Note from the Editor

One year ago when we launched our first issue of Legal Eye we were uncertain of our readers’ response and our ability to issue the newsletters regularly. Kudos to the editorial team who risked unpopularity in the office (not to mention threats to life and limb) by browbeating all concerned into submitting their articles on time and for keeping the newsletters rolling.

As you are reading this newsletter, India is in the throes of forming a new government for the third time in as many years. With everyone hopeful that the new government will last its full term, the BSE and NSE indexes have been peaking at new highs as investor confidence grows.

One of the major maladies of the Indian judicial system is the long and inordinate delay a litigant faces, be it the common man or a corporate entity. We are privileged to have articles written by two eminent senior advocates of the Supreme Court of India, Mr. Abhishek Singhvi and Mr. Justice M.P. Chandrakantraj Urs who offer a glimmer of hope that, despite the bleak situation, things will change for the better with the new legislation.

We thank all our readers for their feedback and encouragement. In fact, if you would like to contribute to Legal Eye, you are most welcome to send in your articles. Thanks, once again.

- Rajesh N. Begur, Editor, Legal Eye
Arbitration in India - features and importance of the new Act of 1996

- DR. ABHISHEK M. SINGHVI, Senior Advocate, Supreme Court of India, Former Additional Solicitor General, India

The subject is arbitration in India. The issue is which key to strike and which note to highlight. Since the subject is so vast, I am constrained to just touch upon it without going into the details.

Clearly the starting point must be the rationale and the growing recognition of the imperative necessity for new initiatives in arbitration which must be seen as part of the larger movement for alternative dispute resolution (ADR). Why a flurry of activity in this area? The "why" question is clearly important and vital since it highlights the pathology of litigation, underlines the causes of the malaise afflicting the system and also reflects the contours of the remedial measures necessary.

J.S. Aurbach summed up the pathology of litigation when he said:

"Litigation has become an inevitable stage in the life cycle - slightly beyond adolescence but before maturity. It is virtually impossible to survive litigation and remain solvent, but it is occasionally possible to endure it and remain sane. As a modern ordeal by torture, litigation excels. It is exorbitantly expensive, agonizingly slow, and exquisitely designed to avoid any resemblance to fairness or justice. Yet, in strange and devious ways it does settle disputes - to everyone's dissatisfaction."

This lament is by no means unique. It is global and is heard all over the world, including in the so-called developed economies of UK and USA. In England, Lord Benson, Chairman of the Royal Commission on Legal Services told the International Commission of Jurists that the public was showing unwillingness to accept high cost, inefficiency, prolixity, incompetence and delay. Unfortunately, the traditional attitude of the legal profession is that "all change is bad, especially change for the better".

In USA, former Chief Justice Berger told the American Bar Association:

"The harsh truth is that we may be on our way to a society overrun by hordes of lawyers, hungry as locusts, and brigades of judges in numbers never before contemplated. The notion - that ordinary people want black-robed judges, well-dressed lawyers and fine-panelled courtrooms, as the setting to resolve their disputes - is not correct. People with legal problems, like people with pain, want relief and they want it as quickly and inexpensively as possible".

Similarly, a former Deputy Attorney General of USA warned that,

"the legal process, because of its unbridled growth, has become a cancer which threatens the vitality of our forms of capitalism and democracy. The question which many thinking Americans are asking themselves is this: have they reduced the inalienable rights of man to - life, liberty, and the pursuit of litigation? The burgeoning costs and demoralizing delays of litigation in Courts of law are so devastating that litigation has no hope of coming out of the intensive care unit."

And in India, our very own Nani Palkhivala put it in his inimitable style when he said:

"May I turn to the situation in India which has the second largest number of lawyers in the world? While it is true that justice should be blind, in our country it is also lame. It barely manages to hobble along. The law may or may not be an ass, but in India it is a snail; it moves at a pace which would be regarded as unduly slow in a community of snails. A lawsuit, once started in India, is the nearest thing to eternal life ever seen on this earth. Some have said that litigation in India is a form of fairly harmless entertainment. But, if so, it seems to be a very expensive way of keeping the citizenry amused. If litigation were to be included in the next Olympics, India would be quite certain of winning at least one gold medal!"
It was this justifiable disgust with traditional litigation that led to the development of the first bypass or first ADR method to litigation, viz. arbitration. The supreme irony is that every lament about litigation soon came to be repeated about arbitration as well, and therefore you now have new ADR methods and bypasses being developed to arbitration itself as also a reform of the previous arbitration law by enacting the new Act. The words of Justice Krishna Iyer regarding arbitration underline this irony and reflect the deep dissatisfaction which consequently led to the passage of the new Arbitration & Conciliation Act of 1996.

He said:

"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 the Arbitration Act, 1940 ("Act" for short). However, the way in which the proceedings under the Acts are conducted and without an exception challenged in courts, has made lawyers laugh and legal philosophers weep. Experience shows and law reports bear ample testimony that the proceedings under the Act have become highly technical accompanied by unending prolixity, at every stage providing a legal trap to the unwary. Informal forum chosen by the parties for expeditious disposal of their disputes has by the decisions of the courts been clothed with "legalese" of unforeseeable complexity."

It is clear that the old Indian arbitration law had ceased to fulfil any of the four objectives which I believe any good legal system must fulfil, viz. speed, cheapness, finality and justice. Does the new law fulfil some or all them, at least on paper?

Some of the features of the new law which, happily, in my opinion, pass one or more of these four tests may now be discussed.

1. **Challenges to award virtually eliminated: Conclusivity of Award:**

   The first and perhaps the most revolutionary rule in the new arbitration law is the elimination of the excessive "interference" model and the substitution of a doctrine of virtual conclusivity of an arbitral award. "Party autonomy" has replaced "Court sovereignty" and is the prevailing creed.

   (a) Indian arbitration law has historically been ruled by the error apparent doctrine. This has been akin to the English legal position. England changed its law some time in 1975 and substituted the "error apparent" doctrine by bringing in the concept of appeal against an arbitral award on extremely restricted grounds - something like Sec.100 of the Indian CPC. The new 1996 law goes further than the English modification of 1975. It goes to the other extreme and specifically provides for challenges to a domestic award only on grounds identical to challenges to a foreign award. The very equation of the grounds of challenge of domestic and international awards is unique and in the Indian context quite revolutionary.

   (b) Consequently, the entire gamut of challenges to an award, inter alia, under Sec. 30 and 33 of the old 1940 Act are over. The entire jurisprudence of bias, misconduct or virtually any error, which could lead to the challenge to or upsetting of an award is now all over. Indeed, in the old 1940 law, misconduct had become one of the widest doors through which anyone could drive the coach. Mere lip service was being paid to the doctrine or review or error patent. In fact, what were being heard by way of objections to an award, were full-blooded regular appeals on both facts and law. Arbitration had thus become pre-litigation litigation. The removal of arbitrators on grounds of bias and misconduct had become the most casual and common hobby. It is reflected in the joke which goes as follows:

   "My Aunt's maid-servant's sister's son heard a policeman on his beat say to a house maid that he had a brother who had a friend who knew that the claimant had links with the arbitrator".

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2. Reasons mandatory unless parties specifically agree otherwise:

The second major reform is the doctrine of reasons. Previously, perhaps the only thing in the entire Indian legal world, which was unreviewable, was an unreasoned award. The Supreme Court's decision in *Raipur Development Authority* [(1989) 2 SCC 721] had emphasised the desirability of giving reasons, but maintained that an unreasoned award could not be reviewed. Now, in the new 1996 law, the presumption is reversed - all awards must be reasoned unless parties specifically agree that no reasons need be given (see sec.31).

As far as I am concerned, I still subscribe to the old conservative view of Lord Mansfield of U.K. who told a General who was about to embark on a career in the West Indies as follows:

"Be of good cheer - take my advice and you will be reckoned a great judge as well as a great commander-in-chief. Nothing is more easy than to act as a judge: only hear patiently, then consider what you think justice requires and decide accordingly. But never give reasons - for your judgement will probably be right but your reasons will certainly be wrong".

3. Disputes regarding periods carrying interest no longer relevant:

Thirdly, the entire controversy as to whether arbitrators can award interest and if so at what rate and for which stage (i.e. whether pre-reference or pendente lite or post award) have now been laid to rest. Sec. 31(7) empowers arbitrators to specifically award interest for any or all the aforesaid periods and even the rate, post-award, is prescribed in the statute to be 18% till payment, while for pre-award periods it has to be at "reasonable rates". Hence judicial decisions like *G.C. Roy's case* (1992) 1 SCC 508 or hot debates on the applicability or otherwise of the Indian Interest Act, 1978 are now rendered substantially irrelevant and superfluous.

4. Courts and/or arbitrators given full power to take any interim measure of protection:

Section 9 of the 1996 Arbitration Act empowers courts fully to take "any interim measure of protection". This is similar to the powers already available under the 1940 Arbitration Act, but what is clearly revolutionary is section 17 of the 1996 Arbitration Act which uses the same phrase and thus gives co-terminus powers to grant interim protection to arbitrators as well.

5. Grounds of challenge:

   (a) The first point, already made above, is the equation of grounds of challenge in both domestic arbitration (sec. 34) and foreign arbitration (sec. 48). This is significant and indeed revolutionary in the Indian context.

   (b) The grounds of challenge now made available (for both domestic & international arbitration) may broadly be divided into 3 categories:

      (i) **Procedural** grounds of challenge, e.g. denial of natural justice, lack of notice;

      (ii) **Jurisdictional** grounds of challenge, e.g. incapacity to enter into an arbitration agreement or dispute falling beyond the terms of reference; or the alleged arbitration agreement being invalid or illegal;

      (iii) **Substantive** grounds of challenge, e.g. dispute not capable of settlement by arbitration or violation of public policy of India.

   (c) Some limited light can be thrown on these grounds in the context of some judicial precedents existing under the earlier Foreign Awards (Recognition & Enforcement) Act 1961, many of which I had the privilege of appearing in as counsel for one of the two contending parties (an appropriate discounting factor may therefore be applied to my remarks on these cases).
As far as public policy is concerned, the width, amplitude and scope of this substantive ground of challenge has been reduced to virtually vanishing point by the decision of the Supreme Court in Renusagar vs. G.E.C. (1984) 4 SCC 679. That decision clearly adumbrated the following propositions in respect of public policy (and there is no reason to suppose that that decision would not apply under the new Act):

(i) A mere violation of any law, even of a statutory provision of Indian law, does not ipso facto or ipso jure constitute a violation of Indian public policy.

(ii) Only an act or omission or violation of something fundamental, gross, shocking or contrary to the basic canons of morality would constitute a violation of public policy of India.

(iii) Thus, a violation of public policy of India would clearly belong to the rarified class of cases involving prostitution, champertous agreements or slavery.

(iv) Even assuming that some act or omission by one of the parties to the contract is contrary to the public policy of the jurisdiction whose proper law is the proper law of the contract, that by itself, ipso jure or ipso facto, would not constitute a violation of the public policy of India. In other words, if the proper law of a contract involving an arbitration agreement is for example New York law, and if it can be shown that an act or omission by one of the parties is admittedly contrary to the public policy of New York, that by itself would not automatically constitute a violation of the public policy of India. The Supreme Court held so by relying on the words "of India" which follow the words "public policy" in the 1961 Act and emphasised that the violation must be of Indian public policy and not of public policy of any other forum. Since the same phrase "public policy of India" occurs in Sec.48 and also in Sec.34 of the 1996 Act, there is no reason to suppose that the ratio of the Renusagar vs. GEC would not apply.

(v) Even if a substantive mandatory law or Indian statute is violated, it is not an automatic violation of public policy of India. For example, even if a mandatory provision of the Indian Interest Act, 1978 can be said to be violated, it would not per se constitute a violation of Indian public policy.

The only further route to challenge an award on substantive grounds is provided in the explanation attached to section 48, empowering the court to set aside an award obtained by "fraud or corruption”. However, under well-established law, both these substantive grounds require the discharge of a burden of proof beyond reasonable doubt and constitute an extremely strict threshold of success for any party raising these grounds.

Incacity would normally mean all the well-established forms of legal or physical incapacity, e.g. mental incapacity, minority, medical disability, etc. The question may arise as to whether inherent poverty or lack of means available to an Indian litigant, who finds the international commercial arbitration fees too high, can constitute incapacity or not. Although the issue remains res integra, I am of the opinion that it would not, since that would travel beyond the well-recognized contours of incapacity as known to law. This, however, is not to say that the issue is not an important or deserving one. I have myself appeared as counsel in cases where an Indian litigant has an extremely strong, virtually cast iron case as a claimant and invokes the jurisdiction of the ICC at Paris as a claimant, but then finds himself unable to sustain the litigation on account of inability to meet the ICC’s ad valorem schedule of fee. Clearly such categories of mandatory incapacity or "third world" incapacity, although highly deserving of consideration, are not subsumed under the definition of incapacity under the new arbitration law.

The phrase "unable to present its case" normally implies an overriding supervening inability operating upon a party so as to constitute a defence against the enforcement of an award. A question may arise when party A to an international arbitration agreement files a claim before ICC and party B files a civil suit on the
same subject matter before the domestic court. Suppose party A then files an application for stay of the domestic suit. Suppose party A’s application for stay of the suit is rejected by the domestic court. Suppose, further, that party A assails that rejection in a superior court and the superior court dismisses the appeal or revision by party A, thereby confirming the lower court’s order. Suppose, still further, that party A challenges the appellate court’s rejection before the apex court and the apex court reverses the decisions of the two courts below and grants the stay of the suit. Suppose, however, that the time period between the date of decision of the first court and the date of decision of the apex court is 4 years; and suppose during this period of 4 years, the arbitration proceedings have continued abroad and have culminated in an award in favour of A and against B; and suppose that B has not participated in the arbitration proceedings during this 4 year period, on the basis of B’s contention that two courts had rejected party A’s application for a stay of the suit and held in favour of B. Would the resultant award by the international arbitral forum be liable to be rejected by party B when the award comes for enforcement on the grounds that party B “was unable to present its case”? One of the earlier Renusagar vs. G.E.C. (1987) 4 SCC 137 decisions of the Supreme Court (1987) suggests that the answer to this query is in the negative on the basis that, when the apex court reverses the earlier courts’ decision to stay the suit, it is legally deemed to relate back to the date of the first order of the first court. Hence party B’s non-participation in the arbitration proceedings would clearly be at its own risk and cost and would not constitute an excusing circumstance.

To be concluded in our next issue.

Bank guarantees – the best security?

ALIFF FAZELBHOY, PARTNER, A.R.A. LAW

With the Indian legal system in a sad state of delays and inefficiency, it becomes very important for parties entering into commercial transactions, and in particular making large loans and advances, to ensure that their money is protected by taking adequate security. One of the more popular and generally considered to be the most secure form of security is the furnishing of a bank guarantee by the person obliged to pay any money or perform any obligation.

A contract of guarantee is defined under section 126 of the Indian Contracts Act, 1872 (the ‘Act’) as a contract to perform the promise and/or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the surety. The person in respect of whose default the guarantee is given, is called the principal debtor; and the person to whom the guarantee is given is called the creditor. The section also clarifies that a guarantee may be either oral or written.

The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided in the contract (section 128). Thus, it is not open to a surety to argue that the guarantee cannot be invoked against him unless the principal debtor has first defaulted. A creditor is entitled to proceed either against the principal debtor or the surety or both.

What makes a bank guarantee different from a guarantee by anyone else? The Act does not distinguish between a guarantee given by a bank and a guarantee given by anyone else. A bank guarantee has been accorded a slightly higher status by judicial precedents and commercial practice. In one of the leading cases on the point, the Supreme Court of India, in Centex India Ltd. vs Vinnar Impex Inc. (1987, 61 Company Cases 697), has added that, in the case of an unconditional guarantee, the nature of obligation on the bank is absolute and not dependent upon any dispute or proceeding between the party at whose instance the bank guarantee is given and the beneficiary. In the given case, the bank had given a performance guarantee for a particular construction of a steel plant to be completed within the stipulated time. The appellant then rescinded the contract and invoked various bank guarantees given towards mobilisation advances, security advances, etc. The appellant invoked the guarantees on the date he rescinded the contract. The respondent contractor sought an injunction restraining the appellant from encashing the bank guarantee. The lower Court refused the injunction, but the High Court reversed the order and granted an injunction. The Supreme Court, whilst reversing the High Court decision, stated that a
guarantee is an independent and direct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the primary contract between the person at whose instance the bank guarantee is given and the beneficiary. The Court ordered that, in the case of an unconditional guarantee, the nature of obligations of the bank is absolute and not dependent on any dispute or proceeding between the party at whose instance the bank guarantee is given and the beneficiary.

The Courts have consistently followed this principle and have been refusing to grant injunction orders restraining the enforcement of bank guarantees. The only exception, which is being recognised by the Courts to this general rule, is in case of fraud. Even so, fraud must be prima facie apparent on the face of the transaction in order for the principal debtor and/or the bank to obtain an order restraining the beneficiary from encashing the bank guarantee.

Can a bank refuse to honour the guarantee?

The Rajasthan High Court in *M/s Basant Rhymers, Alwar v. State Chemicals Pharmaceutical Corporation of India Ltd.* held that a bank guarantee is, for all purposes, to be taken as a credit note issued by the bank in favour of the person in whose favour the bank guarantee has been issued and it should be encashable just like a credit note ordinarily, unless the intention of the parties is otherwise.

Even in practical terms, it is now very difficult for a bank to legitimately refuse to honour its obligations under a guarantee. If, for any reason, a bank defaults in paying up on a bank guarantee, a complaint can be made to the Reserve Bank of India (RBI). If that is done, the banks invariably pay up the money on the guarantee as they risk sanctions being passed against them by RBI. Thus, practically speaking, the chance of the bank defaulting on a guarantee is almost nil.

The RBI Act further provides the power to RBI to issue directions to a bank, enforce penalties for failure to follow up such directions and in extreme cases, even provides for an acquisition by the Central Government in case of consistent default by a bank in complying with provisions of the RBI Act or directions issued by the RBI.

Therefore, a bank guarantee is considered almost sacrosanct and the best form of security that can be taken.

UCP for Documentary Credits

A bank guarantee could also qualify as a documentary credit (usually described as an irrevocable letter of credit or standby letter of credit) as defined under the Uniform Customs & Practices for Documentary Credits. It could also be possible to include the terms of the UCP into a bank guarantee to make the specific rules on interpretation and enforcing the liability of the bank, applicable to the contract.

Why then is a bank guarantee not taken in all cases? In view of the bank’s almost absolute obligation under a guarantee, banks are not readily agreeable to give guarantees for any and every obligation. Banks are being increasingly cautious now and insist on a substantial deposit, often of 100% of the value of the amount secured, before they are in a position to give a guarantee on behalf of a customer to a third party. This is certainly good practice commercially, but makes the availability or the ability to give a bank guarantee accessible only to a few persons who have either the liquidity to deposit the money in the bank or a longstanding relationship with the bankers. Besides, banks also charge a commission which could vary from anything between 1% to 5% p.a. of the value of the amount guaranteed.

Notwithstanding the high cost of obtaining a bank guarantee, persons would be well advised to seek this form of security and bear the bank charges if they can commercially afford this. With money being almost 100% secure if backed by a bank guarantee, the additional costs incurred in obtaining the security could well lead to saving of much more as well as of several years which would otherwise be spent in litigation, trying to enforce any other security.
Law's delays

- JUSTICE M.P. CHANDRAKANT RAJ URS, Senior Advocate, Supreme Court of India, Former Judge, High Court of Karnataka, Former Chairman, Karnataka Administrative Tribunal

Even in the times of Queen Elizabeth the First "the insolence of office and the law's delay" were well known. Is there any significant change in the times of Queen Elizabeth the Second? Perhaps there is. The House of Lords was reconstituted and the ruling was reviewed in Pinochet's case at great speed. This was more an exception than the rule. Way back in 1965, five of us had been invited by the then Chief Justice of Hong Kong, to study the judiciary at work in that Crown Colony as it was then. One event that has found a place in my rather erratic memory is the meeting with the young Attorney General who had called us over to have tea with him. He very outspokenly said that, even in the ancient land of China, the archaic Anglo-Saxon procedural laws worked, though at a snail's pace. That has been the truth in the administration of justice in more or less all the former British colonies. India was the Jewel of the Crown and yet, no different from the other colonies.

Fifty years into independence, the Code of Civil Procedure has only seen cosmetic changes while the Code of Criminal Procedure has been replaced by a new code. The statistics of disposals under both the codes are very discouraging. Our civil courts have more cases pending at any given point of time than the learned judges are capable of rendering decisions. The Human Rights Commission tells us that there are more under-trial prisoners than convicted ones in our jails. That may not include the number of persons charged with crimes of all sorts and out on bail. Just the other day I read in a leading English daily newspaper that the Karnataka High Court had secured electronic equipment and that copies of judgement would shortly be available to the litigants soon after the judge has signed the judgement. Commendable indeed that we should resort to more and more use of modern science and technology, but how do we speed up the rendering of decisions in the courts at all levels? My endeavour in this short essay is to suggest a few remedies that may avoid delays in all the courts.

National Law School graduates are not going to launch their careers as advocates and solicitors in our semi rural-semi urban towns. A law graduate is essentially an urbanite though he may have his origins in rural areas. This cannot be disputed. The craze of our state governments to establish courts at every tehsil or taluka headquarters must be discouraged. Courts must be located in well-developed urban areas and district headquarters. The only correct approach to give access to rural litigants is to improve our transport system and have better roads and railways. In rural areas litigants cannot find sufficient number of lawyers and often get counsel from urban areas at great cost and delay. A handful of lawyers in rural areas have no competition to encourage better performance in their profession. Lack of library facilities is yet another handicap. In urban areas the litigant has a wider choice of counsel which is denied to him in the rural areas. State governments must continue with village level settlement of disputes. Like in the U.S., where a Justice of Peace settles disputes free of cost though his decisions are not binding. The parties may approach courts if they are not satisfied.

Our laws provide for too many appeals and every appellate court is required to give reasons for setting aside the lower court's decision. It may be prudent to provide for the first appellate court to follow such a procedure but unnecessary for the next appellate court. If the second appeal is dismissed without assigning a reason or reasons, the assumption is that the first appellate court was right in its decision. This system is followed in the highest court in France. It is high time our Supreme Court followed a similar procedure when the Supreme Court affirms the decision of the High Courts in India. The real need to write a separate judgement arises only when the High Court's decision is to be set aside or reversed or modified. It is a sheer waste of time and money of the litigants to write yet another long judgement only to affirm the conclusions of the High Court. Finality of a decision must be reached as speedily as possible by suitable amendments to substantive and procedural laws in our country. The Supreme Court of India is given corrective jurisdiction over all Courts and Tribunals. Therefore, access to justice is denied to the poor.
The Indian litigant is very persistent and litigatious and he or she must be discouraged from pursuing endless litigation.

The Code of Civil Procedure (CPC) is observed more in the breach than in following procedural compulsions. It is indeed very old and needs some radical and substantive changes in order to keep pace with the technological changes that have come about. Similarly, the Evidence Act needs to be amended to accommodate the tremendous progress made in the fields of science and technology. Judges who are required to record evidence and proceed with trial work must be given greater facilities. The courts must be provided with computers with dual screens and the judge must dictate in English or the regional language. The completed and corrected oral evidence duly signed by the judge must be transferred to computer discs supplied by counsel appearing for the parties. The code requires to be amended so that the judge who records evidence, alone writes the judgement. Routine transfers at the time of the long vacation should be avoided and more importantly the vacation should be cut short to the minimum. No other country enjoys the numerous holidays that the government employees in India do, particularly the judicial officers. The vacations were arranged to facilitate the English judges', who served in India in the days of the Raj, visiting their homeland. It has no relation to Indian judges who need not return to their native land on a visit annually or biannually. Hard work is the only substitute for quick disposals in courts. Frequent transfers of judicial officers with all the incidental delays upset the calendar of court work. A judicial officer must stay at a station for a minimum of 4 years and any premature transfer must be on account of promotion only. If the government opens courts in every nook and corner where there are no well-equipped hospitals, illness of the judge or a member of his or her family gives an excuse to seek transfer. That is another reason why courts must be located in well-developed urban areas.

Besides the facilities and comforts to the judge and his family, more important is the cooperation expected of the counsel, lawyer or advocate. This is an area where speedy disposal of cases gets blocked or burked. The judge must insist on it or force it out of the counsel.

Order V, Rule I of the CPC provides for issue of summons to the defendant. The prescribed forms demand that the defendant appear in person or by pleader who is instructed fully, with all documents in his or her possession and witnesses if any in defence of the case against him or her for settlement of issues. In my whole career as a lawyer it has never happened. Much less have I seen it happen in the period I was a judge (please see Form 1 & 2 prescribed in the appendix). Counsel seeks time to enter appearance orally when there is no rule or law permitting such practice. In some courts as much as 4 to 8 weeks are given for filing power and twice as much or more to file the written statement. All this when the summons indicates clearly that his first appearance is for settlement of issues. There was an instance where the defendant stated on oath that he read the written statement for the first time while he was tendering oral evidence in support of his defence though he had verified and signed the written statement some seven years before he entered the witness box.

The normal rule for a counsel is to examine the plaint or written statement and seek amendments or seek remedy under Order VI, Rule 17 of the CPC. He does not make use of the provisions for interrogatories, which will shorten proceedings. We were told that when documents are to be filed, draft issues should be filed. I have never seen that happen after 1965 when I left my original side practice. Issues are framed by the judge without any assistance from counsel. Often issues are flimsily framed and a succeeding judge wants to amend them. The list of duties and conduct of counsel vis-à-vis the court is long. The judge by his own conduct and firm action may compel such cooperation, but he does not, as he lacks courage to antagonize the bar and thereby gives room for his judicial authority to be eroded. Many judges at all levels retire without writing judgement in cases whose arguments they have heard. Then how do we expedite delivery of justice to the litigants? It is a question which must be solved only by awarding a pension cut by law. Similarly, counsel who needlessly delay justice, expeditiously must be penalised by awarding costs in favour of the litigant that suffers the delay and made recoverable from such counsel.
Lastly, litigants also must cooperate. They should not resort to dragging on the proceedings before the courts only to delay the course of justice. A watchful judge certainly owes it to the opposite party to impose penal costs. Parties must examine witnesses promptly. Sometimes the delay may be fatal to the case as the key witness may die or leave the country. The code must be amended so that costs follow the result as a rule. It should not be left to the discretion of the court.

The system must work in tandem. Updating laws is necessary, but by itself it achieves nothing. The human element in our judicial system from the court peon to the Presiding Officer and the counsel who are indispensable to the system must join hands in unison, lest the system itself collapses due to its inadequacies.

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**Intellectual Property Rights and the Internet**

- STATIRA RANINA, ASSOCIATE, A.R.A. LAW

Digital technologies and increased global use of the Internet have made the protection of intellectual property and their application, areas of growing concern. Once content is digitalised, it is easier to manipulate, distort and reproduce the content through virtually any media. In addition, the Internet gives users worldwide free access to information, resulting in a growing need for protection of intellectual property.

Since the field of intellectual property rights deals mainly with copyrights, trademarks and patents, each one of these categories is considered separately below.

**Copyrights**

According to a variety of international copyright agreements and conventions, copyrights are granted to protect an expression or form of an idea, such as a book, a song, or the script of a play. Copyrights are automatically given to the creator of a work and grant the creator the rights to authorise reproduction and distribution of these reproductions.

Some of the following copyright issues tend to arise with the growth of the Internet:

- Ownership of information by the person placing it on the web;
- Protection of a web site’s design and software operations;
- Prevention of manipulation and distortion of information on the net;
- Liability of ISP providers for copyrighted material that is distributed on their networks;
- Whether the downloading of files or creation of hyperlinks would amount to a breach of copyright.

The existence of these issues has led to the development of various copyright protection strategies by artists, content providers and ISP’s for the protection of intellectual property in the digital age, such as:

- **On-Line contracts** on a web site that must be agreed to by visitors, before they are given access to a site, have already been found on various sites on the net. It is believed that over time, courts will have a greater inclination to accept certain on-line contracts, for e.g. the display of a warranty card on the net.

- **Digital technology** may also be used to solve the existing copyright challenges by providing access, but preventing users from making copies.

- **Marking technologies** such as watermarking which identifies the copyright owner; fingerprinting which identifies and monitors the recipient of digital content; cryptolope technology which provides a secure container for encrypted digital content; and data hiding which actually embeds information about the digital object into the object itself, etc. may also be used to regulate copyrights.
Secure marketing and distribution strategies are essential to prevent theft of intellectual property, for e.g. putting limited portions of entire works on the Internet.

**Trademarks**

A trademark is a name or symbol that identifies a product or service and can be used only by the trademark owner. Today the need to modify trademark laws to meet Internet needs has led to active worldwide discussion on trademark protection issues and the legal and other solutions to such issues. Two of the most important issues are:

- **Domain name.** Readily identifiable domain names enable consumers looking for particular products, services, or companies to find them more easily on the Internet. Problems tend arise when more than one company tries to use the same name as its domain name. For e.g. McDonald’s took the domain name *mcd.com*, but was then faced with a magazine reporter who obtained the *mcdonalds.com* domain name for himself. Sprint took the domain name *mci.com*, but had to relinquish it to MCI. Today, such an activity is called “site jacking” and case law is being developed in several countries to protect against it.

  The practice of using trademarks as a part of domain names is becoming a significant international problem.

- **Anti-dilution.** A lesser well-known aspect of trademark law is dilution. Trademark dilution refers to the use of a famous mark in a manner that causes confusion. For e.g. A toy company Hasbro has, over a period of time, been marketing a game called Candy Land. They were upset to learn that the reason they could not be assigned the *candyland.com* domain name was because Internet Entertainment Group was using it for a pornographic site. Hasbro sued Internet Entertainment Group for using the *candyland.com* domain name. The court found that Internet Entertainment Group had diluted Hasbro’s trademark, and Internet Entertainment Group was ordered to take down its web site.

**Patents**

Patent issues are becoming an area of increasing concern as more software developers try to patent their applications. Although some people are trying to patent the basic way software works, including disk reading, disk buffering, people are increasingly seeking out design patents that protect the way the content looks. In India, however, the law on patents is nowhere near international standards. The government is, however, in the process of updating it, although how long the entire process would take is unforeseeable.

**Conclusion**

Intellectual property law in India and most countries will have to undergo radical changes to meet new Internet challenges. Though the policy makers and judicial authorities in most countries across the world, including India, are quite ignorant on these issues, the dynamic growth of e-commerce will necessitate awareness on the part of these authorities, especially while drafting remedial laws on these topics. India, though yet unaware of such fast emerging issues, will soon be in no position to continue in this blissful state, due to the rapid development of e-commerce in the global economy. Corporates and individuals will also have to keep in mind intellectual property issues in their IT related operations.

**Inter-corporate loans and investments**

- **LEKHESH N. DHALAKIA, ASSOCIATE, A.R.A. LAW**

The Companies (Amendment) Act, 1999 has introduced a new section in the existing Companies Act of 1956 (‘the Act’) to modify the provisions relating to inter-corporate loans and investments made by a company. For the purposes of this article, ‘Company’ would mean a public company, a private company which is a subsidiary of a public company, or a deemed public company.
Prior to the 1999 amendment, the provisions relating to loans, guarantees and securities were governed by section 370, and investments by section 372.

Before we deal with the provisions of the new section 372A, it may be prudent to briefly discuss the provisions of the erstwhile sections 370 and 372, so as to get a better understanding of the changes sought to be made by the legislature to the provisions dealing with loans, investments, guarantees and securities.

Section 370

Section 370 was meant to address the issue of loans proposed to be made by a company, and any guarantee or security, which a company could provide in connection with a loan, made by any other person or to any other person, by any body corporate.

The section sought to regulate the limits upto which a company could make loans, give any guarantee or provide any security, in the following manner:

Provisions for making loans

It was mandatory for a company (known as the lending company), which was desirous of making loans to other bodies corporate whether under the same management as the lending company or not, to obtain consent by way of a special resolution from its shareholders in a General Meeting and take prior approval from the Central Government, if the aggregate of such loans was more than 30% of the aggregate of the subscribed capital and free reserves of the lending company.

However, if the aggregate of such loans was less than 30% as stated above, neither special resolution of the shareholders nor Central Government approval was required. The exception to this rule was that loans made to bodies corporate under the same management as the lending company required a special resolution irrespective of the 30% ceiling.

Provisions for giving guarantees and securities

In the case of a transaction that involved the giving of any guarantee or the provision of any security by the lending company, irrespective of the amount of the guarantee or the security, a special resolution passed by the shareholders in a general meeting was required to approve the giving of such guarantee or the provision for such security. It was not necessary for the lending company to take prior approval of the Central Government before giving any guarantee or providing any security.

Section 372

Section 372, on the other hand, sought to regulate the amount of investments a company could make in another company by acquiring its shares, whether by it or together with its subsidiaries.

Provisions for investments

The section specified the maximum ceiling, in percentage terms, within which the investing company could acquire the shares of any other body corporate without any restrictions, either by purchase, subscription or otherwise.

Although the percentage was fixed, the basis for computing the permissible level of investment was dependent upon the nature of investment the investing company proposed to make.

For example, at any one point in time, the investing company could invest upto 30% of the subscribed equity share capital, or the aggregate of the paid up equity and preference share capital of any other body corporate, whichever was less. However, the aggregate of the investments which the investing company could make in several other bodies corporate, was limited upto 30% of the aggregate of the subscribed capital and free reserves of the investing company. This rule also applied to investments made in bodies corporate within the same group as the investing company.
If any investment that was proposed to be made by the investing company was in excess of the ceiling prescribed above, the investing company was required to obtain prior sanction for such investment from its shareholders in a general meeting, and the Central Government.

Section 372A

The Companies (Amendment) Act, 1999, which has inserted a new section 372A in the Act, has combined the features of sections 370 and 372 into the newly inserted section, and omitted sections 370 and 372. This new section has increased the limit of inter-corporate loans and investments, and guarantees and securities in terms of a company’s paid-up share capital and free reserves.

Increase in the limits of loans, investments, guarantees and securities

According to the new section, a company has the liberty to make any loan to any body corporate, give any guarantee, or provide any security, and invest in securities of any other body corporate upto 60% of its paid-up share capital and free reserves, or 100% of its free reserves, whichever is more.

However, where the aggregate of the loans, investments, guarantee or security to be provided by a company to all other bodies corporate, together with the loans, investments, guarantees and/or securities already made by the company, is in excess of the limits specified above, then the new section mandates that a special resolution be passed in a general meeting of the company authorising the making of such loans and investments, or the provision for guarantees or securities.

Thus, the Board of Directors can, without shareholders’ approval by special resolution, invest, make loans, give guarantees and securities upto:

- 60% of the paid-up share capital and free reserves; or
- 100% of the free reserves,

whichever is more.

The net effect of these new provisions is as follows:

(i) The new provisions are quite liberal as compared to sections 370 and 372.

(ii) The limit of investment or loan or guarantee or security to be given, has been raised from 30% to 60% of the company’s paid-up share capital and free reserves, or 100% of the free reserves of the company making such loan, investment etc., whichever is more.

(iii) The new section applies to loans, investments, guarantees and security to be provided by a company in connection with a loan.

(iv) The concept of companies under the same management has been dispensed with.

(v) Investment by a company in other bodies corporate which hitherto was restricted only to shares, has now been expanded to cover all types of securities, namely, shares, bonds, debentures, etc.

(vi) Approval of the Central Government is dispensed with even if the investment, loan, guarantee, or security, exceeds the specified limit. The only approval, in case the limits are exceeded, is from the shareholders of the company by a special resolution in a general meeting.

Prior approval of public financial institutions

Although section 372A does not provide for any Central Government approval before the making of any investments and loans, or the provision for any guarantee or security, sub-section (2) of section 372A, makes it compulsory for companies to obtain prior approval from public financial institutions, as referred to in section 4A of the Act, if any term loan, which may have been taken by the company from such public financial institutions, is subsisting.
The section mandates that, if there is a default by the company in the repayment of loan installments or payment of interest thereon as per the terms of such loan taken from the public financial institutions, a prior approval from the public financial institutions is required irrespective of the quantum of the loan, investment, guarantee or security, intended to be made or provided.

The operative word here is ‘default’. If there is no default, but the term loan is subsisting, then the approval from the financial institution is required only if the limits prescribed in the section are sought to be exceeded.

The section only talks about public financial institutions, therefore, if there is default in the repayment of any term loan taken from any nationalised or scheduled bank, the bank’s consent is not required.

Provisions affecting subsidiaries and wholly-owned subsidiaries

Another distinguishing feature of the new section is that inter-corporate financial transactions by a holding company with its wholly-owned subsidiary, namely:

(a) any loan made by a holding company to its wholly-owned subsidiary;
(b) any guarantee given or any security provided by a holding company in respect of a loan made to its wholly-owned subsidiary; or
(c) acquisition by a holding company, by way of subscription, purchases or otherwise, of the securities of its wholly-owned subsidiary,

are outside the scope of the new section. However, the exclusion is in respect of only wholly-owned subsidiaries. Therefore, even if an insignificant portion of shareholding (e.g. 0.01 per cent) is held by any third party in the subsidiary, the subsidiary would cease to be a wholly-owned subsidiary, and the provisions of the new section would be applicable.

This was not the case in the erstwhile sections 370 and 372. These erstwhile sections did not cover inter-corporate financial transactions by a holding company with its subsidiary.

Fixed rate of interest

The new section also seeks to regulate the rate of interest on a loan that is made by a company to any body corporate. Till now, companies had the liberty to fix any rate of interest for the loan advanced by them, irrespective of the prevailing bank rate of interest. A company could even advance an interest free loan to its group companies. However, with the introduction of the new section 372A, a company can now lend money only at the prevailing bank rate of interest, or at a rate of interest that is higher than the bank rate of interest.

Definitions

The new section has also defined the following words:

‘Loan’: includes debentures or any deposit of money made by any company with another company not being a banking company;

‘Free reserves’: means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

Compliance Checklist

While making an inter-corporate loan or investment, or providing guarantee or security, the following step by step course may be adopted:
(i) In the case of a lending company, ascertain the aggregate amount of paid-up capital and free reserves. (According to the definition of ‘free reserves’, only reserves created out of genuine profits of the company or share premium account shall be considered.)

(ii) Finalise the transaction keeping in view the prescribed percentage in relation to the company’s paid-up capital and free reserves.

(iii) Convene a Board meeting to pass a unanimous resolution approving the proposed transaction, provided it, together with the loans, investments or guarantees and securities already made and/or given, is within the limits specified under the section. In case it exceeds the specified limits, then before entering into the proposed transaction, convene a general meeting of the shareholders to approve the transaction.

(iv) Obtain a prior approval of the public financial institution for the transaction, if required, in terms of the provisions of the section.

(v) After complying with the above steps, invest the fund or advance the loan or provide the guarantee or security to the company concerned.

(vi) Enter full details in the register kept for the purpose, as specified in sub section (5).

(vii) Ensure that the register is kept at the registered office of the company and remains open for inspection as per the provisions of the Act.

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**LEGAL SNAPSHOT**

**Entry of foreign law firms under debate**

The Law Commission has taken up a study on the entry of foreign legal consultants and liberalisation of legal practice in India. Though Western law firms have been trying to gain entry into the Indian market following economic liberalisation, local firms have been resisting them, even to the extent of litigation and protests against foreign lawyers appearing in Indian courts.

One of the key issues to be tackled by the Law Commission will be the amendment of the Advocates Act and rules, which prevent foreign lawyers from setting up liaison offices under different names and practising in India. The Bar Association of India has endorsed the guidelines issued by the International Bar Association, but whether the legal fraternity will accept them as well, is debatable.

**Initial Public Offering (IPO) limit for information technology (IT) companies reduced**

The Securities & Exchange Board of India (SEBI) has relaxed the minimum public offering for IT companies from 25% to 10% of the issued capital. However, in order to be eligible for this reduction, the IT companies will be required to make a public offering for at least Rs 500 million and offer at least 20 lakh securities to the public. This is a relaxation of Rule 19(2)(b) of the Securities Contract (Regulation) Rules, 1957 which stipulates that a company must offer a minimum of 25% of its issued share capital to the general public.

The reason for this relaxation is to discourage high net worth IT industries from listing their shares outside India and thereby depriving the Indian investor of the opportunity of investing in these companies.

A similar recommendation was made to relax the minimum public offering at the time of the IPO for media and telecom industries. However, this recommendation was not accepted.

**Y2K Action Force set up**

A Y2K Action Force has been set up by the government under the Chairmanship of Montek Singh Ahluwalia to formulate a Year 2000 Ordinance to deal with issues relating to Y2K and provide a framework for dispute resolution.

The Y2K Action Force secretariat has already prepared a draft ordinance which provides for:
• compliance and disclosure of computer processing problems, solutions, test runs and results, etc.;

• all government, public and private sector organisations to keep their offices open on 1st and 2nd January 2000 to test all IT products utilised by them for Y2K compliance;

• setting up of crisis management centres, which will be fully equipped with logistical and technical support and will prepare guidelines and procedures for handling the Y2K crisis, in all major cities, state capitals and at the district level;

• a clearing house to be set up for collecting and disseminating all Y2K related information in the country, managing the Y2K crisis and establishing Y2K crisis management centres; and

• priority treatment to be given to Indian users by Y2K solution providers.

Used capital goods imports made easy

The Directorate General of Foreign Trade (DGFT) issued guidelines for the import of secondhand capital goods. The guidelines state that though the import of used capital goods will remain on the restricted list, the DGFT’s Licensing Committee will automatically clear the import of capital goods not older than five years. For capital goods older than five years but less than 10 years the Committee will take into consideration the comparative advantage of such goods vis-à-vis new capital goods. Import of capital goods older than ten years will normally not be allowed except for heavy equipment in the infrastructure sector.

Government to set up one-stop service body for FDI

The Union Cabinet has decided to set up a Foreign Investment Implementation Authority (FIIA), independent of the Foreign Investment Promotion Board (FIPB), to act as a single point interface between the investor and the government. FIIA is proposed to be headed by the Secretary, Industry. The FIIA will provide pro-active one-stop services to the investors in obtaining necessary government approvals. FIIA will help in sorting out operational and coordination problems between different departments of the government.

Security norms set out for Net gateways

The Government has formulated the implementation mechanism for security provisions and clearances for Internet Service Providers (ISP’s) to set up their own international gateways as per the Internet Policy announced in November last year.

According to the implementation mechanism, no permission is required for use of encryption up to 40 bit key length while for stronger encryption, the decryption key splits into two parts to be deposited with the telecom authority. The ISP’s are also to provide monitoring equipment for security provisions costing up to four lakhs per gateway. The guidelines and application for setting up an international gateway would be available with the Department of Telecommunications.

Summary Suits for credit card defaulters

Banks can now file summary suits for quick recovery of dues arising out of credit card defaults, as per a recent judgement of the Bombay High Court. The order effectively forces a defaulter to pay up part or whole of his dues before arguing his case. The order was passed after the Court had heard out all credit card-issuing banks.

Foreign Exchange Dealers’ Association of India (FEDAI) clears Reuters system

FEDAI has given Reuters Transaction Services Ltd. the go ahead to operate the Reuters Dealing 2000-2 foreign exchange matching systems in India. Reuters has been holding that its 2000-2 system is merely ‘matchmaking’ and does not amount to broking. However, forex brokers contend that the Reuters system does actually amount to broking and have decided to move the Bombay High Court if the system is installed. The forex broking community has already sought the opinion of Justice Bhagwati, who has clearly stated that, “the activity proposed to be carried out by Reuters plainly and indisputably constitutes broking”.

MNC’s with patent technology free to retain equity in JV’s

The Foreign Investment Promotion Board (FIPB) approved a move to permit foreign companies using proprietary technology to retain their equity and not divest it in favour of foreign entities. This is a reversal of an earlier stand of the Industry Ministry, which imposed conditions under which 100% foreign owned companies had to divest 26% equity to Indian partners or public within 3 to 5 years, depending on the case.
No tolls for private road builders

In yet another policy change in the road sector, the government has decided to shift to annuity-based payments to the operators and do away with direct tolling due to the operational difficulties being faced. Even shadow tolling may be passed by if the proposed pilot projects do not work properly. The government has already resorted to a cess on petrol and diesel and is planning to use a part of this cess towards making payments under the annuity-based payment scheme.

Interim order on telecom by Delhi High Court

The Delhi High Court has conditionally allowed the government to issue new licenses under a revenue sharing arrangement to existing operators. In its interim order, the Court said that new licenses would be issued only to those existing basic and cellular operators who agree to give an undertaking that the migration from the license fee regime to a revenue sharing regime would be subject to the approval of the next Council of Ministers and new Parliament. The undertaking would be valid till 31 December 1999. It will be made a part of the new license and each operator will have to submit the undertaking in the form of an affidavit before the High Court.

If the New Telecom Policy, including the migration package, is not approved by the new Council of Ministers or Parliament, then the operators would not be able to claim any legal rights under the new licenses. In that case the new licenses would stand terminated and the operators would have to revert to the old licences issued in 1995.

Electricity tariff regulator set up in State

The Government of Maharashtra has constituted the Maharashtra Electricity Regulatory Commission on 5th August 1999. The Commission will have complete power on all tariff-related issues, including that of agriculture. The Commission will also have the power to determine the nature as well as the quantum of reimbursement of subsidies given to the farming sector, to be given to the Maharashtra State Electricity Board (MSEB).

Independent power producers in the State will, however, fall outside the purview of the Commission as the tariffs in these cases are determined by power purchase agreements. The Commission will have limited power over licensees like BSES and Tata Electric Companies who supply power to Mumbai.

Net Trading

The Securities and Exchange Board of India (SEBI) is keen to introduce trading over the Internet to investors. A SEBI Committee on Internet-based securities trading and services has decided to constitute two working groups for finalisation of norms and guidelines for trading over the Internet. The first working group would look into standardisation of interface and security protocols for Internet trading at various levels. The second working group will examine surveillance and monitoring issues related to trading over the Internet. Brokers would have to work out a different system of ensuring authenticity of clients and place limits for orders depending on the type of client.