krishna Gopal Prasad v. Chandiprasad Duryandhan Prasad* AIR 1953 Nag 309 (DB), *Louis Dreyfuss Co v. S. Balasubbaraya Chettiar & Son* AIR 1961 Mad 186, *Baldev Singh Sardool Singh*

<sup>422</sup>*Supra* note 2, at 35.

<sup>423</sup> *Ibid*

<sup>424</sup> *Ibid*

system was made to keep the dispute resolution less technical and simple and it has been unresponsive to the cannons fair play and justice. If the arbitrator had not applied the principles of natural justice, the aggrieved party must be proved with recourse for the justice. The argument in which a final decree has been passed and it holds no water, but still there are provisions in the Civil Procedure Code for the review and revision. Arbitration and Adjudication are not different but both are means of seeking justice, so if any of the method fails, the other means is resorted to seek justice. Both should be regarded as complementing to each other rather than fighting for supremacy over each other.

### **SETTING ASIDE:**

*Not everyone takes defeat in their stride. So, at times when ever any arbitral award goes against any one of the party to dispute, he looks for any possible way of setting it aside. Any award can only be set aside on the grounds as mentioned in Section 34 of the Arbitration and Conciliation Act, 1996. The purpose of setting aside any award is to modify in any way the award in part or as a whole.*<sup>425</sup>

### **Salient Features of S. 34 of the Act:**

1. It prohibits any recourse against arbitral award other than the one provided for in Sub-section (1) of Section 34.
2. It limits the grounds on which the award can be assailed in Sub-section (2) of Section 34.
3. It promises a fairly short period of time in Sub-section (3) of Section 34 within which the application for setting aside can be made.
4. It provides for remission of award to the arbitral tribunal to cure defects in them.

### **LIMITATION:**

Section 34(3) specifies a time period of three-months within which an application for the setting aside of an award can be made, from the day the applicant receives the award. The provision to the sub-section 3 says that if the applicant shows that he has been prevented by any sufficient cause from filing the application in three months, an extended time period of 30 days may be given to file the application, but thereafter, no extension shall be provided. Question as arisen in a case, *Union of India v. Popular Construction Company*<sup>426</sup>, whether the provisions as given in Sec. 5 of Limitation Act were applicable to any application that challenges the award under Section 34 of the Act? And the court in

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<sup>425</sup> A. Redfern & M. Hunter, *Law & Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 2004 edition) at p. 404.

<sup>426</sup> MANU/SC/0613/2001.



the process of forming a conclusion took into view the objective and the history of the Act in addition to and the intention of the legislature for interpretation. One of the main objectives of the Arbitration and Conciliation Act, 1996 is to minimize the intervention of the Court in arbitral process. Also, the motive and the intention of the legislature can be found out from the expressions but not thereafter appearing in the Section 34(3).<sup>427</sup> It was then held that this expression was exclusion under the meaning of Section 29(2) of the Limitation Act, and would then bar the application of Section 5. If the Court admits the application for setting aside the award after the expiration of the limitation given in the Act, then it will be tantamount to be making the phrase but not thereafter as a whole.<sup>428</sup> It is said that the decision given is in need of reconsideration. Although, the Act was framed with a motive to provide justice to the litigants but in the process of doing so, one should not forget the practicalities of life which may prevent an honest litigant from coming to the Court of law for justice. For example, when anyone is prevented from challenging a perverse award in time on the ground of some terminal illness or any situation in which the proceedings were *bona fide* instituted before the court without any jurisdiction or under the provisions of some repealed statute. Then, does the proviso to Section 34(3) restrict such persons from asking for justice?<sup>429</sup> Procedural law must not defeat the right assigned by the substantive law. The Indian Supreme Court has observed from time to time that the absence of any remedy assigned by the statute should not defeat the demands of justice. In such a case, it is then the duty of the court to interpret the procedures by deriving analogy from other forms of laws and practices.<sup>430</sup> Due importance should be given to the intention of the legislature and to the objective of the Act but in the process of doing so, the overall motive of the judicial system in providing redressal to the party in need should not be hampered. This will then further ensue if a narrow interpretation is given to the Section 34(3). An award obtained through fraud or by means of corruption would then be given finality. Provisions of this Act needs to be interpreted a manner which promotes the goals and values of our society. D.R. Dhanuka (Justice Retd.) provides a view that the provisions in Section 4 of the Limitation Act will be applied automatically in case if the court is closed. Section 29(2) of the Limitation Act, says that where any special or local law prescribes the period for limitation, the provisions as contained in the statute from Section 4 to Section 24 shall apply only in case where they are not expressly excluded by any special law whereas, Section 34 of the Limitation Act does not expressly exclude Section 4 of the Act. In all such cases, the necessary

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<sup>427</sup> *Supra* note 10.

<sup>428</sup> *Ibid.*

<sup>429</sup> M.V. Sundararaman, on Finality of Domestic Arbitral Awards, *Company Law Journal* (2003), at p. 46.

<sup>430</sup> *Supra* note 13, at page no. 47.

application is needed to have been filed on the last day of the court, although factually, it was filed on the first day of the reopening of the court.<sup>431</sup>

### **PUBLIC POLICY:**

The Act provides that an arbitral award can be set aside, if it is in conflict with any public policy. An attempt to describe a public policy says that “it is a set of principles in accordance with which communities need to be regulated in order to achieve the good of the entire community or public.”<sup>432</sup> The term public policy covers a wide aspect depending on socio-cultural notions going on in the society.<sup>433</sup> It isn’t possible to classify the elementary distinctiveness of the public policy. Public policy is interpreted to mean:

- Firstly, anything that doesn’t go against the fundamental conceptions and morality;
- Secondly, which do not prejudices the interests of the country or the relations with the foreign countries; and
- Lastly, a policy which is not against the conception of human liberty and the freedom of action, as per English system in England.<sup>434</sup>

In one of its decisions in *Gherulal Parekh v. Mahadeodas Maiya*<sup>435</sup>, the Apex Court gave a narrow interpretation of public policy. It was said that in India, the public policy, lays a certain determinate specified head.

In *Central Inland Water Transport Corp. Ltd. v. Brojo Nath Ganguly*<sup>436</sup>, the Indian Supreme Court interpreted the term public policy on the basic grounds of public interest, public good and public conscience.

### **JUDICIAL RESPONSES:**

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<sup>431</sup> Justice D.R. Dhanuka (Retd.), Critical Study of Recent Judgments Pertaining to Arbitration Law, 5(2) Company Law Journal (2005), at page no. 42.

<sup>432</sup> P. Anklesaria, Scope of the expression public policy in domestic and foreign awards” 9 AIR (2005) at page no. 310.

<sup>433</sup> O.P. Malhotra, *The Law and Practice of Arbitration and Conciliation* (New Delhi: Lexis Nexis Butterworths, 2002) at page no. 786.

<sup>434</sup> *Supra* note 17, at page no. 787.

<sup>435</sup> AIR 1959 SC 781.

<sup>436</sup> AIR 1986 SC 1571.

The Supreme Court in the case, *Renusagar Power Co. Ltd v. General Electric Co.*<sup>437</sup> interpreted public policy respectively and Court held that the doctrine of public policy must be construed and applied in the field of private international law and the enforcement of foreign award is contrary to the subject of public policy and also if it contrary to:-

- (a) Fundamental Policy of Indian Law;
- (b) The interests of India;
- (c) Justice and morality.

In the *Saw pipes case* it was decided in the context of Indian Award and the recognition and enforcement proceedings for foreign awards was not applied in pursuant to Section 48 of the Act.

Enforcement of awards in Section 48(2)(b) and 34 (2)(b)(ii) are essentially mirror to each other with regard to provisions on public policy of setting aside of the awards. Such type of uncertainty was compounded by the Supreme Court's decision in *Bhatia International v. Bulk Trading SA*<sup>438</sup> where Part I of the Act was made applicable to Part II and unless expressly excluded by the parties. So as domestic policy considerations, not act as a hindrance in the enforcement of international arbitral award, many authors around the world have proposed the concept of international public policy. The concept includes the broader public interest of fair dealing and honesty.<sup>439</sup> In public policy, interpretation in domestic arbitration should totally different from that of international arbitration. The basic reason behind it is that interpretation of public policy in domestic arbitration should be different from that of international arbitration.

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<sup>437</sup>P.C. Markanda, *Law Relating to Arbitration and Conciliation*, 2nd Edition, 1997, Wadhwa Publishers, Delhi.

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## **IMPLEMENTATION OF THE OCCUPATIONAL SAFETY AND HEALTH ACT 1994 (ACT 514) IN SMALL AND MEDIUM ENTERPRISES (SMES): IS SELF- REGULATION WORKING?**

**SHARIJA CHE SHAARI<sup>440</sup>**

### **ABSTRACT**

The paper seeks to discuss the underlying principles of implementing the Occupational Safety and Health (OSH) in the small and medium enterprises (SMEs). The main statutes that govern OSH in Malaysia are the Factories and Machineries Act 1967 (FMA) and the Occupational Safety and Health Act 1994 (OSHA). However, the discussion is solely based on the OSHA. The underlying principles between FMA and OSHA differ. FMA is very prescriptive whilst OSHA is based on self-regulation. The main objective of this paper is to determine whether self-regulation is actually working in SMEs? It is hypothesised that self-regulation is not actually working in SMEs as many of them do not understand the legal duties imposed by OSHA upon them. It is due to limited access to competent staff, funding and technological resources. The study deploys qualitative method. It was conducted at the small and medium manufacturing enterprises in Kota Kinabalu Industrial Park (KKIP). The finding supports that self-regulation is not actually working in SMEs. Hence, the underlying principle of self-regulation cannot simply be transferred to SMEs. Such finding is congruent with the findings derived in the Australia and the United Kingdom. Nevertheless, there is limitation in this research as the finding cannot be generalised to represent the situation throughout Malaysia. Thus, this paper concludes with a call for greater comprehensive research regarding the challenges faced by SMEs in adhering to the OSHA.

Keywords: Occupational Safety and Health, Self-regulation, SMEs, Statutory

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## INTRODUCTION

International Labour Organisation (ILO) has estimated that there are over 2.02 million workers who die from work-related diseases and 321,000 die from occupational accidents per year throughout the world. The ILO has also estimated 160 million non-fatal work-related diseases and 317 million non-fatal occupational accidents per year (ILO, 2013). Over the recent years, the organisations are strongly encouraged to enhance their awareness on the importance of occupational safety and health (OSH) as a healthy workforce is an asset to any organisation. When employees' safety and health is enhanced, it leads to the increase of workers' productivity. It will then lead to the improvement of the organisations' overall performance and profitability. Thus the operating costs, such as healthcare expenditures or time off due to absenteeism, will decrease. There have been calls over the need for more effective safety and health legislation and the quest for the best approach to reducing occupational fatalities, injuries and disease.

In Malaysian scenario, it is the vision of the leaders to transform Malaysia into a fully developed country by the year 2020. In achieving the vision, rapid industrial development are inevitable, particularly in manufacturing and construction industries. Thus it has led to influx of numerous new hazards in workplace. Malaysia faces new emerging occupational safety, health and ergonomic issues such as infectious disease, chemical exposure, mental health, musculoskeletal and so forth. The rate of alarming occupational injuries and work-related disease per annum prompts Malaysia to deal with efficient delivery of OSH.

Hence Malaysia has placed special attention in dealing with these problems by emulating the occupational health and safety legislations that are commonly practiced in the United Kingdom. In the case of Malaysia, the governing legislations are the Factories and Machinery Act 1967(Act 139) (hereinafter referred to as FMA) and Occupational Safety and Health 1994 (Act 514) (hereinafter referred to as OSHA) together with the supplementing regulations. Both legislations are administered by the Department of Occupational and Health under the purview of Ministry of Human Resource. The philosophy between FMA and OSHA differs. The former is limited to certain industries namely only to the manufacturing, mining, quarrying and construction (Xavier, 1996). The FMA is mainly concerned with the safety aspects of the workers in the listed industries and safety aspects of the machineries used in workplaces covered by its application. It is interesting to note that the FMA is very prescriptive which contained detailed technical provisions. For example, Section 25 FMA

1967 covers the provisions concerning welfare which is to be read together with the Factories and Machinery (Safety, Health and Welfare) Regulations 1970 (Revised 1988). Regulation 9 provides that stairway must not be less than thirty six inches wide and other details. Regulation 23 provides detailed provisions concerning cleanliness, to the extent that the floor shall be cleaned at once a week. Regulation 34(3) provides that in a factory that has fifteen or more women employees, thus the employer shall provide at least one rest and dressing room for their exclusive use.

The FMA applies to the employers and occupiers in the abovementioned four industries. Whilst OSHA 1994, on the other hand, covers not only the employers and occupiers, but self-employed person, designers, manufacturers. OSHA nevertheless is more flexible and encourages self-regulation. It is the underlying principle of OSHA that the responsibility to ensure safety and health lies with those who create the risk and those work with the risk. The Act, which is based on the findings of the Robens Committee of Inquiry, has the following features:

- to focus the attention of the parties of interests on the need to prevent work-related injury, illness and death;
- to impose on duty on the parties such as employers etc in the workplace to ensure that they exercise their responsibilities, so far as is practicable, to ensure that their employees, visitors and/or any person;
- to provide mechanisms for consultation between employers and employee on safety and health issues;

### **BACKGROUND OF THE STUDY**

Small and medium enterprises (SMEs) play vital role in the Malaysian economy. The Census on Establishments and Enterprise 2005 indicates that SMEs in Malaysia account for 99.2% or 518,996 of the total number of business establishments, of which 411, 849 or 78.7% are micro enterprises. Small enterprises accounted for 18.4% or 95,490 establishments, followed by medium enterprises, representing only 2.2% or 11,657 establishments. Most of these SMEs are in the services sector, particularly in retail, restaurant and wholesale businesses. Their presence in the manufacturing and agriculture sectors are only 7.3 percent and 6.2 percent respectively. Total employment in the SMEs accounted for more than 3 million employees (Normah Mohd Aris, 2007).

Generally speaking, all employers and employees have the same OHS rights and obligations. In Malaysia, there is no discrimination in the law to distinguish compliance among the various sized industries except for the requirement of formation of safety and health committee whereby the law makes it compulsory only for organisation employing more than forty workers to form the committee (Section 20, OSHA 1994) and the duty to formulate safety policy is imposed upon the employers having five or more employees (Section 16, OSHA 1994). One of the many challenges that SMEs face is the high workplace accidents rate which may reflect badly to the way safety and workers' well-being are being handled by Malaysian SMEs. In view of the constraints in the OSH legislation, there is no doubt that SMEs are still struggling to meet the minimum requirements for safety and health at the workplace. The OSHA currently rests with the concept of self-regulation amongst SMEs. A responsible employer is one who takes charge to work with the risks he or she has created by applying relevant preventive measures to control safety and health risks. This is clearly displayed if an employer who requires an employee to undertake a risky task applies what is required of him by law to provide the necessary training to enable the employee to perform his duties safely. The employee on the other hand must do his or her part in following instructions to work safely. The statutory provisions are not formulated to burden the employers as the law has taken into considerations various factors in implanting OSH. However, it is submitted that there are many of SMEs are unaware of the legal requirements imposed upon them. it is argued that modern OHS legislation and interventions to help improve work environments need to increasingly take account of the specific characteristics of SMEs. Thus the aim of this paper is to discuss the legal requirements concerning occupational safety and health (OSH) that are applicable to small and medium enterprises (SMEs) in Malaysia.

### DEFINITION OF SME

In Malaysia, SMEs is categorized based on either their annual sales turnover or the number of full-time employees as shown in the table 1.1 below

**Table 1: Definition of SMEs**

	Micro Enterprise	Small Enterprise	Medium Enterprise
Manufacturing,	Sales turnover of less than RM250,000 or	Sales turnover between RM250,000	Sales turnover between RM10



Manufacturing- related Services and Agro-based Industries	full time employees less than 5	and less than RM10 million or full time employees between 5 and 50	million and RM25 million or full time employees between 51 and 150
Services, Primary Agriculture and Information & Communication Technology (ICT)	Sales turnover of less than RM200,000 or full time employees less than 5	Sales turnover between RM200,000 and less than RM1 million or full time employees between 5 and 19	Sales turnover between RM1 million and RM5 million or full time employees between 20 and 50

Source: SME Corp Malaysia

## OBJECTIVE

OSH is a discipline concerned in preserving and protecting human and facility resources in the workplace. The objectives of this article are:

1. to investigate whether the small and medium enterprises understand their legal duties imposed by OSHA; and
2. to explore whether the small and medium enterprises are able to execute their legal duties pertaining to occupational safety and health (OSH) practices.

## LITERATURE REVIEW

Large multinational companies and SMEs are very different in many aspects. These differences have huge impact when it comes to the implementation of OSH and this raises several issues. When it comes to implementing OSH, the size of the company plays a big part (Cook, 2007). Large multinational companies often have the financial means and structure to effectively implement a good OSH system. They have sound financial capability which in most cases, lacking in SMEs to

commit and develop a safety program inside their organization. However, the statute concerning OSH applies similarly to all business establishments.

It is observed by Gunningham (1999) that many small enterprises are facing difficulty in complying to OSH legislation due to lack of commitment and high employees turnover. His observations are similar to many studies which have noted that accidents in small firms are more frequent compared to large organizations. The studies have also identified that the smaller the firms are thus more ergonomic, physical and chemical hazards exist and higher workplace fatality rates. SMEs, particularly small companies, are often particularly financially fragile. Hence the organisations perceive that it is unattractive to invest in OSH because the financial benefits of OSH preventive measures are not obvious in the short term. Non-compliance of OSH could also occur because the management of SMEs does not see OSH as within their domain of responsibility and/or they are unclear about their responsibilities.

The above statement corresponds with Eakin's observation that economic concerns as one of the main reasons for non-adherence to fully implement OSH. Eakin conducted a study to determine implementation of OSH in small businesses (Eakin, 2010). He concluded that the small business owners can be too preoccupied with cost constraints and day-to-day needs to be concerned about OSH. Eakin's observation matches with Mayhew et. al.(1997), who has noted that at times, the owners/management understood and recognised safety breaches but rationalised non-adherence on the basis of economic survival.

Policies can be difficult to implement when they do not fit with working relationships in the organisations particularly in small companies. Lingard and Rowlinson (1997) has made an observation that organisations that have more resources and experience tend to deal with health and health issues more effectively. Hutter (1993) has observed that the underlying principles of self-regulation have not been fully achieved despite the flexibility between the employer and employee advocated by Lord Robens. It was mainly due to lack of understanding of their roles by both the employers and employees.

A previous study by Watfa et.al (1998) showed that occupational safety and health conditions at the small medium enterprises (SMEs) were a cause for concern. Workers in SMEs in different countries were at risk of exposing themselves to hazardous chemicals without proper and effective control measures. The study also found that 70% of chemical containers were not labelled properly. Workers in SMEs were using improvised personal protective equipment and proper personal protective

equipment were not available. Watfa et al. (1998) also discovered that the housekeeping, welfare facilities and personal hygiene of those working in SMEs were poor and neglected. The survey also showed that there were health complaints in different industries among these SMEs workers who were exposed to hazardous chemicals either by inhalation, skin absorption or ingestion via poor personal hygiene.

The European Union has paid considerable attention to the occupational safety and health in SMEs since the last decades. Champoux and Brun (2003) has noted that small firms are more fragile financially, which makes OSH investments less attractive because the financial benefits of prevention are not obvious in the short term. As a result, OSH is very low on their list of priorities. Gardner et al (1999) has made an interesting remark that some employers believe their OSH management is adequate simply because problems rarely occur. As a result, they do not ascribe much importance to prevention.

In Malaysia, OSH in small and micro firms have received far less attention and this is reflected in the small number of publications available. It was highlighted in Saleh and Ndubisi (2006) that heavy regulatory burdens are among the challenges faced by the SMEs in Malaysia. The above observations made by Gardner, et. al. and Champoux and Brun are confirmed by a research conducted by Chan, et. al (2008) whereby part of the research was to determine the small and medium accommodation operators' legal awareness. It was found that 66.7% claimed that they are aware of their obligations imposed by OSHA. Thus it is interesting to determine the small and medium-sized accommodation operators' understanding of OSHA. A further in-depth interview revealed that 20.61% of the respondents associated OSHA with rules that are being enforced by the government in ensuring the safety of the guest. However, they were unsure when asked to elaborate further in their understanding of OSHA by referring to specific circumstances. Another 19.08% of the respondents specifically linked OSHA to Fire Department (BOMBA). A further 15.27% of the respondents claimed that OSHA referred to the requirement pertaining to hygiene and cleanliness of the premise. The finding reveals that it is only 5.34% of the respondents have managed to portray a clear understanding of what OSHA is. The research shows that small and medium accommodation operators have placed OSH very low in their list of priorities. However, the above research has its own limitation as it was carried out among 169 operators throughout Sabah only. A similar research could be carried out nationwide in order to confirm the said findings.

Lilis Sureinty et. al (2011) has noted that legislation role may not be appropriate here if the level of awareness about it is low among SMEs. In addition, SMEs with their lack of knowledge in OSH

legislation are confused by the legal and technical content in the OSHA. Yet, employers of the SMEs still need to ensure the safety, health, welfare of all their employees and the public that may be affected by their business activities. SMEs are not exempted from complying with any laws or regulations under the OSHA 1994. The OSHA 1994 includes high technical content in which many may find to be difficult to understand without the appropriate knowledge. This barrier prevents SMEs from correctly interpreting and implementing OSH requirements in their companies. Apart from that, the lack of enforcement could also lead to SMEs perceiving that implementation of OSH is not important. A lack of human capital is the most significant challenge facing Malaysian SMEs. It is often too expensive for SMEs to employ a professional and competent workforce (Saleh and Ndubisi,2006).

In Malaysian context, Khairiah Soehod and Lekha Laxman (2007) has conducted a legal research to study the scope of common law and statutory regulations pertaining to OSH in Malaysia focusing on the manufacturing industry. However their study did not address the reason why the rate of accidents in manufacturing industry remains high despite the effort to enforce OSHA 1994, FMA 1967 and related regulations. Zaliha Hj Hussin et.al (2008) studied the types and factors of accidents that happened in food manufacturing factories in small and medium-sized industries and the actions taken by the respective employers following the occurrence of accidents in their respective workplaces. However, Zaliha's study is limited to the food manufacturing SMEs in Kedah. Thus the study is not reflective of the OSH implementation in Malaysia as a whole. Furthermore, Zaliha's study did not establish explicitly on the stakeholders' understanding of their roles and duties imposed by the OSH regulations.

Ummu Kolsome et.al. (2011) had conducted a quantitative study in Malaysian manufacturing companies that have established safety committee, the findings have shown that the level of functioning in the safety committees derived from 278 respondents companies fall on medium scale. The findings show that the safety committees are lax in several areas as listed below:

- i. Collecting general information on OSH issues;
- ii. Lack of access to reports provided by external experts;
- iii. Lack of access to safety audits;
- iv. Lack of role in assisting the employers in OSH competition (regulation 18);
- v. Lack of expertise in carrying out studies on OSH matters at their respective workplace.

Though Ummu Kalsome's study concentrates upon safety committees in manufacturing companies, the study does not furnish further details on the respondents' companies for example the total number of employees in respective respondents' companies. If such particulars are provided, thus the study could have pointed whether the safety committee is less functioning in smaller companies, therefore the findings of Lingard and Rowlinson (1997) is confirmed.

Nevertheless, the findings from Zaliha and Ummu Kalsome show that the employers are not clear of their legal duties imposed by OSH regulations. Zaliha's study has shown that most of the employers that took part in the study pay only little attention in giving out incentives to the workers that have fully complied with all OSH rules and regulations. The study also finds out that warning is the most common form of punishment imposed by the employers. The findings are closely related to the objective of this present study, that is whether the employers understand their legal roles and whether self-regulation is workable at SMEs? Similarly in Farouk's study, the findings show that the level of safety committees' performance in respondents' companies are only at medium range. Could it again due to lack of understanding of how to implement OSH rules and regulations?

Previous studies have shown that occupational accidents are closely related to the prevailing work environment and tasks carried out (Cooper, 2000; and Clarke, 2006,). Research by Dejoy (1985) showed that safety programme is most effective when it involves two-way communication between managers and workers. However, high level management often has little first hand experience on site; it is therefore difficult for them to relate to the needs of the workers. Hinze (1988) showed that regular meetings held on site help to identify OSH problems and solutions thus improve accident prevention. Past researches have shown that the working conditions improve when the rank-and file workers are involved in the process (Widerszal-Bazyl and Warszewska-Makuch, 2008). An investigation conducted by Nishgaki (1994) in construction injuries, showed that management commitment is responsible for the majority of humanware problem. The situation is perceived to be similar in manufacturing industry. Workers' participations are important in executing OSH policy of an organisation (Podgorski, 2005). He found that the factor that leads to failure of OSH management system in Poland is due to low level of workers' participation. The findings derived from Podgorski are supported by Khairiah Soehod (2008). It is noted that workers' participation can make a significant impact on the prevention of occupational accidents if the management give its total support.

Ratnasingam et.al (2011) found that workforce characteristics and management's commitment must be accorded primary importance in any safety system in the wooden furniture manufacturing industry so as to ensure that work occupational accidents is minimized. The success story of workers' participation in improving working condition can be seen in Mitsubishi plants. An intervention in Mitsubishi plants has significantly reduced lower back injuries for its assemblers. Lessons from Mitsubishi success could be utilised by other manufacturing companies in order to reduce occupational accidents and diseases. The studies conducted by Shaw and Turner(2003) and Niu (2010) had noted that more quality workers will result in higher effectiveness of workers' participation. The above studies had also observed that more experienced and committed workers are able to conduct their own risk assessment; hence they will actively participate in OSH policy at their workplace.

Overall, previous researches tend to show that OSH management problems in small firms are related to employer isolation, lack of knowledge of the firm's risks and its OSH rights and obligations, and a lack of resources. All authors seem to agree that a specific, customized approach is required to promote awareness and management of OSH in small and medium business establishments.

## **METHODOLOGY**

This study is categorized as a socio-legal research as it is a study that combines legal research with an investigation of some problem or question which is essentially of 'social nature" and uses techniques of data collection used in social science research (Anwarul Yaqin, 2007,p.10). A pure legal research (which is also known as doctrinal research) examines the philosophies underlying law and legal system. For the purpose of this study, it is submitted that a socio-legal approach is deployed as it will give clearer picture of the problem, that is, whether self-regulation pertaining to OSH is actually working in SMEs. If the researcher were to deploy a pure legal-research, the outcome in this study may not be fulfilling. Examining the statutes *per se* may not be an answer to a problem, issue or question. On that note, the researcher has decided to use qualitative method. The study is confined to the small and medium manufacturing companies situated in Kota Kinabalu Industrial Park (KKIP). KKIP was conceived by the government of the state of Sabah to spearhead the state of Sabah's industrialisation programme. It is an area of 3950 acres that is situated 25 km north of the central

business district of Kota Kinabalu (the capital of the state of Sabah) and 5km away from the Sepangar Container Port Terminal.

This study was conducted in April-July 2012, There were 73 small and medium manufacturing companies in KKIP which employ around 1500 employees. Prior to embarking the study, the researcher had contacted the respective companies for their consent to participate. However there were only 53 companies who were willing to participate in this study. The companies were categorized into three categories according to number of employees such as less than five employees; between five and thirty nine employees; and companies having forty and above employees. In each company, the researcher interviewed the proprietor or manager; and its safety and health officer and finally at least 2 employees who were in the safety committee. An interview took roughly two hours per company. The researcher had interviewed 210 respondents.

Table 2: Categories of Company

	Categories of companies	Number of Companies
1	Companies having less than five (5) employees	1
2	Companies having between five and thirty nine employees	32
3	Companies having forty and above employees	20

The methodology used in this study is mainly based upon library research and complemented by field work conducted at the selected manufacturing SMEs in KKIP, Kota Kinabalu, Sabah. A wide range of literature is used that comprises of primary and secondary sources which will include the statutes, reference books, legal scholarly articles that are published and unpublished as well.

This study undertook to describe the body of law pertaining to OSH and examine how it was implemented by the manufacturing SMEs. Therefore it was supported by empirical data. By carrying out an empirical research, it is hoped that the fundamental research questions about the implementation of OSH legislation in manufacturing SMEs are answered. Within the context of research into OSH implementation, empirical research will enable further understanding of the principles that underpin the system of OSH are translated into positive action. Therefore it is hoped

that the abstract statement of law are translated into behaviour (action) so as to enable further understanding on the reality of OSH implementation.

This study takes an integrated approach to exploring implementation of OSH by examining the underlying key influencing factors in the selected manufacturing SMEs. As this study is based on qualitative method, the samples are much smaller than those used in quantitative research. The number of respondents was not pre-determined at the outset. However, the concept of saturation was used as the guiding principle during the data collection. The research adopts multi qualitative methods – in depth interviewing, profile accumulation technique–open ended survey and focus groups to explore existing OSH practices in selected manufacturing SMEs. A purposive sampling was carried out among the selected manufacturing SMEs in Kota Kinabalu based on the SME Annual Report for 2012/13, the SMEs in Sabah account for 6.3% out of the total SMEs establishments in Malaysia. The respondents were selected from the list which was obtained from the then Federation of Sabah Manufacturers (FSM)<sup>441</sup>. The respondents interviewed were the proprietor; member of the board of directors; the safety and health administrator and/or the employees who were in the safety committee.

The interviews were recorded only if the respondents had given their consents. The recorded interview was then transcribed and coded into themes. The thematic analysis enables to determine whether the respondents understand the legal requirements imposed by OSH legislations. The thematic analysis captures key points in the data which are related to the research questions and represent some level of patterned response or meaning within the data set. The analysis enables the research questions to be answered and to determine whether the research objectives are achieved.

The questionnaires were divided into several parts name Part A deals with demographic and respondents' profile; and Part B tried to investigate whether the SMEs management team and employees understand the legal duties imposed by OSHA. The questionnaire tried to explore whether the SMEs are able to execute their legal duties pertaining to occupational safety and health (OSH) practices in their respective companies. The questionnaire was partly adopted from Zakaria, et. a.l.(2002) with some modifications.

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<sup>441</sup> It is now known as Federation of Sabah Industries (FSI).



## **DISCUSSION**

OSH regulations in Malaysia are already in place. However, OSHA is based upon self-regulation. It is unlike the FMA which is more prescriptive. The principle of self-regulation is laid out by the need to establish a safety committee in a workplace that has forty and above employees, Section 30 of OSHA 1994. There are twenty manufacturing companies that employ forty and above employees in KKIP, however six of them do not establish the safety committee. As such the contravention shall render the person liable to a fine of maximum RM5000 or to be imprisoned for a term not exceeding six months or both, Section 30(4) OSHA 1994. Upon further probing on the safety committee that are available in other fourteen KKIP manufacturing companies, it was noted that the 79.2 per cent of the respondents reported that it does not function as what is expected by the law. It is important that the workers have the capability to carry out basic risk assessment, investigate and voice out opinions to the management. It is also noted that two companies that employ more than forty employees do not even have a safety policy in place whilst the law has clearly provided in Section 16 of the OSHA 1994 that it shall be the duty of every employer to formulate safety policy except those who carry on an undertaking with not more than five employees. The non-compliance of Section 16 and Section 30 reflect the attitude of management that do not place the importance of OSH. Perhaps it is the “wait and see” attitude. Only when accidents occur and/or diseases arise, then the management will formulate safety policy and initiate safety committee at the place of work. However, such an attitude defeats the underlying principle of preventive measures in reducing occupational accidents and diseases. The findings in this study have also established the lack of enforcement. It is ironic to note that there are companies who have yet to establish a safety policy and safety committee.

In ensuring effective delivery of OSH, the collaboration between the stakeholders is needed to create the concept of a safe system of work. OSHA provides that the responsibility for safety system lies heavily upon the management. Thus the employer has to make necessary arrangements within its organisation to make adequate arrangements to provide, so far as practicable, appropriate protection of its workers. Section 16 OSHA 1994 provides that every employer and self-employed person shall formulate a written safety policy. The said section also imposes duty to carry out the policy, and to bring the statement and any revision of it to the notice of all his employees. Therefore the policy concerning safety and health must be brought to the attention of the workers. The notice must be communicated to all workers for example by using intranet, placing posters in conspicuous areas that are visible to all workers. If the workforce is comprised of people from various races and ethnics or migrant workers from various countries, thus the posters must be in various languages.

Every employer is required to establish a safety and health committee if there are forty or above workers or as directed by the Director General, shall establish a safety and health committee. A safety committee consists of representative of the employers and employee. The functions of such committee are to make recommendations to promote and develop measures to ensure the safety and health at the workplaces and to monitor the effectiveness of such measures. The rationales underpinning the safety committee are to encourage interaction between the parties and help improve trust and communication. This provision promotes the workers' participation in the efforts to achieve safe and healthy workplaces. The employers are expected to work closely with their employees to improve safety and health at their establishments. Many establishments have tapped into this innovative approach that synergises the management and employees, and has successfully achieved the desired result.

Most studies have established that the key to the successful implementation of OSH is employee engagement. All employees at all levels must be aware that health and safety matters not only to them, but also towards the health and safety of their colleagues at work. Employees tend to more aware of hazards that surround them at their workplace than employers. On that basis, the employees should be involved in the safety programme as they can relate more easily to the safety programme if they are involved. Management cooperation and commitment, the presence of government in ensuring compliance, legal protections, training and access to information are factors that enable employees to play an active role in OSH. Inadequate education and training are examples of workers' vulnerability in the employee/employer relationship.

Out of 53 companies who have had consented to participate in this study, it is found that:

- There are 16 companies do not establish any safety policy in their respective companies thus contravene section 16, OSHA 1994;
- There are six (6) companies who do not establish a safety committee in their respective companies despite having forty and above employees.
- There are two (2) companies who do not establish any safety policy and safety committee in the respective companies despite having forty and above employees.

It is found that majority of the respondents are aware of the need to adhere to the OSH practices in their respective workplaces. However, only a handful of the employees manage to explain correctly

on OSHA. In order for the workers to effectively participate, they must possess certain ability as they need to investigate and express their view to the management. Without this ability, the employers would not benefit from the workers. Their lack of knowledge and/or ignorance is displayed below:

- Respondent No.13 :            “I do not know what it is all about. I only work in order to get paid at the end of the month”
- Respondent No.32 :            “OSH is about DBKK and BOMBA<sup>442</sup>”
- Respondent No 135 :            “How can I come out with rules concerning OSH, when I myself are still in the dark about it”
- Respondent No.137 :            “It concerns SOCSO<sup>443</sup>”
- Respondent No 145 :            “It concerns safety of building from fire”

In answering as to who is involved in establishing rules and regulations concerning OSH practices in their respective workplaces, 43 per cent of the respondents claim that they have no idea as to who creates the company’s rules pertaining to OSH. They simply follow whatever they have been told. Again, the level of education for these respondents is mainly PMR<sup>446</sup> and lower primary. This finding supports that notion that the higher the level of education of the worker, the higher their awareness will be (Khiariah Soehod, 2008). In determining whether the workers think that they should take part in establishing rules and regulations concerning OSH practices in their workplace, 69 per cent

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<sup>442</sup> DBKK is an abbreviation of Dewan Bandaraya Kota Kinabalu (Kota Kinabalu City Hall) and BOMBA refers to Fire and Rescue Department.

<sup>443</sup> SOCSO refers to Malaysian’s Social Security Organisation.

<sup>446</sup> PMR stands for Penilaian Menengah Rendah (Lower Secondary Evaluation). It is taken by students who are in Form3 of their secondary schooling and generally they are 15 years of age. Previously it was known as Lower Certificate Examination.

of the respondents believe that they should be given the opportunity to take part as they are directly involved with the machineries and exposed to chemical substances that may endanger their health. However, the remaining 31 per cent (61 respondents) believes that it is not their duties. They would prefer the management to think of the rules and regulations themselves. Their justification for such an answer is lack of experience (15 respondents), not qualified (37 respondents) and let the “top-gun” do it (9 respondents).

The in-depth interview with the management team that are in contravention of section 16 and section 30 show that mainly they are in the dark as to the requirement to establish safety policy. Similarly they lack of knowledge on the legal requirement pertaining to the establishment of safety committee. For those who have established safety committee in the workplace, mainly the rules and regulations are created by the management without prior discussion with the employees. It clearly defeats the underlying principles of self-regulation propounded by the OSHA 1994. Most of them give their answers that their main priorities are to make profit and they do not know what is expected from them out of OSHA 1994. It is evidenced that most SMEs tend to neglect OSH (occupational safety and health) matters as they lack the manpower, expertise and financial resources to meet the OSH standards as stipulated in OSHA 1994 (Mohd Nizam Jemoin, 2006). However, they have overlooked that their organisations will be negatively affected should an accident occurs at their premises. They do not understand that the legal requirements imposed upon the employers are only “so far as is practicable”.

## **CONCLUSION**

Occupational safety and health is a synergized effort between employers and employees which requires investment of money, time and effort. There must be a balance between the workers’ safety and health; and the efficiency and profitability of the organization. Workers are closer to the machinery and/or chemical substances should be acknowledged and their feedbacks should be given due consideration. OSH rules and regulations will not be effective had they are created in the board’s meeting and/or manager’s room. When workers are encouraged to participate in decision-making within the organization, safety performance is usually higher. The paper provides a background to previous research on safety in SMEs, showing how most current policy and legislation on occupational health and safety (OSH) and the work environment is based on large enterprises may not be suitable to SMEs. The findings are useful for the policymaker and those who dealing with the

employer-employee relationships particularly in OSH matters. However, the findings may not be justifiable to reflect the actual circumstances faced by the SMEs in Malaysia due to limitation in the sampling and location. Hence, there is a relative paucity of carrying out similar research on OSH in SMEs at national level. In conclusion, it is imperative that the employers place a high consideration upon their workers' participation to ensure the successful implementation of OSH.

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## **SIGNIFICANCE OF HAVING AN INDEPENDENT DIRECTOR IN THE COMPANIES ACT, 2013: AN ANALYSIS**

**ATRAYEE DE<sup>447</sup>**

### **ABSTRACT**

The scheme of independent directors has come a long way & has progressed over the eons. In the Indian scenario, Companies Act, 2013 has emerged as a turning point for independent directors. They have been allocated wide powers & errands. The foremost object behind this is that it is being sincerely hoped that independent directors would be fruitful in employing high standards of corporate governance & safeguard that the companies are run in a crystal clear & well-organized routine. It would be interesting to note as to how many people would be actually eager to take so many errands particularly when remunerations are not at all eye-catching. Also what remains to be seen now is whether independent directors are actually going to be able to break away from their shackles of merely acting as rubber stamp & essentially contributing to the evolution of the company rather than merely playing an ornamental protagonist.

### **I. INTRODUCTION**

Although the idea of independent directors cannot be by any means be termed as a new thought yet it has expanded worldwide implication & is being seen under new light in the contemporary years. The concept has become a gigantic substance of debate after corporate frauds like the Enron Scandal, Satyam Scam etc came to light.

One of the dynamics that that has been identified to be conjoint across all these predominant corporate failures around the world has been attributed to the “catastrophe of the board of directors of a corporation to spot internal crisis early on & act in a timely routine to put the organization back on track before hitches become irreparable.”<sup>448</sup> After observing numerous corporate fiascos, scandals & the resultant crisis, endeavors at every level have been made to make corporations robust & active to counter various glitches which crop up in routine transactions. It is at this point that work

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<sup>448</sup> JayatiSarkar, „Board Independence & Corporate Governance in India: Trends & Challenges“ (2009) 44 Indian Journal of Indian Relations <sup>2</sup>Preamble,*OECD Principles of Corporate Governance*,2004



place of independent director draws attention as it is progressively being felt that through them, objectivity & cogent perspective can be transported on board & they can to a great extent safeguard transparency & accountability of a board. They are anticipated to enrich the standards of corporate governance. "Corporate governance is a key component in improving economic efficiency & development as well as ornamenting investor confidence...The corporate governance should promote transparent & efficient markets, be consistent with the rule of law & clearly articulate the division of responsibilities among different supervisory, regulatory & enforcement authorities.."<sup>2</sup> In the next point, the paper will unfold the notion of independent directors.

## II. NOTION OF INDEPENDENT DIRECTORS

The board of directors play a strategic role in harmonizing the interests of managers & shareholders. The board also assumes numerous other roles like keeping a check on the toil of the executive team, scrutinizing their own performance etc. Nonetheless if we liken the mechanisms of extensively held corporations & those corporations which are preserved by a small number of people (typically family owned) we comprehend that the characters and purposes of the board vicissitudes radically between the two.

In extensively held corporations (eg.US & UK) the board's role is singly of "vertical governance" that necessitates working on behalf of the shareholders to maximize managerial opportunism & maximize shareholder wealth.<sup>449</sup> While in family owned corporations the board's part is that of "horizontal governance", of harmonizing amid foremost stockholders who are also part of management & the marginal shareholders & also shielding the latter by the former.<sup>450</sup> It is while brooding on these questions that a need is stroked to have "independent" people on board who are free from any kind of stimulus or bias & can labor individually harmonizing the interests of various parties tangled in a corporation. The role they play in a company approximately includes refining corporate credibility, governance standards & the risk management of the company.<sup>451</sup> They are also

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<sup>449</sup> Roe M., „The institutions of Corporate Governance“ (2004) Harvard Law School

<sup>450</sup> Ibid

<sup>451</sup> YogeshMalhan and Siddhesh Singh, „Independent Directors-under the Companies Act,2013“ (2014) Indian Legal Impetus

<sup>5</sup> UmakanthVarottil, „Evolution and Effectiveness of Independent Directors in Indian Corporate Governance“ (2010) SSRN [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1548786](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1548786) accessed 14 September 2015

<sup>6</sup>KrishnanSinghania, Dr. Olav Albuquerque and Darryl Paul Barretto, „Independent Directors in Changing Legal Scenario (2013) Company Law Journal <http://www.ilntoday.com/files/2013/03/ArticleIndependent-Directors.pdf> accessed 12 November 2015

likely to donate through their massive sum of experience & expertise to advance overall working of the company. They bring a renewed viewpoint to the boardroom & as they have no other consigned interests, their judgment isn't clouded & they can work solely for the advantage of the company. In Indian scenario this association shoulders an additional significant role i.e. safeguarding of the minority shareholder's rights as majority of companies are family owned businesses and therefore they workout sturdy control over the management. Though there is an alternative side to the story which too necessities to be briefly deliberated upon. There is a section of scholars who nurture their doubts on the "independence" of the independent directors. Their selection procedures elevates a lot of eyebrows. When they are almost handpicked by the owners, promoters how can their "independence" be taken seriously? In such environments, why will such people be selected who are likely to clash with the owners? Alternative crucial point here is that commonly people acting as independent directors have their own frantic, full time vocations to take care of. So the amount of time, energy & labour they can dedicate to the board they serve remains an anxiety. Also their inadequate right to interfere in day to day minutes of the company seems to be another blemish. Nonetheless in spite of some reservations, the author is resolutely of the view that independent directors have an enormous part to play in upholding high standards of corporate governance.

### **III. PROGRESSION OF INDEPENDENT DIRECTORS IN USA & UK**

The idea of independent directors can be drawn to the developed parsimonies of the West with the UK & the U.S.A. partaking credit for its fruition during the 1950s even before lawgiving mandated the stimulation of independent directors to certify that corporate entities did not brand plunders into the public interest driven by the profit motive alone at the cost of other values.<sup>6</sup> The idea was spread into other countries over the eons.

#### **USA**

In USA the idea of independent directors was principally developed as an answer to manager shareholder agency delinquent. This delinquency can be evidently understood by seeing the analysis of Berle & Means that stemmed from their seminal study of ownership patterns of US corporations during the era between 1880 and 1930.<sup>452</sup> In humble terms the manager shareholder delinquent in USA corporations was that mangers being in charge of the company were acting contrary to the interests of the shareholders & the shareholders being dispersed & missing financial resources to

contain themselves in affairs of the company were powerless to check the abuse of supremacies done by the managers. And thus managers were demanding in fostering their own interests than those of shareholders. To check this menace it was felt that a body necessitated to be developed to plaid the actions of managers, who were fundamentally in control and accountable for running the corporations to guard the interests of shareholders. Alchian and Demetz in their organization theory advocated that shareholders will be the finest monitors as they are the voters that receive the lingering income of the firm but their theory does not fit sound in the context of the companies with dim shareholding due to the presence of collective action problems among shareholders, who therefore would be unsuccessful as monitors. Thus this eventually led to the responsibility of nursing being transported to the board of directors. And while pondering on the issue of board composition it was understood that transporting such directors on board who are independent of the management's stimulus would actually bring about the wanted results & will monitor better than, inside directors. Thus from here the idea of independent directors arose predominantly to address the manager shareholder agency delinquency.

Then throughout the 1970s the idea of the independent director "entered the corporate governance lexicon ... as the kind of director talented of fulfilling the monitoring role. It was normally felt that independent directors would transport some objectivity & variety to the board besides doing the one-to-one care role. Numerous arms of the government speedily bought into this idea: the judiciary to start with, and then the legislature, with superior emphasis placed by self-regulatory bodies such as the stock exchanges & law review organizations such as the American Law Institute (ALI).<sup>453</sup>

Future scandals surrounding Enron and WorldCom engrossed considerable criticism on the U.S. corporate governance & critics and scholars used these proceedings to mount a strong challenge to the prevailing schemes of corporate governance.<sup>454</sup> Sarbanes-Oxley Act of 2002 (SOX) was passed to reinstate confidence in the markets after the failure of the dot.com stock market boom and corporate governance disgraces.<sup>455</sup> SOX banned corporate loans to executives, obligatory CEO certification of financial statements and reinforced regulation of audits & audit committees.<sup>456</sup> Thus, the upsurge of

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<sup>453</sup> Ibid

<sup>454</sup> Gregory Jackson, „Understanding Corporate Governance in the United States“  
<[http://www.boeckler.de/pdf/p\\_arbp\\_223.pdf](http://www.boeckler.de/pdf/p_arbp_223.pdf)>

<sup>455</sup> Brian R. Cheffins, „The History of Modern U.S. Corporate Governance“ (2010)  
[http://www.risk.jbs.cam.ac.uk/news/downloads/2010/101013\\_cheffins\\_slides.pdf](http://www.risk.jbs.cam.ac.uk/news/downloads/2010/101013_cheffins_slides.pdf)

<sup>456</sup> Ibid

corporate governance transformations was led by the depiction of the Sarbanes-Oxley Act and amendments to the listing rules of NYSE and NASDAQ that familiarized mandatory board composition requests for the first time.<sup>457</sup> The Sarbanes Oxley Act does not order a general requirement concerning independence of the board but while dealing with audit committees, it delivers that each member of the audit committee of a public company shall be an independent director & it is the reviewed rules of the NYSE and NASDAQ that require that all listed companies contain boards that have a majority of independent directors.<sup>458</sup>

## UK

The expansion of corporate governance in the UK has its roots in a sequence of corporate collapses & scandals in the late 1980s and early 1990s. This led to the location in 1991 of a committee chaired by Sir Adrian Cadbury which delivered a sequence of recommendations - known as the Cadbury Report - in 1992.<sup>459</sup> That report presented the notions of non-executive director and independent director (i.e. sub set of executive director); It allocated two principal errands to non-executive directors, viz.: (i) to review the performance of the board & the executives; and (ii) to take the lead in decision making whenever there is a conflict of interest.<sup>460</sup>

In 1995 a separate report (Greenbury Committee) set out references on the remuneration of directors, & in 1998 another report (Hampel Committee) repeated the role of non-executive directors & the two reports were transported together in a single code (UK Corporate Governance Code).<sup>461</sup> In a succeeding series of improvements focused mainly on the role of non-executive directors, the Higgs Report suggested that "at least half of the members of the board should be independent" & also the concept of independence was defined in the Higgs Report in an extensive form.<sup>462</sup> The Combined Code was edited to comprise the principal references of the Higgs Report &

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<sup>457</sup> UmakanthVarottil (n 7)

<sup>458</sup> Ibid

<sup>459</sup> Financial Reporting Council, *The UK Approach to Corporate Governance* (2010)  
<<https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/The-UK-Approach-to-Corporate-Governance.pdf>> accessed 12 November 2015

<sup>460</sup> UmakanthVarottil (n 7)

<sup>461</sup> Financial Reporting Council, *The UK Approach to Corporate Governance* (2010)  
<<https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/The-UK-Approach-to-Corporate-Governance.pdf>> accessed 11 November 2015

<sup>462</sup> UmakanthVarottil (n 7)

the current version of the Combined Code issued in 2008 continues this trend & board independence has thus develop as an integral part of corporate governance in the U.K.<sup>463</sup>

#### **IV. LOCUS OF INDEPENDENT DIRECTORS UNDER THE COMPANIES ACT, 2013**

In Indian corporate past, there is more than an even chance that 2013 will go down as a watershed year in footings of corporate governance reforms as it was the year a path breaking new Companies Act, 2013 found its way in to the statute book.<sup>464</sup> The new Act, 2013 has transported in a lot of radical changes lecturing on a wide array of subjects but the author will in this chapter focus on provisions concerning to independent directors. The 2013 Act, for the first time has defined the term "Independent director". The old Act, 1956 did not comprise of any provisions concerning this so only listed companies had to trail this requirement as per Clause 49 of the Listing Agreement but now independent directors have been made obligatory for unlisted large public companies as well. The Act, 2013 varies from Clause 49 at various opinions but its requirements are far more rigorous than Clause 49.

#### **V. WHO CAN BE TERMED AS AN INDEPENDENT DIRECTOR**

By listing out comprehensive criteria concerning the appointment the Act has transported in a significant transformation. Any promoter of the company or its holding, subsidiary or associate company or anyone connected to them or anyone who has or had pecuniary relationship with the company during the two immediately preceding financial years or current financial year have been excluded from being appointed as independent director.<sup>465</sup> All of this has been done to uphold sheer independence. The Act also lays entails a term-based appointment for a period of five years, renewable, by special resolution for a second term, & not subject to retirement by rotation.<sup>466</sup> This sort of stability permits them to work valiantly & proficiently.

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<sup>463</sup> Ibid <sup>21</sup>SantoshPande and Kshama V Kaushik, „Study on the State of Corporate governance in India- Evolution, Issues and Challenges for the future“ (2012) [http://iica.in/images/Evolution\\_of\\_Corporate\\_Governance\\_in\\_India.pdf](http://iica.in/images/Evolution_of_Corporate_Governance_in_India.pdf) accessed 10 November 2015

<sup>464</sup> Bala N Balasubramanian, „Strengthening Corporate Governance in India-A review of Legislative & Regulatory Initiatives in 2013-14“ (2014) <http://www.iimahd.ernet.in/assets/snippets/workingpaperpdf/15793330072014-06-04.pdf> accessed 24 October 2015

<sup>465</sup> Companies Act 2013, s 149(6)

<sup>466</sup> Companies Act 2013, s 149(10) and (11)

## **VI. INDEPENDENT DIRECTORS WHEN OBLIGATORY**

There is a precise obligation on every listed public company that at least one-third of the board of directors should comprise of independent directors & also empowers Central govt. to include other class/classes of companies within the scope of this requirement.<sup>467</sup> To brand the procedure even simpler, an independent director may be designated from a data bank comprising details of persons willing to be appointed, maintained by anybody etc as may be notified by the Central government.<sup>468</sup> But, the firm fact rests that it is really problematic to find satisfactory amount of persons sufficiently competent & also eager to take up this job.

## **VII. REMUNERATION**

Another significant step taken is that the Act also places limit on the amount of shares that can be held in the company by a relative of such a director.<sup>469</sup> The Act also expressly disallows them from obtaining stock options.<sup>470</sup> Profit related commission may be paid to them, but subject to the approval of the shareholders.<sup>471</sup> The anxiety which ascends here is wide inequality amid the remunerations & the errands given to accomplish.

## **VIII. RESPONSIBILITIES**

The Act has imposed manifold responsibilities on independent directors. The Act requires the individuals to submit a self-declaration confirming that they have satisfied the criteria prescribed for the position.<sup>472</sup> It is also stated that any board meeting held at shorter notice (to transact urgent business) requires the presence of at least one independent director & if such is not present, the matter discussed at the board will be considered approved only once an independent director ratifies it.<sup>473</sup> Further, they can be removed if they fail to attend any board meeting for 12 months period with or without permission from the Board.<sup>55</sup>

## **IX. SEPARATE MEETINGS**

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<sup>467</sup> Companies Act 2013, s 149(4)

<sup>468</sup> Companies Act 2013, s 150(1)

<sup>469</sup> Companies Act 2013, s 149(6) (e)( iii)

<sup>470</sup> Companies Act 2013, s 149(9)

<sup>471</sup> Companies Act 2013, s 197(7)

<sup>472</sup> Companies Act 2013, s 149(7)

<sup>473</sup> Companies Act 2013, s

173(3) <sup>55</sup> Companies Act

2013, s 167

The Act makes it obligatory for all the independent directors to hold at least one meeting annually, without the presence of non-independent directors & members of management.<sup>474</sup> At this juncture they are expected to review the performance of the Chairperson, non-independent directors & the Board as a whole.<sup>475</sup>

## X. COMMITTEES

The Act has made it obligatory for independent directors to be a chunk of some committees.

- **Corporate Social Responsibility Committee**- The Act delivers that every company having net worth of rupees five hundred crore or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a CSR Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.<sup>476</sup> This facility has been included so that independent directors can keep a check on the workings of the CSR committee.
- **Audit Committee**-The Act requires that the Board of every listed company & such other companies as may be prescribed shall constitute an Audit committee which shall consist of a minimum of three directors with independent ones forming a majority.<sup>477</sup>
- **Nomination & Remuneration Committee (NRC)** - The Act requires that the Board of every listed company & such other companies as may be prescribed shall constitute an NRC consisting of three or more non-executive directors out of which not less than one half shall be independent directors.<sup>478</sup> The role of NRC is to (a) identify persons qualified to become directors, (b) recommend to the Board their appointment & removal, (c) evaluate directors performance, (d) recommend to the Board a policy relating to the remunerations for the directors etc.<sup>479</sup>

## XI. INDEPENDENT DIRECTOR'S LEGAL RESPONSIBILITY

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<sup>474</sup> Companies Act 2013, Schedule IV

<sup>475</sup> Ibid

<sup>476</sup> Companies Act 2013, s 135(1)

<sup>477</sup> Companies Act 2013, s 177

<sup>478</sup> Companies Act 2013, s 178

<sup>479</sup> Ibid

Also in order to provide an atmosphere where independent directors feel free to function to their full capabilities the 2013 Act protects them from liability, however, only to a certain extent. It is provided that they are liable only if any fraudulent act has been committed with the consent of such a director or where such director has not acted diligently & if such act is attributable to the board process.<sup>480</sup>

## **XII. CODE FOR INDEPENDENT DIRECTORS**

The company & independent directors are required to “abide by the provisions specified in Schedule IV” of the Act,<sup>481</sup> which delivers a detailed Code for independent directors. However the code appears to be mandatory which can lead to certain issues like the code states that an independent director shall uphold ethical standards of integrity & probity, however what would constitute ethical behavior is not defined & is open to interpretation.<sup>482</sup> Also it mentions to appointment of independent director by the board after evaluating certain attributes, the concern that remains unaddressed is the manner in which companies need to carry out an assessment of the attributes as specified under „manner of appointment“ in the code from the databank maintained by the MCA.<sup>483</sup>

## **CONCLUSION**

The establishment of independent directors has come a long way & has progressed over the eons. In Indian scenario, Companies Act, 2013 has developed as a turning point for independent directors. They have been allocated wide powers & errands. The foremost object behind this is that it is being openly hoped that independent directors would be fruitful in employing high standards of corporate governance & safeguard that the companies are run in a crystal clear & well-organized routine. They also carry with them the anticipation that they would act as the guardian of minority shareholder’s interests which is extremely vital at least in Indian scenario.

However the sort of roles & responsibilities that have been designated to them under Act, 2013 appears to be plentiful & at certain times, prodigious. It remains to be seen as to how many people would be eager to take so many errands particularly when remunerations are not at all eye-catching. It also vestiges to be seen whether independent directors, in reality are actually being able to carry

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<sup>480</sup> Companies Act 2013, s 149

<sup>481</sup> Companies Act 2013, s 149(8)

<sup>482</sup> PwC India, *Companies Act, 2013 Key highlights and analysis*

<<https://www.pwc.in/assets/pdfs/publications/2013/companies-act-2013-key-highlights-and-analysis.pdf>> accessed 13 October, 2015

<sup>483</sup> Ibid



out so many purposes as been allocated to them in a well-organized manner. But at the same time it is too premature to analyze whether these provisions would be fruitful in implementation or not.

To conclude, the author feels that all the wanted regulations, provisions etc have been put in place to safeguard the office of independent directors to enable him to contribute in augmentation of the scheme of corporate governance. All that remains to be seen is whether independent directors are actually able to break away from their shackles of merely acting as rubber stamp & essentially contributing to the evolution of the company rather than merely playing an ornamental protagonist.

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# **THE ROLE OF NGOS AND CIVIL SOCIETIES IN THE ENFORCEMENT OF CHILD RIGHTS IN DEBRE MARKOS TOWN: CHALLENGES AND SOME SOLUTIONS**

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## **ABSTRACT**

This term paper tries to explore the role of civil societies in the enforcement of child rights-the law and the practice. It attempts to assess whether the role expected from civil societies working on/with child rights is put into practice in Debre Markos Town. For the assessment of the practice relevant international and regional instruments and national laws of Ethiopia are examined in light of enforcing child rights. In so doing, this study has reached that civil societies aren't playing a decisive role in enforcing child rights. Thereby, it analyzes the restrictive civil society law of Ethiopia which is enacted in 2009 in contravention of international and regional child rights instruments in general, and the FDRE Constitution of Ethiopia in particular. Finally, the study concluding that civil societies are not playing their best expected role in the enforcement of child rights, it calls the government and other concerned stakeholders for amendment of such coercive law ameliorating enforcement of child rights problems.

**Keywords:** NGOs and Civil Societies, child Rights, Restrictive CSO/NGO Legislation, Human Rights, Development.

## **1. INTRODUCTION**

### **1.1. Organizational Background**

Civil society comprises different sections of social community. It includes NGOs, professional associations, cooperatives, trade unions, religious institutions, independent media organizations, and think tanks which work at different levels; global, regional national and local. Civil society, therefore refers to us groupings of social communities whose activities is distinct from the market and the state; in which citizens come together to pursue common interests through collective actions; neither for profit not for the exercise of political power like political parties. Thus, all organizations and associations that lie between the family and the state are said to be civil societies.<sup>1</sup>

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Civil society organizations play pivotal role in all areas of nation building efforts throughout our globe up-to-date. Nowadays, civil society is recognized as constituting diverse and wider ecosystem of individuals, communities, and organizations. For this, information and communication technologies opened up spaces of power, influence, and association to new grouping of actors that paves the way to significant roles of civil societies. Basically, among the multifaceted roles of civil society the World Economic Forum watchdog, advocacy, service provision, expertise, capacity building, incubation, representation, citizenship champion, solidarity support, and defining of standards can be mentioned as functions of civil societies.<sup>2</sup>

To deal the aforementioned roles of civil societies, let us see one by one.

**Watchdog:** it is the means of holding institutions accountable and transparent for their acts.

**Advocacy:** it is raising awareness of societal issues and challenges with their remedial solutions.

**Service Provision:** serving the community to meet societal needs such as education, health, food security, implementing disaster management, preparedness and emergency responses...etc.

**Expertise:** this refers bringing knowledge and experience so as to shape policy and strategy, and identifying and devising rewarding solutions.

**Capacity Building:** as its name ostensibly shows, it is enhancing the ability or capacity of the community by providing trainings, education and other related measures.

**Incubation:** it is a means of developing solutions that may require a long gestation or payback period.

**Representation:** in this way, civil societies give power to the voice of the marginalized, voiceless or underrepresented sections of the society.

**Citizenship Champion:** civil societies encourage and support citizens to engage in social justice promotion and other public-spirited deeds.

**Solidarity Support:** civil societies are means of promoting fundamental and universal values.

**Defining Standards:** civil societies create norms that can shape or direct market and states' activities.<sup>3</sup>

Being a state party or signatory to the Conventions, Ethiopia is obliged to work in line with human rights NGOs, child and youth led organizations, women associations and coalitions, parent and family groups, faith groups, academic institutions, and also professional associations. Following the

promulgation of a restrictive civil society's law in 2009, the Committee on the Rights of the Child has tried to do over the restrictions imposed upon civil society starting from the 2005 elections. Consequently, the Committee recommended Ethiopia to respect the role played by civil society in implementation of the Convention on the Rights of the Child. In addition, the Committee required Ethiopia to encourage the active, positive and systematic involvement of civil society, including NGOs, in the promotion of children's rights.<sup>4</sup>

Proclamation for the Registration and Regulation of Charities and Societies (Proclamation 621/2009) which had been adopted by the House of Peoples Representatives has resulted in a three-pronged classification of charities and societies. These are: Ethiopian charities, Ethiopian resident charities and international and foreign charities. The law says that only Ethiopian charities are allowed to engage on advocacy on human rights including the rights of children. But the law orders Ethiopian charities to obtain 90 percent of their funding from local sources. By this time, Ethiopian charities are not able to get/secure 90 percent of funding for their activities from domestic sources. Hence, the law is not still kin to Ethiopian Charities since it adversely impacted their activities for the promotion of the rights of children.<sup>5</sup> Here, when we say child rights, it is a common name for best interest of the child, civil and political rights, economic, social and cultural rights, right to equal opportunities, evolving capacities of the child, respect for the views of the child, the right to protection against discrimination, and discrimination and punishment.<sup>6</sup>

## **1.2. Relevance and Objectives of the Assessment**

The Charities and Societies Proclamation No. 621/2009 which is enacted in February 13, 2009 has brought new challenges to most of the civil societies operating in the country in general and those working on child rights in particular. Hence, it is significant for us to examine the law's hurting potential taking into account practical scenarios by observing civil societies which are working on child rights protection in Debre Markos Town. Therefore, in appreciation of the legal and practical gaps it is possible to make appropriate decisions and devise well calculated ways to aptly cope within the current international, regional and domestic legal framework which are akin to child rights enforcement.

The general objective of the assessment is, hence, to show the possible effects of the new Charities and Societies Proclamation and other societal issues on the enforcement of child rights. This enables

us to further identify possible future directions from recommendations given that can positively impacting the lives of children.

Under the above stated general objectives, the specific objectives of the assessment are the following; these are:

- To reveal the possible implications of the new proclamation on CSOs in light of child rights enforcement;
- To study extra legal or societal concerns in the conduct of child rights enforcement;
- To identify possible future directions and recommendations for concerned stakeholders in their child focused interventions; and
- To point the possible working relationship of CSOs, the government and the public at large in bringing better child rights enforcement.

### **1.3. Methodology and Information Sources**

To have a critical analysis of the role of CSOs which are working on child rights enforcement important documents such as its research articles, handbooks and manuals, guidelines...etc related papers were consulted allowing a careful investigation of the issue at hand. Besides, a close examination of the provisions of the proclamation and relevant documents of the CSO during the drafting process of the proclamation were referred too..

This term paper is of qualitative, and the data was collected mainly through interviews, and informal discussions held with Program Coordinators and MERL (Monitoring, Evaluation, Reporting and Learning) Officers of the three selected CSOs which working on children in Debre Markos Town. These selected CSOs were: Tesfa Social and Development Association (TSDA), Migbare Senay Children and Family Support Organization (MS-CFSO), and Developing Families Together (DFT).

### **1.4. Limitation of the Assessment**

The process of the generating information from the aforementioned CSO personnel, of course, was accomplished without limitations. The major limitation originates during the interview and informal discussions with some officers. Some of them were not cooperative- not willing to express their ideas and become reluctant to have a say on the issue and the rest were not well informed with the laws and regulations governing their activities and they couldn't trace practicalities with their causal element, especially when they raise problems in activities of child rights enforcement.

## **2. INTERNATIONAL, REGIONAL AND NATIONAL LEGAL FRAMEWORKS ON CHILD RIGHTS**

## 2.1. International Instruments

The CRC is the most complete international instrument of children's rights and is the first document to recognize rights of children before international law. As the convention defines, child is a person under the age of 18, unless domestic laws provide an earlier age of majority. For this, the convention stipulates under its Article 2 that States parties must respect the rights in the Convention "...without discrimination of any kind, irrespective of race, color, sex, language, religion, political or other opinion, national, ethnic or social origin, property, disability, birth or other status". And Article 19 (1) states that the child shall be protected from "...all forms of physical or mental violence, injury or abuse, neglect or negligent treatment, maltreatment or exploitation, including sexual abuse...." The same is true, Article 23 Concerns the rights of children with disabilities and Article 24 (2) (d) of the Convention requires States to ensure the appropriate prenatal and postnatal health care for mothers.<sup>7</sup>

In the same token, The Universal Declaration of Human Rights (UDHR) enshrines in Article 25 (2) that "...motherhood and childhood are entitled to special care and assistance. All children whether born in or out of wedlock, shall enjoy the same social protection." The International Covenant on Civil and Political Rights (ICCPR) says in Article 24 (1) that, "Every child shall have, without any discrimination as to race, color, sex, language, religion, national or social origin, property or birth, the right to such measures of protection as are required by his status as a minor, on the part of his family, society and the State..."<sup>8</sup>.

And the International Covenant on Economic, social and Cultural Rights (ICESCR) in its Article 10 states that "...special protection should be accorded to mothers during a reasonable period before and after childbirth...Special measures of protection and assistance should be taken on behalf of all children and young person's without any discrimination for reasons of parentage or other conditions. Children and young persons are required to be protected from economic and social exploitation. In addition, ICESCR convenes that employment in work harmful to their morals or health or dangerous to life or likely to hamper their normal development entails punishment. And states are expected to set age limits below which the paid employment of child labor should be prohibited and punishable by law." In Vienna Declaration on Program of Action, states the best interest of the child to be a prime consideration and states are urged to ratify and enforce the CRC<sup>9</sup>.

All in all, though the aforementioned international instruments has dealt with child rights as one aspect of their objective. CRC is the owner of child rights. It is merely designed to regulate child rights benevolently. For this, CRC is primarily concerned with four aspects of children's rights, which are known as "the four 'P's". These are: participation by children in decisions affecting them; protection of children against discrimination and all forms of neglect and exploitation; prevention of harm to them; and provision of assistance to children for their basic needs. Generally, CRC has shown us the following five wonderful achievements; these are<sup>10</sup>:

- It has brought new rights for children under international law that previously had not existed, such as the child's right to preserve his or her identity (articles 7 and 8), the rights of vulnerable children like refugees to special protection (articles 20 and 22), and indigenous children's right to practice their culture (articles 8 and 30). And such innovation geared towards child-specific versions of existing rights, such as those in regard to freedom of expression (article 13) and the right to a fair trial (article 40).
- CRC stipulates in a global treaty rights that hitherto had only been found in case law under regional human rights treaties (e.g., children's right to be heard in proceedings that affect them) (article 12).
- The CRC also substituted non-binding recommendations with binding standards (e.g., safeguards in adoption procedures and with regard to the rights of disabled children) (articles 21 and 23).
- Emergence of new obligations which are imposed on States Parties with respect to the protection of children, in such areas as banning traditional practices prejudicial to children's health and offering rehabilitative measures for victims of neglect, abuse, and exploitation (articles 28(3) and 39).
- CRC puts an express ground obligating States Parties not to discriminate against children's enjoyment of CRC rights. The right to participate in proceedings, it is argued, besides the principles of non-discrimination in Article 2 and provision for the child's best interests in Article 3, which are among the guiding principles of the Convention that implicates the vision of respect and autonomy the drafters intended to make for all children.

## **2.2. Regional Instruments: African Charter on the Rights and Welfare of the Child 1990**

The African Charter on the Rights and Welfare of the Child (ACRWC) is the first regional treaty on children's rights which is based on the 1979 Declaration on the Rights and Welfare of the African Child. However, most of its provisions are modeled after those of the CRC. ACRWC unlike CRC introduced provisions concerning children's duties under article 31 as per the African Human Rights Charter. The Preamble reads as that the child occupies a unique and privileged position in the African society and requires legal protection as well as particular care with regard to health, physical, mental,



moral and social development. Then after, ACRWC defining a child using age wise approach under article 2, it has stipulated the principles of non-discrimination and the best interests of the child, inherent right to life, prohibition of death penalty (articles 3-5), right to a name and nationality as well as to freedom of expression, association and peaceful assembly; thought, religion, and conscience; privacy; education; and rest and leisure (articles 6-12).<sup>11</sup>

### **2.3. National Laws of Ethiopia on Child Rights: the 2009 Civil Society law Regarding the Rights of Children**

The Ethiopian Constitution which is adopted after the overthrow of the communist regime, has made fundamental human rights its part. Then after, Ethiopia has acceded to and/or ratified many international human rights treaties. Among them, the Convention on the Rights of the Child (CRC) and the African Charter on the Rights and Welfare of the Child (ACRWC) can be mentioned. And to entertain these treaties and existing domestic laws in consistency, Ethiopia has revised many of its existing laws talking about children. For example, the revised family code, criminal code, and labor code are good examples.<sup>12</sup>

However, in 2009, the Federal Government of Ethiopia has come up with one of the most controversial proclamations in the country. This is the Charities and Societies Proclamation (CSP) dealing with the formation and operation of CSOs. As opposed to the previous practice that the registering authority divided CSOs into the categories of development, advocacy, religious, and professional associations, this law categorizes CSOs into two broad categories known as Charity (when they established for the benefit of third parties) and Society (when they established for the benefit of its members and third parties). And what is new is that the new law envisages three forms of legal establishment of charities or societies, which may vary depending on their place of registration, source of income, composition of members 'nationality, and place of residence'<sup>13</sup>.

The three forms of association include: one, "Ethiopian Charities" or "Ethiopian Societies" are Charities or Societies formed under the laws of Ethiopia and whose members are Ethiopians, generate income from Ethiopia, and are wholly controlled by Ethiopians. However, they may be deemed Ethiopian Charities or Ethiopian Societies if no more than 10 percent of their funds are received from foreign sources; two, "Ethiopian Residents Charities" or "Ethiopian Residents Societies" are Charities or Societies that are formed under the laws of Ethiopia and consist of members dwelling in Ethiopia, and who receive more than 10 percent of their funds from foreign sources; three, "Foreign Charities" are Charities that are formed under the laws of foreign countries,

or consist of members who are foreign nationals, or are controlled by foreign nationals, or receive funds from foreign country sources<sup>14</sup>.

As Debebe Hailegebrel and Ashagrie wrote in their research article under International Journal of Not-for-Profit Law / vol. 12, no. 2, February 2010 / 10, and The Interdisciplinary Journal of Human Rights [Vol. 7: 1] respectively, and as article 14(5) of the 2009 law clearly reads, those who can take part in activities of:

- The advancement of human and democratic rights,
- The promotion of equality of nations, nationalities and peoples and that of gender and religion,
- The promotion of the rights of the disabled and children's rights,
- The promotion of conflict resolution or reconciliation, and
- The promotion of the efficiency of the justice and law enforcement services shall be only Ethiopian Charities and societies.

The above areas of CSOs activities are denied for Ethiopian Resident and Foreign Charities and Societies as it can be understood from the sole permission of Ethiopian Charities and Societies to engage in those enlisted activities. Here to our concern, confining child rights advocacy works to a specific form of CSO ostensibly goes against the best interest of the child which has get a distinct place under international, regional and national child rights instruments and other human rights documents. This incident clearly reveals that demolishing a well-built child right protection environment where once upon a time it has laid down on a firm basement. Even though the CSP law leaves an entrance to Ethiopian Charities and Societies to engage in child rights advocacy, in the practical course of action it is impossible to bring an effective result since the financial capacity of Ethiopian Charities and Societies which is relied only on domestic sources in a least developed country -Ethiopia, where issue of children is highly sensitive <sup>15</sup>. So, such move of the law amounts to urging CSOs not to work on child rights promotion completely. Child rights by its very nature need the hand or contribution of all the concerned stakeholders by which the finance, expertise, skill and knowledge...etc inputs accumulated and work effectively in coordination. The responsibility to promote child rights should neither be left solely to the government, citizens, parents or caregivers nor to anybody else.

The CSP law, in addition to restriction on activities and denial of access to foreign funds for Ethiopian CSOs more than 10 percent, has another pitfall adversely impacting rights of children. It has also denied the right to access to justice. That is Ethiopian Residents or Foreign Charities do not have

access to judicial recourse or appeal of administrative decisions. Judicial recourse or appeal is only allowed only for Ethiopian Charities and Societies. This is unduly a clear violation of the right to access to justice enshrined under ICCPR. Inclusion of such provision not only contravenes lawfully established CSOs right, but also what would be very grave is forbidding claiming the right to advocate for child rights before the court of law. Such so restrictive law is making children helpless and more vulnerable than they are by their very nature<sup>16</sup>.

### **2.3.1. The Proclamation in Light of Human Rights Interpretation in General and Child Rights in Particular under the FDRE Constitution**

Among the composite of 106 articles of the Constitution of Ethiopia, 31 are destined to human rights. And out of them, article 36 of the Constitution provides that the best interest of the child is given the primary consideration. In another way round, article 9(4) of the Constitution succinctly states that “treaties ratified by Ethiopia are an integral part of the law of the land.” Under the Human Rights Chapter, the Constitution also states that “[T]he fundamental rights and freedoms specified in chapter three of the constitution shall be interpreted in a manner conforming to the principles of the Universal Declaration of Human Rights, International Covenants on Human Rights, and international instruments adopted by Ethiopia.” The phrase “in a manner conforming to” refers that domestic laws should not be given priority in time of apparent contradiction or during ordinary application of the laws. This is what has already stated in the Vienna Convention on the Laws of Treaties, which reads: “[A] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.” Therefore, international laws such as the CRC and ACRWC prevails or take precedence over the Ethiopian civil society law (proclamation No. 621/2009) when contradiction arise.<sup>17</sup>

### **2.3.2. The Proclamation in Light of the Principle of the Universality, Indivisibility, and Interdependence of Human Rights in General and Child Rights in Particular**

The Ethiopian CSO law taking source of funding has resulted activities that would be exercised as proper and not proper for civil society organization concerning human rights advocacy. Then this law is enacted in a clear contravention of the fundamental principles of universality, interdependence, and indivisibility of human rights. When we see the principle of the best interest of the child, which is purported to protect, promote, and realize the rights of children so that the well-being of a child cannot be realized by mere provision of services (provision of books, food, school uniform to be educated...etc). Rather there are child rights that can only be achieved via advocacy (like bringing a case before a court during child rights violations, creating awareness to the public

about child rights, lobbying government to take measures concerning quality education, child labor, trafficking, prostitution...etc). Thus, prohibiting civil society organizations working on advocacy rights solely and making them service-providers because they receive more than 10% of their funds from abroad is contrary to the heart of the principle of human rights: universality, indivisibility, and interdependence which are duly recognized under human rights instruments in general and CRC in particular.<sup>18</sup>

In sum, when we examine the CSP in light of NGOs/CSOs as a whole and those which were working on child rights it so oppressive. It has introduced complicated and laborious requirements and processes in licensing and registration, expansion of branch offices, membership, administration and operation system, fundraising and collection, limitation of activities...etc challenges are for NGOs/CSOs to work on child rights and empowers The Federal Charities and Societies Agency (FCSA) to conduct an arbitrary oversight, surveillance, controlling, and managing authority. And similarly, any federal or regional government institutions had given the same power to do so under article. Hence, NGOs/CSOs are under a hall of prison that fastens their extinction in the near future.

### **3. THE JUSTIFICATIONS BEHIND THE LAW ON THE PART OF THE GOVERNMENT**

When we heard of the voices of the government concerning the CSP, by its part it enlists different arguments and tries to strengthen the functionality of the law. The first thing is that the government is in suspicion of foreign or foreign funded NGOs/CSOs for their influence and lobbying activities in the democratization and development aspects. Since most organizations are foreign funded they are very likely to implement their donor's social, cultural, political and economic agendas. And this usually does not go in line with the government's move.

It is a public knowledge that the work or task of democratization and promotion of human rights, to our case child rights is the concern of all of us. Hence, if we try to make our effort in our own way it is possible to make good contribution to enhance child rights enforcement. In cursing such argument of the government may not always hold water. This is because all charities or societies may not always found working on their public-spirited philanthropic activities. Some acts as watchdogs of imminent developed states and organizations interest, others may be engaged in spying activities against the sovereign interest of the state. Mostly, they are susceptible to lack of accountability, poor administration and management, poor auditing and reporting...etc malpractices that ends to corruption.<sup>19</sup> However, the government should not have taken measures by enacting such too repressive civil society law that easily endangers the very existence of philanthropic works. So, the

government could have resorted to alternative management and controlling legal and institutional mechanisms.

#### **4. MAJOR FINDINGS (PRACTICAL SCENARIOS FROM THE ASSESSMENT)**

So as to substantiate the theoretical conceptions found in different research articles and documents concerning the role of NGOs/CSOs in the enforcement of child rights, we have tried to take facts from the experiences of philanthropic organizations related to children in Debre Markos Town. In doing so, it is possible to get three Ethiopian Resident Charities/Societies: Tesfa Social and Development Association (TSDA), Migbare Senay Children and Family Support Organization (MSCFSO), Developing Families Together (DFT) which opens their branch and operates in the town. In these each three organizations, we have interviewed one project coordinator and MERL (monitoring, evaluation, reporting, and learning officer).

To fasten our view on these aforementioned organizations, let us have a look which are they and why they have established for. When we see TSDA, the following paragraph reads as follows:

“ ..... Tesfa Social and Development Association (TSDA).....legally recognized NGO by the name of Tesfa social and development association in September 2000. Presently, TSDA is providing home based care, educational and psychological support and economic support to orphan and vulnerable children and PLHIV and orphan who are burdened with the responsibility of caring for their grandparents due to the death of their own parents as a result of HIV and AIDS. TSDA is also striving to create a positive attitude in the community towards PLWHA and those affected by the epidemic and bring behavioral change to intensify the fight against the prevalence through organized communal and household actions. TSDA is also contributing to wards poverty alleviation of the country by supporting the impoverished community groups through its livelihood and capacity building programs.<sup>20</sup>

Whereas, Migbare-Senay Children and Family Support Organization’s (MSCFSO) mission is to contribute towards improving socio-economic development and bring better livelihood through children and family support<sup>21</sup>

And lastly, Developing Families Together (DFT) is an Ethiopian Residents’ Charity organization committed to:

“.....work for poverty reduction, HIV/AIDS prevention, and care and support for needy people in Ethiopia. DFT was established in March 2002 and re-registered in October 20, 2009 under Ethiopian

Charities and Societies Agency with a license number 0087. To contribute to the national efforts to improve livelihoods and health status of marginalized families, women, children and other vulnerable groups of the society through household and community based development approach.”<sup>22</sup>

Presently, all these three NGOs/CSOs are working on the following activities in commonly sponsored by Yekokeb Berhan Program for Highly Vulnerable Children; these are:

- Provision of food items
- Shelter
- Educational support
- Health and Nutrition
- Psychosocial Support; and
- Life skill training

Yekokeb Berhan Program for Highly Vulnerable Children is originally a USAID funded and designed program which is now operating in Debre Markos town and nearby East Gojjam Zone Woredas by these charities/societies mentioned before. Any how this project is:

“Yekokeb Berhan, which means “starlight” in Amharic, works to ensure that children and their families have access to high-quality services and are empowered to lead healthy, productive and fulfilling lives. The long-term vision of the Yekokeb Berhan Program for Highly Vulnerable Children is to implement a child-focused social welfare framework in Ethiopia that allows all children, including those who are highly vulnerable to HIV and other crises, to thrive. With funding from the U.S. Agency for International Development, Yekokeb Berhan aims to reach 500,000 highly vulnerable children throughout Ethiopia by strengthening the capacity of government and community systems and structures to deliver essential services and increase resiliency. Led by Pact, FHI 360 partners with Child Fund and other civil society organizations to reach all regions in the country, as well as two administrative towns and 231 selected *woredas* (districts).<sup>23</sup>

Under Yekokeb Berhan, FHI 360 provides technical leadership in the areas of: Database development and strengthening, Food and nutrition, Health care, Protection and legal support, Psychosocial support, Shelter and care, Family-based alternative care for orphans and vulnerable children, Behavior change communications and national systems strengthening.

From our interview conducted with key officers and branch heads of the above NGOs/CSOs in Debre Markos town, we have got similar responses and approaches to our questions. We believe why that was so is that they are under similar project, place, community, area of activities and legal and institutional environment. So, they have enlisted the following major Challenges:

**A. Limitation on Activities:** they have told us that they are completely prohibited to work on child rights and related human rights and advocacy works. They said that even we cannot use the phrase 'child rights' Even though a slip of tongue or pen make us to speak out or include in their writings, they are under a duty to apologize and delete or reshuffle the phrase into 'child safety' This term unduly eases their frustration in dealing with children's issues, as they said in their words.

**B. Intimidation and Atmosphere of Fear:** the recurrent and serious warnings and intimidations from the nearby government officials have made them to live in an atmosphere of fear and instability. They have added, despite the fact that we haven't had enough or deeper understanding on the CSP, they responded that they are duly informed from the boss at head offices in Addis Ababa. Hence, they will not go against the law knowingly or unknowingly. But, what is worst is an all-time confrontation of local government sector officials. The intimidation and fear goes up to volunteers and persons in close contact with a victim child.

**C. Bad Societal Attitudes:** the society is less sensitive to the concern of children. The society is characterized by selfishness, lack of commitment, self-censure,...etc bad habits. As an example, they have given us a practical incident whereby they have sustained embarrassing emotional feelings. For example when, a certain child has sustained rape, stabbing, trafficking, labor exploitation, procrastination,...etc violations, they are expected to help the victim child, collect relevant data from health centers, parents, care givers, police...etc sections of the community to assist the victim child and identify the wrong doer. However, such activities could not be done due to:

- Hiding/concealing of information by the child him/herself, parents, care givers, volunteers, neighbors,...etc passerby that have witnessed the child rights violations;
- Seeking of money or other kinds of incentives by community police officers, and informants from NGOs/CSOs which are facilitating children's case at hand;
- Lack of commitment on the part of parents, care givers, neighbors, volunteers and care givers and other sections of the society;

- Less status accorded to children in the community. Especially when a child is disabled, girl-child, orphan...etc who suffers from double vulnerability, the society has not any hear to their voice. They considers them as a commodity; and
- Consideration of children as a property; the society would like to use them as it needs without seeing them as persons who have their own rights and interests.

**D. Discontinuity of Follow up or Facilitation Activities:** after facilitation of children's case to be handled by the government on advocacy works, the public prosecutors and other government officials inhibits them to make themselves even to ask where the case have reached. Their role is already harnessed from the time they have informed the police or public prosecutor as an ordinary responsible citizen. They cannot even ask the final decision of the case provided that the court has a ruling on child rights violations case. From here, we can understand that there is no any sense of good perception for charities/societies in the eyes of the government. Hence, sense of coordination and cooperation has already buried.

## 5. CONCLUDING REMARKS

Enforcement of child rights in Ethiopia is highly curtailed by the CSP that seems totally ignored the international, regional and the FDRE constitution which are hierarchically higher legal regimes duly incorporated promotion of child rights and their enforcement. This has brought the following evil results which are the basic manifestations of the oppressive NGOs/CSOs law. These are:

- adverse effects or limitations on areas of intervention;
- Encumbrance on accessing foreign aid and other supportive mandated tasks;
- Retaining of skill, knowledge, and the right attitude of skilled staff in government offices;
- Ignorance of the government to the felt need of the society; and
- Blockage of networking among NGOs/CSOs among themselves, with the government and abroad strong organizations which are kin to knowledge, resources and skill transfer.

Generally, unless the repressive civil society law gets amended for the interest of the society at large and children in particular, Ethiopia would become hopeless to see well grown and effective succeeding generation in the near future.

## 6. RECOMMENDATIONS (SOME KEY SOLUTIONS)

In this term paper, it is tried made visible that civil society working on children have lost their key role in enforcing child rights. Accordingly, the following recommendations are thought to be some



solutions in smoothing the repressive law and enhance child rights enforcement; these are presented as follows:

- **Conducting Nationwide Discussion and Impact Assessment:** As bright idea fights will result a sustainable and effective outcomes, it is highly recommended to conduct comprehensive national dialogue comprising of all concerned stakeholder towards child rights like civil societies, government, media, international organizations, representative community figures,...etc. Another basic thing is conducting participatory impact need assessment of the existing civil society law. As law is designed to regulate the behavior of the society, it is better to research how much positive-negative impacts it has resulted. This enables us to weigh the usefulness of the law at current situation of children in Ethiopia.
- **Devising Alternative and Interim Solutions:** having accepted the problem and live idle refraining from doing nothing to children would not be a lasting and good solution. Rather civil societies are expected to strengthen themselves and formulate alternative measures is rewarding. This for the time being enables to go in line with the law having protected its demerits strategically. Such task can be done via child right policy reformation and devising of other legal areas of intervention to relieve children from their vulnerability in such least developing state.
- **Establishment of Government-Civil Society Coordination Task Force:** this is so a meritorious get way to enforce child rights better than using other mechanisms till the law get amended or reformed. This task force keeps mutual interests of both the government and the civil societies shielding from reciprocal interventions that affect their respective normal functioning. The division or categorization of functions of the government and the civil societies and seeing in confrontation and suspicion would not be a lasting solution.
- **Independent Child Rights Enforcement Budget from the Government:** if the government of Ethiopia is still not convinced of criticisms against its repressive law, it should give a due concern for child rights enforcement by itself by locating enough budget that would substitute aspired foreign funds and subsidize the little domestic sources for Ethiopian Charities/Societies that derive more than 90 percent of their income from domestic sources. If the government can do as such, it can promote child rights enforcement with 90 percent locally or domestically funded civil societies.
- **Call for Amendment of the Existing CSP Law:** if the government of Ethiopia is still now at discomfort on aforementioned recommendations or understood its demolishing effect of the law by itself, the last thing is reforming its law as per the procedures it has come with its enactment by its legislative organ.

## END NOTES

<sup>1</sup>Ayele Angelo Ago, 'The Roles, Contributions And Challenges Of NGOs In Ethiopia' (Dissertation Prepared in partial fulfillment of the requirements for MA Degree in Social Development and Sustainable Livelihoods, University of Reading 2008).

<sup>2</sup>Debebe Hailegebriel, Promoting Democracy and Good Governance: The Role of Ethiopian Media and Civil Society Organizations (1st edn, Debebe Hailegebriel Law Office 2014).

<sup>3</sup> Ibid.

<sup>4</sup>Girmachew Alemu and Yonas Birmeta, Handbook On The Rights Of The Child In Ethiopia (Center for Human Rights College of Law and Governance Studies Addis Ababa University In Collaboration with Save the Children Norway- Ethiopia 2015).

<sup>5</sup> Ibid.

<sup>6</sup> Child Rights Glossary, UNICEF.

<sup>7</sup>United Nations, 'Child Labor' (2015) <<http://www.un.org/en/index.html>> accessed 20 November 2015.

<sup>8</sup> Ibid.

<sup>9</sup> Supra.

<sup>10</sup> LIBRARY OF CONGRESS, 'Children's Rights: International Laws' (2015) <<http://www.loc.gov/law/help/child-rights/international-law.php>> accessed 10 November 2015.

<sup>11</sup> Ibid.

<sup>12</sup>Ashagrie G. Abdi, 'THE ETHIOPIAN CIVIL SOCIETY LAW IN LIGHT OF THE PRINCIPLE OF THE BEST INTEREST OF THE CHILD' 7 the Interdisciplinary Journal of Human Rights.

Ayele Angelo Ago, 'The Roles, Contributions And Challenges Of NGOs In Ethiopia' (Dissertation Prepared in partial fulfillment of the requirements for MA Degree in Social Development and Sustainable Livelihoods, University of Reading 2008).

<sup>13</sup>International Center for Not-for-Profit Law, "Sub-Saharan Africa Country Reports, Ethiopia" (International Center for Not-for-Profit Law 2010).

<sup>14</sup> Ibid, see at p.10.

<sup>15</sup>Ashagrie G. Abdi, 'THE ETHIOPIAN CIVIL SOCIETY LAW IN LIGHT OF THE PRINCIPLE OF THE BEST INTEREST OF THE CHILD' 7 the Interdisciplinary Journal of Human Rights.

<sup>16</sup> See note 13 above, p 20.

<sup>17</sup> Ibid, p 140.

<sup>18</sup> Ibid, p 144.

<sup>19</sup>ebebe Hailegebriel, Promoting Democracy and Good Governance: The Role of Ethiopian Media and Civil Society Organizations (1st edn, Debebe Hailegebriel Law Office 2014).

<sup>20</sup> Tesfa Social and Development Association (TSDA, 'About Us' (2015) <<http://www.tesfasocial.org.et/index.html>> accessed 17 November 2015.

<sup>21</sup> Migbare-Senay Children And Family Support Organization (1st edn, Migbare-Senay Children and Family Support Organization 2015) <<http://esap2.org.et/wp->

<sup>22</sup> Developing Families Together (DFT), 'About Us' (2015) <<http://www.dftethiopia.org/home.html>> accessed 19 November 2015.

<sup>23</sup> FHI 360, 'Yekoeb Berhan Program For Highly Vulnerable Children' (2015) <<http://www.fhi360.org/about-us>> accessed 12 November 2015.

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## **THE WHISTLE BLOWING REGIME IN THE USA AND THE UK: THE WAY AHEAD FOR INDIA**

**NIKHIL VARSHNEY, RIDDHIMA PREM MURJANI<sup>486</sup>**

### **ABSTRACT**

Whistleblower policy, though new in India has been in practice by Securities and Exchange Commission (“SEC”) in U.S. and Financial Conduct Authority (“FCA”) in U.K since a long time. The policy aims to bring transparency in the running of huge corporations and to protect the individual who comes forward and discloses unfair practices or violation of law by these corporations. Still, even in those advanced countries, the laws relating to whistleblower are fraught with limitations. This paper provides all the statutory protection which a whistleblower is entitled to in the U.S. and the U.K and what lacunae still exists. This paper provides an insight to the practices prevalent in U.S. and U.K. and in that backdrop, moves on to discuss the situation in India, which is still in a very nascent stage. The author in the conclusion has dealt with various issues and factors that the Indian market regulator Securities and Exchange Board of India (“SEBI”) shall consider before coming out with the whistleblower policy so as to ensure proper, efficient and effective results.

### **INTRODUCTION**

The term whistleblower has its origin in United Kingdom. It was first discussed by Doggett, J., in the case of *Winters v. Houston Chronicle Pub. Cos.*<sup>487</sup> The term can be attributed to the action of the ‘English bobbies (police constables)’ who blew whistle when they noticed the commission of a crime.

A widely used definition of whistle blowing is “*the disclosure by organization members (former or current) of illegal, immoral or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action.*”<sup>488</sup> A more restrictive definition is “*Whistle blowing is a deliberate non-obligatory act of disclosure, which gets onto public record and is made by a person who has privileged access to data or information of an organization, about non-trivial illegality or other wrongdoing whether actual, suspected or anticipated which implicates and is*

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<sup>487</sup> 795 S.W.2d 723 (Tex. 1990)

<sup>488</sup> Near, J.P. and M.P. Miceli, ‘Retaliation against whistle-blowers: Predictors and Effects’, *Journal of Applied Psychology*, 1986, pp 137-145

*under the control of that organization, to an external entity having potential to rectify the wrongdoing.*<sup>489</sup>

Peter B. Jubb in his paper titled Whistleblowing: 'A Restrictive Definition and Interpretation' explicitly pictures whistle blowing as an act of dissent, which publicly implicates a company by externally disclosing wrongdoing. In response to scandals and the new legislation, an increasing number of companies have adopted whistle blowing policies that should make external disclosure unnecessary by solving the problem internally. These policies are examples of what Dr. W. Vandekerckhove and M.S.R. Commers call *institutionalized whistle blowing*<sup>490</sup>, defined as "the set of procedures allowing potential whistleblowers to raise the matter internally before they become whistle blowers in the strict sense". The concept of whistleblowers in the strict sense refers to Peter. B Jubb's narrow definition. The whistle blowing mechanism has proved out to be a useful tool to bring to fore any wrongdoing by a particular organization. Talking about securities market, SEC and FCA have capitalized over this mechanism in order to prosecute any company/firm engaged in illegal activities.

## **THE UNITED KINGDOM CHAPTER**

### **THE WHISTLE BLOWING REGIME IN U.K.**

Talking about the common law background, the common law has never given its workers a general right to disclose information about their employment. Even the revelation of non-confidential material could be regarded as undermining the implied duty of trust and give rise to an action for breach of contract. Where employees have allegedly disclosed information in breach of an express or implied term, they may seek to invoke a public interest defense to a legal action. Although the common law allows the public interest to be used as a shield against an injunction or damages, it has proved to be a weapon of uncertain strength.<sup>491</sup>

It is significant to have a look at the judicial precedents in this regard. In the case of *Initial Services v. Putterill*<sup>492</sup>, the Queen's Bench was of the view that law has allowed an exception to the principle of non-disclosure of confidential information where there is 'any misconduct of such a nature that it ought to in the public interest be disclosed to others'. However, the disclosure must be to

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<sup>489</sup>Jubb. P.B., 'Whistleblowing: A Restrictive Definition and Interpretation', *Journal of Business Ethics*, 1999, pp. 77-97

<sup>490</sup>Vandekerckhove, W. and M.S.R. Commers, 'Whistle Blowing and Rational Loyalty', *Journal of Business Ethics*, 2004, pp. 225-233

<sup>491</sup> Lewis David, Ten Years of Public Interest Disclosure Legislation in the U.K. Are Whistleblowers adequately protected, *Journal of Business Ethics*, Vol. 82 No. 2, Oct. 2008, pp. 497-507.

<sup>492</sup> [1968] 1 QB 396

someone who has an interest in receiving it. In the case of *Lion Laboratories Ltd. v. Evans*<sup>493</sup>, two employees gave national daily copies of some internal documents doubting the reliability of breathalyzers manufactured by their employer. The company sought an injunction to prevent publication of the information on the grounds of breach of confidence. The action by the company failed because the employees were found to have 'just cause or excuse' for disclosure. Subsequently, in *Re a Company's Application*<sup>494</sup>, the High Court refused to grant an injunction against the employee in the financial services sector from disclosing confidential information about his company to a regulatory body, notwithstanding that the disclosure might be motivated by malice. Though Justice Scott continued an injunction against general disclosure, he held that an employee's duty of confidence did not prevent them from disclosing to regulatory authorities matters which were within the province of those authorities to investigate. Thus, apart from the situation where an employee reports a breach of statutory duty to a relevant regulatory body, the common law has not provided reliable guidelines about what could be disclosed and to whom.

The two legislations carving out the circumstances in which whistleblowers are protected in U.K. are the 'Public Interest Disclosure Act, 1998 ("**PID Act**") and the 'Employment Rights Act, 1996' ("**ER Act**"). The former provides protection to workers who make a "qualifying disclosure". The protection is afforded to the whistleblower whether or not the report proves to be accurate so long as the whistleblower possessed a 'reasonable belief'. There is an obligation being casted upon workers to act in good faith and disclosures are not protected if they are motivated by malice or personal gain. Generally the disclosure is made to the employer; though a disclosure can also be made to a responsible third party or a prescribed person i.e. the list of bodies provided by Parliament including the FCA, the Serious Fraud Office and the Office of Fair Trading. Under the PID Act, a "disclosure" is not defined but according to the judgment in *Kraus v. PennaPlc*<sup>495</sup>, it covers both oral and written submissions.

Under the U.K. law, there is no such stringent rule that the employer has to establish a formal whistle blowing procedure; though generally the employers do prefer to have a procedure because of the provision section 7(2) of U.K. Bribery Act, 2010 ("**Bribery Act**") whereby a commercial organization guilty of an offence under section 7 can have a defense in place to prove that the commercial organization had in place all procedures to prevent such an offence. The whistle blowing policy and procedure forms an integral part of the "adequate procedures" that companies must have in place if they want to avoid criminal prosecution for failing to prevent bribery under the Bribery Act.

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<sup>493</sup> [1985] QB 526

<sup>494</sup> [1989] IRLR 477

<sup>495</sup> [2004] IRLR 260

There is no requirement under U.K. law that the identity of whistleblowers is to be kept confidential or that employees are allowed to make reports anonymously. However, the European Commission's Article 29 Data Protection Working Party expressly advises organizations against encouraging employees to make anonymous reports due to the intricacies involved that can create hassles both for the employer and the employee.<sup>496</sup>

In the U.K., the PID Act protects both internal and external disclosures from retaliation but does not encourage companies to institutionalize whistle blowing. To this end, the erstwhile Financial Services Authority (the current FCA) introduced the Combined Code on Corporate Governance in July 2003 which mainly is for guidance and provides best practice suggestions and has a provision on whistle blowing<sup>497</sup>:

*The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.*

The Combined Code does not have the status of law but all U.K. companies listed on the London Stock Exchange are required by the Financial Reporting Council "to report on how they have applied the principles of the Code, and either to confirm that they have complied with the Code's provisions or where they have not, to provide an explanation."<sup>498</sup>

## FCA WHISTLEBLOWING REQUIREMENTS

The FCA is the SEC counterpart in U.K. Under *Chapter 18 (Clause 18.1.2) of Senior Management Arrangements, Systems and Controls sourcebook (SYSC)* of the FCA Handbook<sup>499</sup>, the FCA encourages firms to consider adopting appropriate internal procedures that will encourage staff to blow the whistle internally about matters that are relevant to the functions of the FCA.

In 2002, the erstwhile FSA established a dedicated whistle blowing hotline which, in recent times, has rapidly grown in popularity. Whistle blowing cases reported to the FCA have increased by 35% in one year, according to information obtained under the Freedom of Information Act by Kroll, the global investigations firm<sup>500</sup>. It has been found that between November 2012 and

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<sup>496</sup> Available at <http://about.bloomberglaw.com/practitioner-contributions/whistleblower-regimes-in-the-us-and-uk/> as last accessed on August [20], 2015.

<sup>497</sup> Financial Services Authority 2003, *The Combined Code on Corporate Governance* (FSA, London, p.52)

<sup>498</sup> Financial Reporting Council 2005, available at <http://www.frc.org.uk/corporate/combinedcode.cfm> as last accessed on August [18], 2015.

<sup>499</sup> Available at <http://fshandbook.info/FS/html/FCA/SYSC/18/1> as last accessed on August 4, 2015.

<sup>500</sup> Available at <http://www.kroll.com/en-us/intelligence-center/press-releases/whistleblowing-on-the-rise> as last accessed on July 20, 2015.

October 2013 the FCA received 5,150 contacts to its whistle blowing helpline compared to 3,813 in the same period the previous year. The FCA's current guidance nudges employees to first report any concerns they have to their own firms, pursuant to the firm's own whistle blowing policy, before making reporting to FCA.

### **THE LINKAGE WITH U.K. BRIBERY ACT, 2010**

As stated earlier, though there is no legal requirement under English law for a company to set up and administer an internal whistle blowing policy or procedure but having such a facility may have an impact on a company's ability to demonstrate "adequate procedures" for the purposes of *section 7(2)* of the *Bribery Act 2010*. Under the said Act, if a company can demonstrate adequate procedures i.e. a good anti-bribery compliance programme, then it acts a complete defense to the charge that the company committed the corporate offence of "failure to prevent bribery".

### **PROVISIONS UNDER U.K. EMPLOYMENT RIGHTS ACT, 1996**

In the U.K., employees who qualify as whistleblowers are entitled to statutory protection. The tests for determining whether an employee qualifies are set out in the ER Act (as amended by Public Interest Disclosure Act, 1998). Where an employee makes a disclosure that is both "qualifying" and "protected" in accordance with those tests, then the employee has the right not to be either:

- (i) Dismissed, where the principal reason for the dismissal is that he made a protected disclosure; or
- (ii) Subject to a detriment on the grounds that he made a protected disclosure.

The six categories of wrongdoing covered by the legislation are criminal offences, miscarriage of justice, breach of a legal obligation, and damage to the environment, danger to health and safety and deliberate concealment of information about these wrongdoings. Also an additional requirement has recently been added under section 17 of the Enterprise and Regulatory Reform Act, 2013 as per which the disclosure must be made "in the public interest".

### **OBLIGATION TO COOPERATE WITH FCA**

All directors, officers or employees of firms authorized in the U.K. under the Financial Services and Markets Act, 2000 who have approved person status have a stand-alone, regulatory obligation under the FCA's Statements of Principle and Code of Practice for Approved Persons (APER) or both the FCA's APER and the Prudential Regulatory Authority's APER if the firm is dual-regulated. In particular, APER Statement of Principle 4:

*"to deal with the FCA, the PRA and other regulators in an open and co-operative way and disclose appropriately any information of which the FCA or the PRA would reasonably expect notice".*



Any failure to comply with this obligation could result in disciplinary action being taken against the approved persons.

### **OBLIGATION TO REPORT SUSPICIONS OF MONEY LAUNDERING**

The financial institutions and other companies in U.K. have legal or regulatory obligations to report knowledge or suspicion of money laundering (i.e. suspicious activity reports (SARs)) to Serious Organized Crime Agency (“SOCA”) i.e. the UK financial intelligence unit under relevant provisions of the *Proceeds of Crime Act 2002*. SOCA has recently been abolished and SARs are now to be made instead to the new National Crime Agency.

### **PRACTICAL PROBLEMS IN WORKING OF WHISTLE BLOWER POLICY IN U.K.**

One fact that is universal is people want to avoid conflict and so they keep quiet. Besides this, there are no cash incentives in U.K. as are available under U.S. laws. As a matter of fact, the FCA is working on bringing cash incentives according to Mr. Wheatley who is heading the FCA. According to Mr. Wheatley, the FCA is “absolutely interested” in exploring whether to offer cash incentives to whistleblowers.<sup>501</sup>

The Public Interest Disclosure Act of 1998 which amended the ER Act provides protection for an employee who reports the suspected malpractice in good faith. Claims of detriment or dismissal in response to a whistle blowing disclosure have to be brought in the Employment Tribunal in which costs are not recoverable by the winning party. This means that an employee has to take on significant financial risk in bringing a claim, usually against a party with deeper pockets. The financial ruin that the National Health Service Chief executive faces after speaking out about high death rates is the most apt example. This evinces how British law fails to encourage and protect whistleblowers. Gary Walker, (Chief executive of United Lincolnshire Hospitals Trust, he was dismissed in 2010) claims that he may “lose everything” after speaking out against the “culture of fear” in the NHS<sup>502</sup>.

### **THE DEVELOPMENTS BY FCA IN PIPELINE**

Financial incentives for whistleblowers are on the cards in U.K. In the aftermath of the investigations into manipulation of the London Interbank Offered Rate (LIBOR), ministers on the

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<sup>501</sup> Available at <http://www.out-law.com/en/articles/2013/march/fca-must-address-whistleblowing-concerns-before-looking-to-offer-incentives-says-expert/> as last accessed on July 24, 2015.

<sup>502</sup> Available at <http://blogs.telegraph.co.uk/finance/ianmcowie/100022981/nhs-and-ppi-scandals-show-why-we-need-financial-protection-for-whistleblowers/> as last accessed on August 18, 2015

Treasury Select Committee have called for the FCA to consider the merits of introducing an incentive program similar to the SEC's Office of the whistleblower. The FCA is expected to produce a note for the Parliamentary Commission on Banking Standards on how it might go about incentivizing whistleblowers in the future, presumably. Another issue on which FCA is working on is how to provide knowledge to the employees about their coveted right to blow the whistle in case of illegal happenings in their organization so that people can come out robustly and bring fore the misdeeds of their companies/firms.

In addition, by way of a *discussion paper* on transparency published in March 2013 (DP13/1), the FCA is consulting on ways through which it can be more open and transparent about how information received from whistleblowers is to be dealt with. For example, the FCA is pondering over whether to provide a written response to the whistleblower to let them know whether any official action is being taken in response to the report, and provide a general overview of next steps the regulator will be taking. It is also under consideration whether to provide regular status updates to the whistleblower and the compilation and publication of aggregate statistics on whistle blowing. This would bring more transparency and providing regular information would assure whistleblowers and others that FCA takes seriously the information it receives and that it forms an important part of its intelligence-gathering toolkit which would exhort more whistleblowers to come forward.

In the UK, the Whistleblowing Commission has been set up to examine the effectiveness of the current arrangements for workplace whistle blowing, and to make recommendations for change. The Commission on March 27, 2013 launched a *public consultation* to gather evidence on certain crucial issues related to whistle blowing policy.

## **THE UNITED STATES CHAPTER**

### **THE WHISTLE BLOWING REGIME IN U.S.**

In 2010, in response to a long series of corporate scandals that defrauded countless investors and shook investor confidence, the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act which amended the Sarbanes Oxley Act to a very large extent. Section 922 of the legislation amended the Securities Exchange Act, 1934 by adding Section 21F, entitled "Securities Whistleblower Incentives and Protections"<sup>503</sup>. The new section 21F required the SEC

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<sup>503</sup> Codified at 15 U.S.C. § 78u-6

to enact a whistleblower program to pay financial rewards to individuals who provide information about possible securities violations to the SEC. The very first award was given in August 2012 of US\$50,000 which was paid to a whistleblower that helped the SEC stop a multi-million dollar investment fraud, and amounted to 30% of the monetary sanctions actually collected by the SEC at that time (US\$150,000). (An additional payment of US\$500 was paid to the whistleblower in September 2012, and further amounts will be payable to this individual as and when the SEC makes additional collections.)<sup>504</sup>

The SEC adopted the final rules governing the new whistleblower program in May 2011 as Regulation 21F<sup>505</sup>. As per the new rules, an individual who voluntarily provides the SEC with original information resulting in a successful enforcement action in which the SEC collects over 1 million\$ in sanctions will be eligible for a financial reward of between 10% to 30% of the amount collected, depending on various factors. The program recognizes the fact that law enforcement authorities need the public's help to effectively and efficiently police the market. It is a grim fact that securities fraud schemes are often difficult to detect and prosecute without inside information or assistance from participants in the scheme or their associates. For the SEC to obtain a monetary civil penalty, the relevant securities violations must have occurred or have remained ongoing within the past five years even if the whistleblower did not discover the possible violation until a later date.<sup>506</sup>

The most common types of securities violations reported by whistleblowers<sup>507</sup> are financial fraud which involves the filing of false or misleading financial statements with the SEC and use of manipulative business transactions that generally have no practical purpose but to manipulate revenues, expenses, earnings and/or losses for a reporting period. Next comes, offering fraud wherein an individual make misrepresentations and/or omissions of material fact to potential investors in a new company. Then comes insider trading followed by trading and pricing violations, market manipulation and market events which refers to disruptions or aberrations in trading on securities exchange.

Dodd Frank Act, 2010 ("**Dodd Frank Act**") armed the whistleblowers with powerful anti-retaliatory action from their employer. The Act significantly improved the extant whistleblower protection laws in force in U.K. including the much touted Sarbanes-Oxley Act, 2002 which played a seminal role in carving whistle blowing landscape in the United States. The primary purpose of Sarbanes-Oxley Act was to protect shareholders by holding accountable publicly traded

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<sup>504</sup> Available at [www.practicallaw.com/9-525-9018as](http://www.practicallaw.com/9-525-9018as) last accessed on August 12, 2015.

<sup>505</sup> 17 C.F.R. § 240.21 F *et seq.*

<sup>506</sup> *Gabelli v. SEC*, 133 S.Ct. 1216(2013).

<sup>507</sup> Available at <http://www.sec.gov/about/offices/owb/annual-report-2012.pdf> last accessed on July 14, 2015.

companies and individuals engaged in corporate wrongdoing. The Sarbanes Oxley Act provides protection for any of the following types of violations:

- (i) Fraud in general- Where a company engages in a scheme to defraud individuals, another company or the government. Sarbanes Oxley Act provides protection for whistleblowers where the employee is not certain as to the precise violation, so long as the employee reasonably believes based on the information available that fraud is taking place.
- (ii) Securities fraud- Where a company engages in practices illegal for securities issuers, brokers and/or dealers. The most pertinent securities regulations relate to the requirement that a company must disclose to its shareholders certain information about the company's financial health such as accurate financial statements and any other information that an investor likely would take into consideration when making investment decisions. An employee who complains, or provides information, over the nondisclosure of such information is protected by Sarbanes-Oxley from discrimination; and the employee need not be certain that the nondisclosure of the information is illegal. A reasonable belief that the information was required to be disclosed on part of employee would suffice.
- (iii) Any federal law relating to fraud against shareholders- Reporting or complaining about fraud against shareholders is also protected. Sarbanes-Oxley only requires that the violated federal law relate to fraud against shareholders. The employee is required only to have a reasonable belief that the company's wrongdoing will sufficiently impact shareholders; certainty is not a requirement.

In the case of *Lawson v. FMR LLC*,<sup>508</sup> the U.S. First Circuit Court concluded that one "more natural" reading of Section 1514A, only the employees of the defined public companies are covered and the anti-retaliation provisions of the Sarbanes-Oxley Act do not cover contractors of public companies who report suspected fraud. An appeal against the decision is pending in the U.S. Supreme Court.<sup>509</sup>

### **THE NEW ANTI-RETALIATION PROTECTIONS FOR SEC WHISTLEBLOWERS**

Under the new Section 21F of the Securities Exchange Act, 1934 (after the enactment of Dodd Frank Act), an employer may not discharge, demote, suspend, threaten, harass or take any other retaliatory action against an employee who either:

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<sup>508</sup> 670 F.3d 61 (1st Cir. Feb. 3, 2012)

<sup>509</sup> Available at <http://blog.thomsonreuters.com/index.php/amicus-weigh-in-on-dispute-over-securities-law-whistleblower-protections/as> last accessed on [August 22, 2015](#).

- (i) provides information about his or her employer to the SEC in accordance with the whistleblower rules;
- (ii) initiates, testifies in, or assists in an investigation or judicial or administrative action; or
- (iii) makes disclosures that are required or protected under SOX, the Exchange Act and any other law, rule or regulation subject to the jurisdiction of the Commission.<sup>510</sup>

In the event of a retaliatory act, section 21F (h) grants an automatic private right of action in federal court to employees who are retaliated without the need to exhaust administrative remedies prior to filing.<sup>511</sup>The remedies available to a plaintiff under this section include reinstatement to the same seniority, double back pay and litigation costs.<sup>512</sup>There exists a limitation period when it comes to the filing of the claim. It has to be filed no later than six years from the retaliatory conduct or three years from when the employee knew or reasonably should have known of the retaliatory conduct, but the filing of the claim shall not exceed 10 years after the date of the violation.<sup>513</sup>

To be eligible for these anti-retaliatory protections, the whistleblower rules established by the SEC provide that the whistleblower must possess a “reasonable belief” that the information provided relates to possible securities violation and the information must be submitted in accordance with the procedures set forth in the rules under Section IV.<sup>514</sup> According to the SEC, a whistleblower has a “reasonable belief” if he or she holds a subjectively genuine belief that the information demonstrates a possible violation and that this belief is one that a similarly situated employee might reasonably possess.<sup>515</sup>The information must demonstrate a “possible violation” which requires a facially plausible relationship to some securities law violation, thus eliminating frivolous submissions from eligibility.<sup>516</sup>

It is pertinent to mention here the case of *Egan v. Trading Screen, Inc.*<sup>517</sup>wherein the Court held that the prohibition against retaliation and the private right of action apply to an employee who makes a disclosure required or protected by law, like a disclosure under SOX even though the employee did not provide the disclosed information to the SEC. Thus, even a statutory whistleblower is entitled to the anti-retaliation protections, regardless of whether he/she eventually qualifies for an award.<sup>518</sup>

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<sup>510</sup> Securities Exchange Act § 21F (h) (1) (A) (i)-(iii)

<sup>511</sup> Securities Exchange Act § 21F (h) (1) (B) (i)

<sup>512</sup> Securities Exchange Act § 21F (h) (1) (C) (i)-(iii)

<sup>513</sup> Securities Exchange Act § 21F (h) (1) (B) (iii)

<sup>514</sup> 17 C.F.R. § 240.21F-2(b)

<sup>515</sup>Implementation Release at 16.

<sup>516</sup>Implementation Release at 13.

<sup>517</sup> 10 Civ, 8202, 2011 WL 1672066, \*5 (S.D.N.Y. May 4, 2011)

<sup>518</sup>Implementation Release at 18.

It is significant to mention that these anti-retaliation protections do not come into effect until an employee reports the possible securities violation to the SEC in accordance with whistleblower program's rules or otherwise makes a protected disclosure under section 21F(h)(1)(A)(iii).

### **ENHANCEMENT OF SOX EMPLOYEE PROTECTIONS**

Dodd-Frank Act also enhanced the employee protections established in SOX. The statute has expanded SOX coverage beyond just public companies to employees of affiliates and subsidiaries of publicly traded companies whose financial information is included in the consolidated financial statements of such publicly traded company.<sup>519</sup> It includes foreign subsidiaries and affiliates of U.S. public companies.<sup>520</sup> Thus, Dodd-Frank Act provides extraterritorial reach in actions brought by the SEC and the Justice Department.<sup>521</sup> The 2010 Act expands SOX coverage to employees of nationally recognized statistical ratings organizations, such as Standard & Poor's Rating Service, A.M. Best Company Inc. and Moody's Investors Service Inc.<sup>522</sup>

Furthermore, Dodd Frank Act has doubled the statute of limitations for SOX whistleblower claims from 90 to 180 days; provides for a jury trial for claims brought under SOX whistleblower protections and declares void any "agreement, policy form, or condition of employment, including a pre-dispute arbitration agreement" which waives the rights and remedies afforded to SOX whistleblowers.<sup>523</sup>

### **LIMITATIONS AND ELIGIBILITY CRITERIA TO GET AN AWARD**

There are certain limitations and conditions for the eligibility of an individual to get an award:

- (i) The information provided by the whistleblower must lead to successful enforcement action by the SEC where monetary sanctions are imposed in excess of US\$1 million.
- (ii) The information provided by the whistleblower must be "original"<sup>524</sup> and must be provided "voluntarily"<sup>525</sup>.

Information provided by a whistleblower is to be considered "original" only if it meets the following conditions:

- (i) It is derived from the individual's "**independent knowledge**" or "**independent analysis**"<sup>526</sup>.

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<sup>519</sup>Pub. L. 111-203, § 929A.

<sup>520</sup>Pub. L. 111-203, § 929P (b).

<sup>521</sup>Pub. L. 111-203, § 929P (c).

<sup>522</sup>Pub. L. 111-203, § 922(b).

<sup>523</sup>Pub. L. 111-203, § 922(c).

<sup>524</sup> 17 C.F.R. §240.21F-4(b)

<sup>525</sup> 17 C.F.R. §240.21F-4(a)(1)

<sup>526</sup> 17 C.F.R. §240.21F-4(b)(2)

- (ii) It is not already known to the SEC from any other source (unless the individual is also the original source of the information).
- (iii) It is not exclusively derived from an allegation made in a judicial or administrative hearing, in a government report, hearing, audit or investigation, or from the news media (unless the individual is also the original source of the information).

Certain classes of individuals are made ineligible. They are:

- (i) a member, officer or employee of the SEC (or a spouse, parent, child or sibling of a member or employee of the SEC, or reside in the same household as a member or employee of the SEC), the Department of Justice, an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board or any law enforcement organization at the time they acquired the original information they are providing to the SEC;
- (ii) convicts of a criminal violation related to the SEC enforcement action in question or any other related action;
- (iii) knowingly and willfully make any false, fictitious or fraudulent statements or representations (or use any false writing or document knowing it is false) with intent to mislead or hinder the SEC or another authority, in the context of making the whistle blowing submission or in other dealings with the SEC or another authority in connection with a related action.

#### **INTERNAL WHISTLEBLOWER POLICIES**

There happens to be no necessity that a whistleblower must first report the misconduct through the employer's internal compliance or whistle blowing procedures or exhaust internal options before making submissions to the SEC. Employees who report misconduct through internal compliance procedures are still eligible to receive a monetary award from the SEC where the employer brings this information and it leads to a successful enforcement action. If after 120 days the employee reports the misconduct to the SEC because of the very reason that the employer has not taken appropriate action or if another employee reports the same misconduct to the SEC within the 120-days period, the employee can still take the award as the 120-day period looks back to the date the first employee reported the misconduct internally.

#### **CASES SPECIFYING WHAT QUALIFIES TO BE A "PROTECTED ACTIVITY"**

Sarbanes-Oxley Act followed by Dodd Frank Act mandates that a company does not retaliate against an employee for engaging in protected activity. "**Protected activity**" includes disclosures

that relate to securities fraud, bank fraud, wire fraud, or violation of any rule or regulation of the SEC, or any provision of Federal law relating to fraud against shareholders.

The law has not specified any particular language to be followed by whistleblower while making disclosures. There is no particular language specified in order to make any disclosure. In the case of *Collins v. Beazer Homes USA, Inc.*<sup>527</sup>, Honorable Court held that if Congress had intended to demand of whistleblowers specific language or references, it would have explicitly stated so. The Court further held that lack of such direction by Congress suggests that it intended instead to be more lax with respect to the burden placed on complainants when their reports may ultimately benefit the company's investors.

In the case of *Carter-Obayuwana v. Howard University*<sup>528</sup>, the District of Columbia Court of Appeals turned down the argument that an employee must complain using “magic words” to engage in protected activity. While rejecting the defendant’s argument that the plaintiff failed to be engaged in protected activity, the Court opined that the plaintiff is required merely to ‘alert the employer and make the employer aware of the fact that he/she is lodging a complaint about an illegal conduct. The court harped upon the fact that in alerting an employer that he/she is lodging a complaint an employee need not utilize “magic words” to trigger statutory protection against later retaliation.

As there are no straitjacket rules in making disclosures, there is uncertainty as to the exact level of specificity courts consider before concluding that an employee’s disclosure constitutes an engagement in protected activity. In *Lerbs v. Buca Di Beppo, Inc.*<sup>529</sup>, the Department of Labor’s Administrative Law Judge found that the complainant failed to engage in protected activity when he reported his vague concerns to various officers at the company. The company had employed the complainant who on numerous occasions questioned his supervisor about certain account entries in the company financial records. Initially, the complainant simply asked his supervisor in general terms but later indicated that it was misleading to bankers and investors because the entry was contrary to generally accepted accounting principles. In rejecting the alleged protected activity, the Administrative Law Judge noted that the complainant subsequently conceded that the company’s practices were in fact consistent with generally accepted accounting procedures but that in applying the new practice, the company should have disclosed its method changes in its accounting records, which the company admittedly failed to, do. The Administrative Law Judge concluded that the complainant’s question about what a particular entry was doing was a mere inquiry and does not qualify as protected activity as it flunked to outline the objectionable

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<sup>527</sup>334 F. Supp.2d 1365 (N.D. Ga. 2004)

<sup>528</sup>764 A.2d 779 (D.C. 2001)

<sup>529</sup>2004-SOX-8



practice. The Judge held in order to be protected, a whistleblower must state *particular concerns* which reasonably identify a respondent's conduct that the complainant believes to be illegal. The employee must believe that the practice over which he or she is complaining is illegal and not merely contrary to industry practice.

To constitute protected activity, the activity about which an employee complains must relate to one of the enumerated frauds outlined in the whistleblower provision of the Sarbanes-Oxley Act and if the activity about which the employee complains does not qualify as securities fraud, bank fraud or wire fraud then the disclosure will not constitute protected activity absent a reasonable belief that the activity will have an adverse material effect on the company shareholders. The court in *Minkina v. Affiliated Physician's Group*<sup>530</sup> granted the respondent's motion to dismiss after finding none of the above frauds applicable.

It has been held in spite of cases that a complainant alleging that a company practice adversely affects shareholders is required to show that the allegedly illegal conduct amounts to *material fraud* against the shareholders. For an instance, in the case of *Harvey v. Safeway, Inc.*<sup>531</sup>, the Administrative Law Judge concluded that the employee's disclosure of discrepancies in his weekly paycheck did not amount to protected activity because he failed to demonstrate that the company practice in question had a *material* impact on the company's financial reports.

### **EXTRATERRITORIAL APPLICATION OF WHISTLEBLOWER PROTECTIONS**

With Dodd Frank Act coming in, the situation has become clear now that SEC and US Department of Justice have reach beyond U.S. territory in whistle blowing matters. However, prior to Dodd Frank Act, the situation was hazy as there were judgments on both the lines.

The Sarbanes-Oxley Act does not contain express language relating to its extraterritorial application to employees overseas who engage in protected disclosures. However, the exclusion of explicit language allowing for its extraterritorial application does not necessarily foreclose the possibility that courts may not find the Sarbanes-Oxley Act's whistleblower provision to contain extraterritorial force.

There were spate of cases wherein the Courts ruled that even in the absence of extraterritorial application, the courts can exercise power beyond the region complaints would be properly brought under the Sarbanes-Oxley Act. However, there existed a body of cases where the Courts ruled otherwise.

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<sup>530</sup>2005-SOX-19

<sup>531</sup>2004-SOX-21

However, after the enactment of the Dodd Frank Act those cases are of no relevance as the Act categorically recognizes the extra-territorial jurisdiction in whistle blowing matters.

One of the stark differences between the whistleblower policy followed in U.S. and U.K. is on the monetary incentivization front. In U.K. there is only limited financial incentivization for whistleblowers in relation to cartel activity. The U.K. Office of Fair Trading incentivizes whistle blowing in the competition sector by offering rewards to companies and individuals who file reports about cartel activity that lead to fines or criminal prosecution. In rest cases, there is no monetary award being given to the whistleblowers. Ironically, bribery and cartel activity share similar characteristics but the Serious Fraud Office is not vested with the power to provide financial incentives to individual whistleblowers in relation to violations of the UK Bribery Act 2010

## THE INDIAN CHAPTER

### THE INDIAN BACKGROUND

Corporate whistle blowing, globally considered as one of the best tools to ensure good corporate governance, is still at nascent stage in India. India has been lagging far behind on the whistle blowing front.<sup>532</sup> The Whistleblower Protection Act, 2011 (“**WP Act**”) which received the President’s assent on May 09, 2014 is restricted to public bodies and does not include private companies in its ambit. Looking back at history, there was no material provision as regards the policy of Whistleblowers in the Code. It was only the Narayan Murthy Committee Report on Corporate Governance, 2003 which gave mandatory recommendation on whistle blowing. The Recommendation involved the following dimensions:

- (i) Personnel who observe an unethical or improper practice (not necessarily a violation of law) shall be able to approach the audit committee without necessarily informing their supervisors.
- (ii) Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting “whistle blowers” from unfair termination and other unfair prejudicial employment practices.
- (iii) Company shall annually affirm that it has not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to “whistleblowers” from unfair termination and other unfair or prejudicial employment practices.
- (iv) Such affirmation shall form a part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

Because of immense pressure from corporate lobby, earlier the mandatory recommendation was relegated to non- mandatory in the amendment made to the Clause 49 of the Listing Agreement. The reason cited was there could be raft of frivolous complaints that could be filed. At present, Clause 49 of the Listing Agreement recommends the company to “establish a mechanism for employees to report to the management concerns about unethical behavior, actual or suspected fraud or violation of the company’s code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism

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<sup>532</sup> Available at [http://articles.timesofindia.indiatimes.com/2013-09-09/work/41903181\\_1\\_india-inc-whistleblowing-organisation](http://articles.timesofindia.indiatimes.com/2013-09-09/work/41903181_1_india-inc-whistleblowing-organisation) as last accessed on July 21, 2015.

and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.”

### **OTHER STATUTORY PROTECTIONS**

There are a few legislations in India that make provision for disclosing information of any wrongdoing in an organization. To start with, Section 46 of the Competition Act, 2002 (“**Competition Act**”) of India grants power to the Competition Commission of India (“**CCI**”) to provide a lesser penalty on any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have indulged in anti-competitive practices, if he has made a full and true disclosure in respect of the alleged violations and such disclosure is vital. It further provides that such disclosure must be made before the investigation report under section 26 is submitted, to make it eligible for consideration for lesser penalty. The Competition Commission of India (Lesser Penalty) Regulations, 2009 under Regulation 3, backs up Section 46 of the Competition Act. It states that in order to avail the opportunity of lesser penalty, the disclosing party must co-operate genuinely, fully, continuously and expeditiously throughout the investigation and other proceedings before the Commission; and not conceal, destroy, manipulate or remove the relevant documents in any manner, that may contribute to the establishment of a cartel. However it is not mandatory on the CCI to grant lesser penalty on the disclosing party. Section 46 uses the phrase ‘*as it may deem fit*’, which establishes that the disclosing party cannot claim lesser penalty as a statutory right. Besides, Regulation 3 provides that, the discretion of the Commission, in regard to reduction in monetary penalty under these regulations, shall be exercised having due regard to –

- (i) the stage at which the applicant comes forward with the disclosure;
- (ii) the evidence already in possession of the Commission;
- (iii) the quality of the information provided by the applicant; and
- (iv) The entire facts and circumstances of the case.

Under the Securities and Exchange Board of India Act, 1992 by virtue of Section 24B the Central Government may grant immunity from prosecution and penalty to an alleged violator of the Act and the rules and regulations made under the Act, if he has made a full and true disclosure in

respect of the alleged violation.<sup>533</sup> Again the right is not an absolute one and depends upon the discretion of the Central Government and the Government can impose conditions as it may deem fit on granting of such immunity.

The Section goes on to provide that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity. The Section has never been used and has over the years been reduced to redundancy, because the power of the Central Government is contingent upon recommendations by the Securities and Exchange Board of India (“**SEBI**”) and the process is time-consuming. The Central Government usually delays in making a final decision within which prosecution gets instituted.

The Reserve Bank of India (“**RBI**”) came up with Protected Disclosure Scheme in 2007, for Private Sector Banks and Foreign Banks operating in India in order to maintain transparency in the conduct of the said institutions. The scheme in due course of time will be applied to co-operative banks, local-area banks and Net-banking financial institutions. The scheme allows employees of the bank, customers, stakeholders, NGOs and public to lodge complaint against any unfair practice by the bank. The Scheme introduces itself with a reference to the Whistleblower Protection Act in USA and the Public Interest Disclosure Act of the UK implying that the primary motto of the scheme is to ensure whistleblower protection. It states that the Central Vigilance Commission established by the Central Government is limited to Public Sector enterprises and hence a regulatory scheme from RBI is necessary to ensure transparency in private and foreign banks. The complaints under the Scheme cover the areas such as corruption, misuse of office, criminal offences, suspected / actual fraud, failure to comply with existing rules and regulations such as Reserve Bank of India Act, 1934, Banking Regulation Act 1949, etc. and acts resulting in financial loss / operational risk, loss of reputation, etc. detrimental to depositors’ interest / public interest.

However the scheme discards anonymous / pseudonymous complaints and commits that RBI would keep the identity of the complainant secret, except in cases where complaint turns out to be vexatious or frivolous and action has to be initiated against the complainant. In such cases of vexatious and frivolous complaint, the banking company can take action against the complainant if directed by the RBI.

The Sachar Committee set up in 1977 to recommend reforms in the Companies Act, 1956 (“**CA, 1956**”) and the Monopolies and Restrictive Trade Practices Act, 1969 had before it the suggestion

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<sup>533</sup> The Section was introduced in 1995 before which it read as: Penalty- Whoever contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made there under, shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

of incorporating the requirement of setting up the Audit Committee by companies of certain size. The clamor for good corporate governance was witnessed in Section 292A in the CA, 1956, which required public companies having minimum paid-up capital of minimum five crore to constitute Audit Committees. The new Companies Act of 2013 (“**CA, 2013**”) reiterates the same in section 177 but has increased the ambit of the same by roping in all listed companies. Section 177(9) and 177(10) requires every listed company or such class or classes of companies to establish a vigil mechanism for directors and employees. The vigil mechanism shall provide for adequate safeguards against victimization of employees and directors who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee or the Director nominated to play the role of Audit Committee in appropriate or exceptional cases.

Rule 7(1) of the Companies (Meetings of Board and Its Powers) Rules, 2014, provides that the every listed company and the following class of companies which

- (i) accepts deposits from public; and
- (ii) which have borrowed money from banks and financial institutions in excess of rupees fifty crore

Shall establish a vigilance mechanism for their directors and employees to report their concerns and grievances.

There have been certain companies in India which have framed their own internal whistle blowing procedure, for an instance Gujarat Alkalis and Chemicals Ltd.<sup>534</sup>, Godrej Y Boyce<sup>535</sup>, Tata Steel<sup>536</sup>.

Before parting away with this section of the article, it is pertinent to mention here one of the biggest frauds in the Indian corporate history is the Satyam scam. Satyam Computer Services Ltd. (“**Satyam**”). On December 16, 2008 Ramalinga Raju announced a \$1.6 billion bid for two Maytas companies i.e. Maytas Infrastructure Ltd and Maytas Properties Ltd stating he wanted to deploy the cash available for the benefit of investors. The announcement was met with fierce opposition from investors and market regulator. Mr. Jose Abraham (whistleblower) who is understood to have used a pseudonym in his e-mails, had first written his email to the company’s independent director Krishna G Palepu. In his email dated December 18, 2008 he disclosed the fact that Satyam did not have any liquid assets, and this fact could be independently confirmed from its banks<sup>537</sup>.

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<sup>534</sup> Available at <http://www.gujaratakalies.com/new/whistle.pdf> as last accessed on August 04, 2015

<sup>535</sup> Available at <http://www.godrejandboyce.com/godrejandboyce/pdf/Whistleblower.pdf> as last accessed on August 08, 2015.

<sup>536</sup> Available at <http://www.tatasteel.com/about-us/pdf/Whistle-BlowerPolicy-for-Employees.pdf> as last accessed on August 07, 2015.

<sup>537</sup> Available at [http://articles.economictimes.indiatimes.com/2009-04-17/news/27650696\\_1\\_sfio-report-satyam-board-member-satyam-scandal](http://articles.economictimes.indiatimes.com/2009-04-17/news/27650696_1_sfio-report-satyam-board-member-satyam-scandal) as last accessed on August 16, 2015.

The email sent by the whistleblower spread like wildfire. A copy of the email was also sent to Mr. B. RamalingaRaju, who thereafter started avoiding calls from its audit committee. Left with no other option Mr. RamalingaRaju on January 07, 2009 wrote a confession letter to the board admitting Rs. 7,800 crore financial fraud and gaps in the balance sheet as a result of inflated profits<sup>538</sup>.

The Satyam scam raised the bar for corporate governance in India. The scam brought about flaws in the Indian corporate governance- unethical conduct, fraudulent accounting, dubious role of auditors, ineffective board, and failure of independent directors and non-disclosure of pledged shares<sup>539</sup>. The Satyam scam was called “India’s Enron” as it highlighted the need and importance of securities law and corporate governance in India. The Satyam scandal served as a catalyst for the Indian Government to reconsider the corporate governance, disclosures, accountability and enforcement mechanisms.

#### **THE WAY AHEAD FOR INDIA AND CONCLUSION**

With the CA, 2013 coming into force, the Indian market regulator SEBI is pondering over to make whistle blowing policies mandatory for companies. In the recent past, there have been slew of events which have pointed towards the need to plug the loopholes. One of the very recent examples is Mr. Khemka who blew the whistle against DLF, the big gun in real estate sector. Another example in the recent times is that Dinesh Thakur who was a former employee of Ranbaxy Laboratories and exposed his ex-employer not in India but in the USA and Ranbaxy had to fork over money to the U.S. government for endangering the lives of its people through production of drugs in India in unhygienic conditions.<sup>540</sup>

The Companies (Amendment) Act, 2015 is a forerunner of positive trends of doing business of India. Section 143 of the CA, 2013 provides for the powers and duties of auditors and auditing standards. Section 143(12) of the CA Act 2013, states that if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government.

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<sup>538</sup> Available at <http://archive.financialexpress.com/news/satyam-fraud-full-text-of-rajus-letter-to-board/407799as> last accessed on August 16, 2015.

<sup>539</sup> Available at <http://www.thehindubusinessline.com/companies/how-satyam-scram-raised-the-bar-of-corporate-governance/article7085855.ece> as last accessed on August 26, 2015.

<sup>540</sup> Available at [http://www.firstpost.com/india/why-the-whistleblower-law-doesnt-extend-to-the-private-sector-1040889.html?utm\\_source=ref\\_articleas](http://www.firstpost.com/india/why-the-whistleblower-law-doesnt-extend-to-the-private-sector-1040889.html?utm_source=ref_articleas) last accessed on August 09, 2015.

The threshold limit for frauds to be reported to the Central Government under section 143(12) is yet to be notified by the Ministry of Corporate Affairs (“MCA”). In the absence of such threshold limit, there is still ambiguity as to when an employee shall report a fraud internally or externally. The MCA should amend the Companies (Audit & Auditors) Rules, 2014 and ensure that the Rules shall specify the instances and threshold limits for employees to report frauds internally or externally. Every company shall ensure that the prescribed threshold limits shall be incorporated in the whistleblower policy and the policy shall include adequate protection to such whistleblowers especially anonymity of the employee.

The success of SEC and FCA in this department is a known fact now. When it comes to United States, the monetary incentive with which the whistleblower is equipped has made the entire scenario more rousing. In the year 2012 itself, the Office of the Whistleblower received more than 3000 tips, coming from individuals in all 50 states along with 49 foreign countries.<sup>541</sup> Even in the recent Ranbaxy case, the whistle was rather blown in U.S. territory, though the matter pertained to something that happened on Indian soil which made the whistleblower eligible to collect an award too. In U.K. too, the FCA is pondering to introduce the incentives in their whistleblower policy. Considering the raft of scams that India has witnessed in recent past, there has arisen a dire necessity to clamp down the situation by bringing the whistleblower policy and making it a mandate for the entire corporate sector. Introducing monetary incentives in India would be a good move as it has worked wonders in U.S. in the recent times. So far as the issue of filing of ‘n’ number of frivolous complaints is concerned as was the issue broached few years earlier making it desirable to have whistleblower policy which actually should have gone down as a mandate; SEBI can take a cue from the U.S. position wherein a ‘possible violation’ of securities law has to be shown in the complaint itself in order to avoid frivolous complaints. Talking economics, it would also add to the amount of recovery that the market regulator makes in a certain year which would eventually help in rebuilding confidence over the market which the investor has lost in light of recent series of events. It is rather an obligation being casted upon SEBI being the market watchdog to catch a whiff of sinister acts happening in the market and to respond to them quickly and sturdily. It would be a positive step if right from the beginning, the SEBI is given an extraterritorial reach in these whistle blowing matters dodging the unsettled time as was seen in U.S. wherein there were judgments on both the lines allowing and rejecting extra-territorial application.

As goes the common saying that SEBI can take any step for investor protection, so to walk the talk it would be better if right from the beginning, the SEBI be vested with wide powers to take drastic

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<sup>541</sup> Available at <http://www.corporatecrimereporter.com/news/200/seccohenwhistleblower06122013/as> last accessed on August09, 2015.



steps. There is a fine reason for this; the employees of subsidiary Indian companies having their offices outside India should be given the equal say as is with their parent companies situated in India. Sometimes the two companies work in tandem and the employees of one are aware about the happenings in another; thus it becomes all the more important to give extraterritorial reach to the market watchdog. Also with the enforcement of CA, 2013 cross-border mergers would give India a strong foothold in international arena and it thus becomes important to vest SEBI with wide powers in this regard.

Anonymity is yet another issue. The WP Act has faced widespread criticism as it does away with the staple need of anonymity. When it comes to bringing the whistleblower policy for the companies, it becomes all the more important that there should not be any obligation being casted upon the whistleblowers to first make a complaint to the employer, the whistleblower should be freely allowed to make a decision whether he should first approach the intra-mechanism in the company itself or shall approach the SEBI. Free and conscious decision gets crucial because herein the whistleblower/employee would always be under the fear of losing his coveted job, so in order to ensure that he shall remain unfazed while blowing the whistle, the need is to ensure that there is no pressure being built upon him. The definition of 'complainant' would be very crucial too and it should be ensured that a very wide and exhaustive definition is being given to the same which shall include other stakeholders too, such as vendors, shareholders and customers. Yet another crucial fact that SEBI shall consider while framing the policy is that in order to ensure that no factor acts as deterrent for a whistleblower, the costs which the whistleblower pays from his own pocket in matters of detriment or dismissal in response to a whistle blowing disclosure before the appropriate authority shall be reimbursed by the losing party i.e. the company. This factor has impinged the blooming of whistle blowing in U.K. as therein there is no such provision of reimbursement; however SEBI shall provide a specific provision in this regard. Furthermore, it would be a positive step if we import the scheme of fast-track disposal of cases, as available under Sarbanes Oxley Act later followed in Dodd Frank Act as per which rulings are to be given in 180 days.

In India, the concept of whistle blowing is not very effective as compared to the U.S. and U.K. because of lack of adequate protection to the whistleblowers. There have been various instances of threatening and murder of whistleblowers working for public entities as well. An engineer, SatyenderDubey was murdered in November 2003 for blowing the whistle in the corruption case in the National Highways Authority of India's Golden Quadrilateral project. A few years later, an Indian Oil Corporation officer, Shanmughan Manjunath, was murdered for sealing a petrol pump that was selling adulterated fuel. Alternatively, the WP Act should be amended and include in its

scope protection to private enterprises with adequate changes and rewording the Act with whistleblower -friendly approach.

Talking about the situation in U.S. territory, the much-touted Dodd-Frank's whistle blowing regime is poised to bring a sea change in the enforcement landscape for U.S. regulated firms in the financial services sector. It is most likely that many of the SEC's most significant enforcement actions will be the result of whistleblower tips which would dish out a new landscape of securities enforcement. When it comes to the position in U.K., taking a cue from the immense success of whistle blowing program by SEC even the government in U.K. is planning to introduce monetary incentives for the whistleblowers<sup>542</sup>.

Now is the time to say omega. To perorate, India till today has been devoid of an effective whistleblower policy for the companies/ firms operating in India or it would not be incorrect there is no policy in existence in India in this regard, be it for private sector or the public sector. With WP Act for the public sector in place, it is imperative for the market regulator to put companies on a tight leash too so that a proper signal is been sent to the market not only at national level but at international level too. Also, it is of utmost importance that we learn lessons from the U.S. and U.K. regime so that we don't get bogged down once finally SEBI comes up with the Whistleblower policy. The Government has already armed SEBI with far-reaching powers and it is now due on SEBI to make good use of it and to ensure that the policy does not fall like ninepins and the powerful corporate lobby does not throw a spanner in the works.

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<sup>542</sup> Department for Business Innovation & Skills, 'The Whistleblowing Framework: Call for Evidence', July, 2013