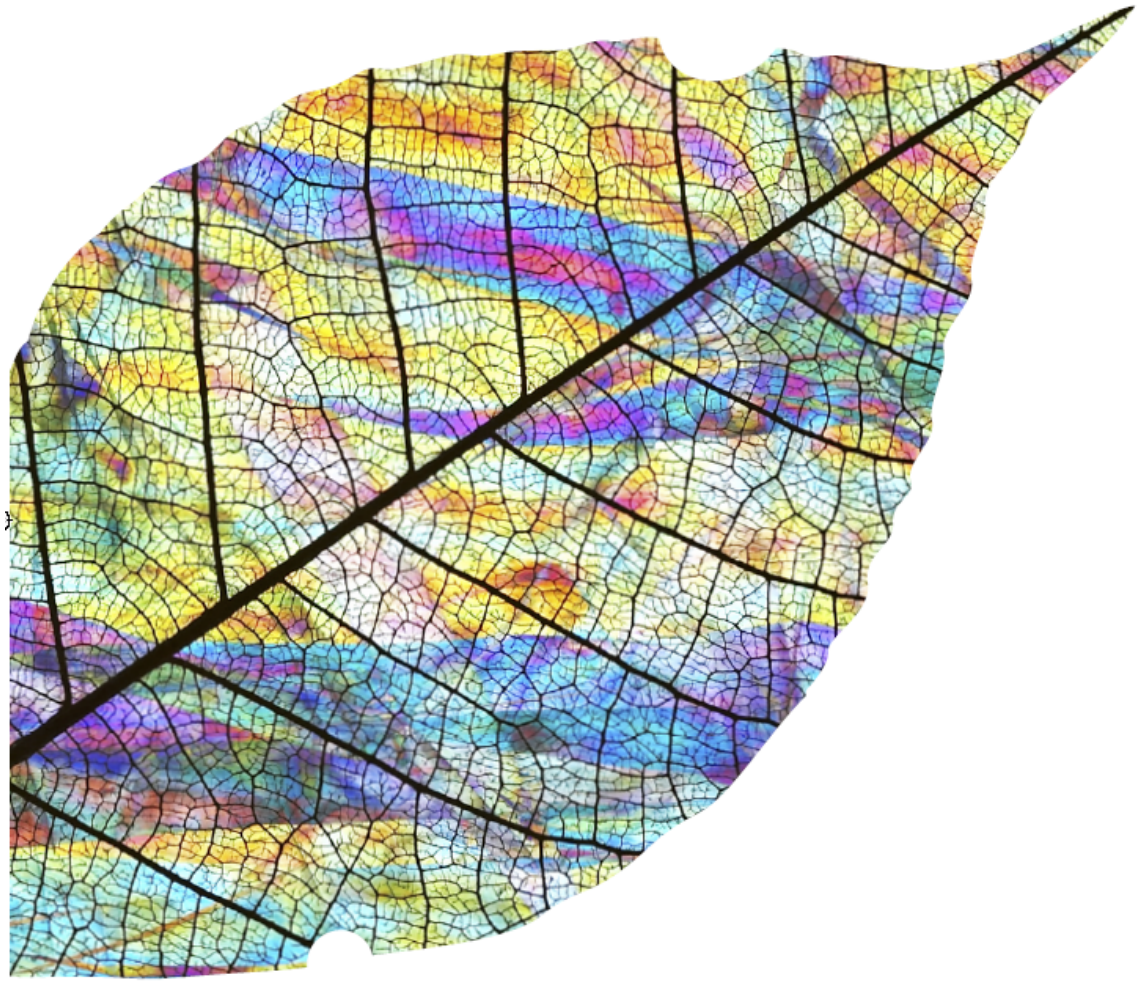
World Universities Comparative Law Project
Legal risk rating of India

carried out by students at the Universities of Bangalore, Hyderabad, Jodhpur and Kolkata

A production of the Allen & Overy Global Law Intelligence Unit



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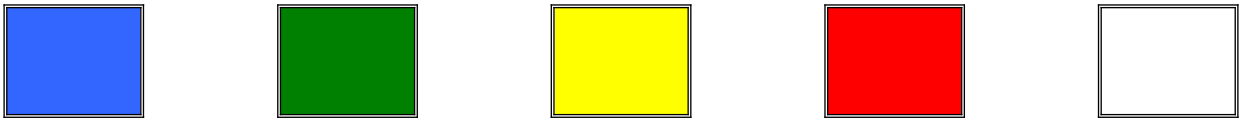

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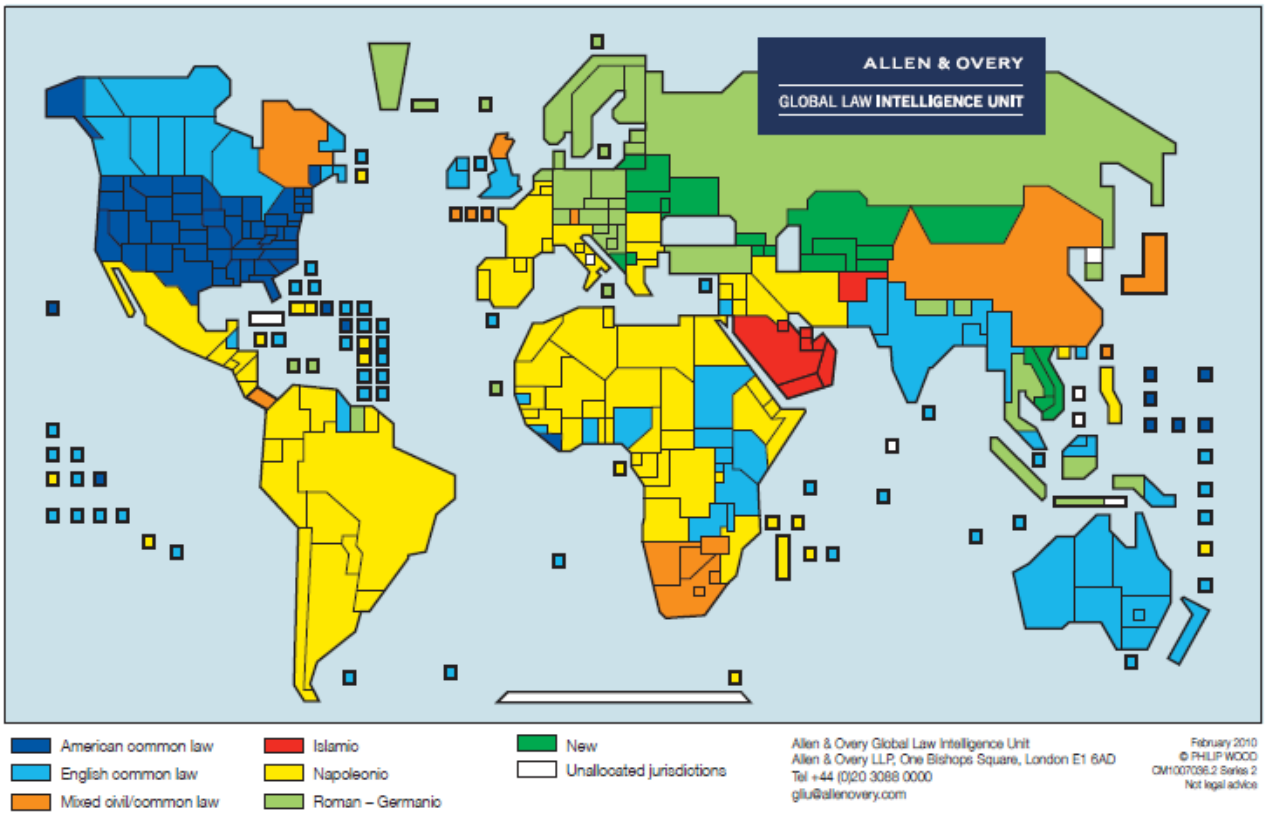
Families of law



Foreword

We are delighted to present this legal risk rating of India, which we hope will be the first in a theory of similar risk ratings carried out by students around the world.

We hope that you will find the colour-coded methodology and the technique of selecting symbolic and resonant legal indicators to be an expressive and creative way of signalling some of the main contours of wholesale financial, corporate and related law in India. We certainly find the result to be most fascinating and helpful and we hope that the reader will agree.

We are most grateful to the four excellent universities in India for being willing to participate in this publication and I in particular am warmly appreciative of the opportunity I have had to teach at each of their law schools in past years.

Finally, I would pay a special tribute to the intellectual flair and dedication demonstrated by the four students who carried out the work. They were all prize winners at the International Finance & Corporate Course 2011. The aim was to produce a survey of the wholesale financial and corporate law in India looking at how India fits in with the rest of the world.

Philip R Wood QC (Hon)

Head, Allen & Overy Global Law Intelligence Unit
Special Global Counsel
Visiting Professor in International Financial Law, University of Oxford
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Visiting Professor, Queen Mary College, University of London
Visiting Professor, London School of Economics & Political Science

Legal risk rating: India

Introduction

This paper assesses aspects of legal risk in India with a view to rating the legal risk. The survey is concerned primarily with wholesale financial and corporate law and transactions, not with retail law.

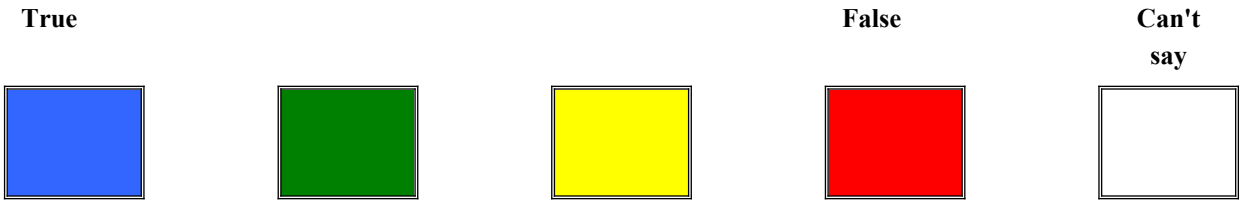
Legal risk has increased globally because of the enormous growth of law; because of its intensity; because many businesses are global but the law is national; because nearly all countries are now part of the world economy; and because the law is considered to play a very significant role in the fortunes of our societies. Liabilities can be very large and reputational losses severe.

The survey was carried out by prize-winning students at leading universities in India. The survey was designed by the Allen & Overy Global Law Intelligence Unit in conjunction with the students concerned.

The views expressed in this survey are the views of the students, not necessarily those of the Global Law Intelligence Unit or the members of Allen & Overy. In accordance with the requirements of academic freedom, the students expressed their views freely and in their own way.

Methodology

The survey uses colour-coding as follows:



Blue generally means that the law does not intervene and the parties are free, ie the law is liberal and open.

Red generally means that there is intense legal intervention, usually in the form of a prohibition.

Green and **yellow** are in-between.

The purpose of this colour-coding is to synthesise and distil information in a dramatic way, rather than a legal treatise. The colours correspond to a rating of 1, 2, 3 or 4, or A, B, C or D.

The cross in the relevant box signifies the view of the students carrying out this assessment of the position of India. This may or may not be followed by a comment, eg pointing out qualifications or expanding the point. These comments were written by the students.

The colour-coding does not usually express a view about what is good or bad. Whether the law should intervene in a particular arena is a matter of opinion. But if the law does intervene, this creates a risk because the law has to be complied with. If it is not complied with, there is generally some sanction in the form of liability, a penalty or the invalidity of a transaction.

Black letter law and how it is applied

This survey measures two aspects of law. The first is black letter law, ie what the law says or the written law or law in the books.

The second measure is how the law is applied in practice, regardless of what it says. Thus, the law of Congo Kinshasa and Belgium has similar roots but its application is very different.

Although there is a continuum, these two measures have to be kept separate. Otherwise we may end up with just a blur or noise or some bland platitude, eg that the law depends upon GDP per capita.

Key indicators

The survey uses key indicators to carry out the assessment. It is not feasible to measure all the laws or even a tiny fraction of them. The law of most jurisdictions is vast and fills whole libraries.

The key indicators are intended to be symptomatic or symbolic of the general approach of the jurisdiction. To qualify as useful, the indicator must usually be (1) important in economic terms, (2) representative or symbolic and (3) measurable. In addition, the indicators usually measure topics where jurisdictions are in conflict. There is less need for measuring topics where everybody agrees.

The key indicators and the text explaining the indicators were produced by the Allen & Overy Global Law Intelligence Unit.

Legal families of the world

Most of the 320 jurisdictions in the world, spread around 195 sovereign states, can be grouped into legal families. The three most important of these are: (1) the common law group, originally championed by England; (2) the Napoleonic group, originally championed by France; and (3) the Roman-Germanic group, originally championed by Germany, with major contributions from other countries.

The balance of jurisdictions is made up of mixed, Islamic, new and unallocated jurisdictions.

Many aspects of private law are determined primarily by the family group, but this is not true of regulatory or economic law.

Excluded topics

This survey does not cover:

- transactions involving individuals
- personal law, such as family law or succession
- competition or antitrust law
- intellectual property
- auditing
- general taxation
- macroeconomic conditions, such as inflation, government debt, credit rating or savings rates
- human development, such as education, public health or life expectancy
- infrastructure, such as roads, ports, water supply, electricity supply
- personal security, such as crime rates, civil disorder or terrorism.

Banking and finance

Introduction

Banks and bondholders (typically also banks, but also insurance companies, pension funds and mutual funds) provide credit to enhance growth. Their main risk is the insolvency of the debtor and therefore the key indicators are whether the law supports creditors or debtors when it matters, ie on bankruptcy. This is when commercial law is at its most ruthless in deciding who survives and who drowns.

This debtor or creditor decision is implemented mainly through the bankruptcy ladder of priorities. A notable feature of common law systems is the presence of super-priority creditors who are paid before anyone else - creditors with a set-off or a security interest and beneficiaries under a trust. For example, if a bank has universal security over all the assets of a company, the bank is paid before all other creditors, including employees and trade creditors. This regime therefore protects the largest creditors who are typically banks (who in turn represent depositors, ie the citizen) and the law is creditor-protective. Their legal risk is reduced and hence the risks of depositors with banks is reduced.

If the jurisdiction prioritises these three super-priority claimants, then the legal system of that jurisdiction is likely to be based on the English common law model, meaning that the indicators are highly accurate in informing us about the rest of the legal system. If these super-priority risk mitigants are debased, this may also tell us whether the legal system is generally pro-debtor or pro-creditor in its bankruptcy law. For example, one might be able to conjecture whether or not there is a tough rescue law and whether wholesale creditors are or are not favoured in the bankruptcy ladder of priorities. The result is that it would be much quicker to check the key points.

Traditional Napoleonic jurisdictions typically do not allow insolvency set-off, have narrower security interests and do not recognise the trust. They are therefore debtor-protective. Most traditional Roman-Germanic jurisdictions are in-between. They allow insolvency set-off and have quite wide security but most do not recognise the trust.

Insolvency set-off

Generally If set-off of mutual debts is allowed on insolvency, the creditor is paid. If it is not allowed, then effectively the creditor is not paid. Hence insolvency set-off is creditor-protective. A prohibition is debtor-protective. Very large amounts are involved in markets for foreign exchange, securities, derivatives, commodities and the like, so that the question of whether exposures should be gross or net is a major aspect of legal risk.

Q1 In India, creditors can set off mutual debts on the insolvency of a debtor if they are incurred before notice of the insolvency.

True			False	Can't say

Comment: Set-off is allowed in insolvency proceedings against Indian companies under the Companies Act 1956 as it is allowed in insolvency proceedings against individuals under the Provincial Insolvency Act 1920 and the Presidency Towns Insolvency Act 1909. However, there are certain entities in India which are incorporated under specific statutes (such as banking companies and other statutory corporations) and therefore may be excluded from the applicability of the provisions of winding up under the Companies Act 1956 and the rights of set-off available under the Companies Act 1956. However, as Indian courts are guided by the basic common law principles of 'equity' and 'justice' and because the principle of 'mutual dealings and set-off' is well entrenched in Indian jurisprudence, Indian courts may uphold otherwise perfected set-off claims against insolvent statutory corporations.

Security interests

Generally Security interests give priority to the creditor with security - typically banks - who are the main providers of credit in most countries.

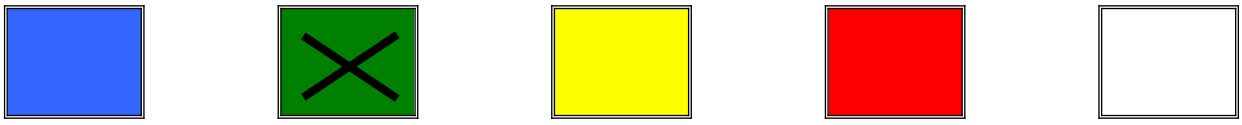
In traditional common law jurisdictions, a company can create universal security over all its present and future assets to secure all present and future debt owed to a bank. Once registered, the security is valid against all creditors, except that the floating collateral ranks after preferred creditors - typically wages and taxes. The security can be granted to a trustee for creditors. On a default there are no mandatory grace periods and the creditor can enforce out-of-court by appointing a receiver (a type of possessory manager) or by private sale. But in some jurisdictions there are freezes on enforcement in the event of a judicial rescue of the debtor. Also, in some jurisdictions there are stamp duties.

On the other hand, in many traditional Napoleonic jurisdictions, universal security is not possible, neither is security for all future debt. There is no trustee to hold the security. On enforcement, there are grace periods and no receiver. Sale is through the court and a public auction. Preferential creditors rank ahead. Some countries have a strict freeze under a judicial rescue statute.

The main tests are therefore (1) scope, (2) debt secured, (3) trustee, (4) priority over preferred creditors, (5) private enforcement and receiver, (6) no rescue freezes and (7) low costs. Security interests reduce the legal risk suffered by banks and hence strengthen the position of depositors with banks.

Q2 In India, the law offers a security interest which is highly protective of the secured creditor.

True **False** **Can't say**



Comment: Mortgages can secure present and future debt: s 58, Transfer of Property Act [TP] 1882. Sale without intervention by the court is possible only in the case of an English mortgage, or where it is written into the mortgage deed and the mortgagee is the Government, or the mortgage property is in a Presidency town: 69, TP Act 1882. There is a right of private sale in respect of pledge (s 176, Indian Contract Act, 1872) and hypothecated property (*SBI v SB Shah Ali,* AIR 1995 AP 134 – only if the hypothecation agreement provides for it). There is also a right of sale under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002, along with other self-help remedies such as

the right to take over the management of the borrower's business, and the right to take possession of and sell the secured assets. As for the trustee, the proceeds of a mortgage sale are to be deposited with the trustee.

Workmens' dues and claims of secured creditors are an overriding preferential claim: s 529A, Companies Act, 2956.

Corporate rescue processes are available under schemes or arrangement under the Companies Act 1956 (to be approved by a majority of creditors representing not less than 75% of value of debt) with the sanction of the Companies Court, and there are restructuring mechanisms under Sick Industrial Companies Act, 1985 (the Act as been repeated, but the repeal is yet to be notified. And the Voluntary Corporate Debt Restructuring System set up by the RBI

Universal trusts

Under a trust, one person, called the trustee, holds title to the assets of another person, called the beneficiary, on terms that, if the trustee becomes insolvent, the assets go to the beneficiary and are not used to pay the trustee's private creditors. The assets are immune and therefore taken away from the debtor-trustee's bankrupt estate.

The main examples of trusts are custodianship of securities, pension funds, securities settlement systems and trustees of security for bondholders and syndicate banks. The availability of the trust mitigates the legal risk of, for example, those who place their securities in the custodianship of banks and the users of securities settlement systems. The amounts involved are enormous.

All jurisdictions have an effective trust of goods (called bailment or deposit), but only the common law group has a universal trust for all other assets (land and intangible property). Most members of the civil code group do not have a universal trust, subject to wide exceptions, especially for custodianship of securities.

Q3 India has a universal trust for all assets.

True			False	Can't say
☒	☐	☐	☐	☐

Comment: Trusts are possible in respect of both movable and immovable property: s5, Indian Trusts Act 1882. The word "property" under the Trusts Act is of the widest import and therefore such intangible property as a running business (*J.K. Trust v. CIT (1957)* 32 ITR 535 (S.C.)) and shares (*Damien Subsidies and Kuries Ltd. v Jose Pulicken.* (2007) 2 CompLJ 479 (Ker)) can be made the subject matter of a trust.

Other indicators

Other bankruptcy indicators not measured have included freezes on the termination of contracts, fraudulent preferences, the priority of rescue new money, the presence and intensity of rescue proceedings and recognition of foreign insolvencies. Director liability for deepening the insolvency is dealt with below.

Other financial law topics not covered in this survey include the regulatory regime, especially capital, liquidity, authorisation of financial business, conduct of business, control of prospectuses, control of market abuse and frauds, such as insider dealing and the insolvency regime for banks. Financial regulation is a very large field.

Corporations

Introduction

Financial law involves competition between debtors and creditors so that jurisdictions can be positioned on a straight line. Corporate law however involves three main competitors: (1) shareholders, (2) creditors and (3) managers - a triangle. If the key indicators show that a jurisdiction strongly favours one or other of the parties at the points of the triangle, whether creditors, shareholders or management, then one can begin to build up a picture of the choices which the jurisdiction habitually makes in resolving the conflicting interests of the parties.

For example, a very tough prohibition on financial assistance (which is protective of creditors against shareholders) tends also to support an attitude to other principles of the maintenance of capital or to support the proposition that mergers by fusion are difficult (because they can prejudice creditors). This would be true of the English regime in 1948. Similarly, a view which easily imposes personal liability on directors for deepening an insolvency might also show a legal approach which is not supportive of the veil of incorporation in other areas, eg shareholder liability and substantive consolidation on insolvency.

The two extreme corporate law models are the Delaware model and the traditional English model, exemplified by the English Companies Act 1948 (now superseded in the UK). Napoleonic and Roman-Germanic models are in-between to varying degrees.

The Delaware regime is highly protective of management in the key areas. The English regime favours creditors on most of the key contests and, where creditor interests are not involved, it tends to favour shareholders as opposed to managers.

Director liability for deepening an insolvency

Generally If the law imposes personal liability on directors for deepening an insolvency, eg carrying on business and incurring debts where there is no reasonable prospect of paying them, then the regime is hostile to the interests of management. The legal risks of management are increased.

There are basically four regimes internationally: (1) directors are hardly ever liable for deepening the insolvency, eg Delaware and most U.S. jurisdictions, plus some traditional English jurisdictions which only punish fraudulent trading; (2) directors are liable for serious negligence (England, Singapore, Australia, Ireland); (3) directors are liable for mere business misjudgements deepening the insolvency (France); and (4) directors are liable if they fail to file for an insolvency proceeding after the company becomes insolvent (France, Germany and others).

Q4 India The law rarely imposes personal liability on directors for deepening the insolvency and there is no rule that the directors must file for insolvency when the company is insolvent.

True			False	Can't say
	X			

Comment: Sections 538 to 543 of the Companies Act 1956 impose liability on directors for non-disclosure and fraud, but not for exacerbating the insolvency. There is no positive requirement for filing for insolvency.

However, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) contains provisions for early detection of a company's economic viability. In the event that the accumulated losses of an industrial company, at the end of any financial year, have eroded 50% or more of its "peak net worth", such company shall qualify as a "potentially sick company" under SICA. If an industrial company qualifies as a "potentially sick company", such company must (through its board of directors), within 60 days of the date of finalisation of the duly audited accounts, report the fact of the erosion of its net worth to the Board for Industrial and Financial Reconstruction (**BIFR**) constituted under SICA and hold a general meeting of the shareholders to report the fact and provide an explanation for it. Any failure by such industrial company to report the potential sickness to the BIFR may result in imprisonment of between six months up to two years as well as a fine against every director or officer who is in default.

If a company has been registered under the Companies Act 1956 for a minimum period of five years, and at the end of any financial year, has suffered losses equivalent to or exceeding its 'net worth', the company would qualify as a "sick industrial company" under SICA. In one case of sick companies, the board of directors of the company is required to make reference to the BIFR to determine the measures to be adopted in relation to the sick company. Any failure by the Board to report that an industrial company is a sick industrial company may result in a pecuniary punishment or a simple imprisonment which may extend to three years.

Directors of a company have a fiduciary relationship with the company and have the duty to act in the utmost good faith. In the event that a director has not acted in good faith or in the interests of the company then they may be held personally liable. In interpreting liability imposed on directors, Indian courts have, in several judgements, held that the courts will not substitute their judgment for the commercial judgement of the directors, if such directors have acted in good faith and have not been negligent.

Financial assistance to buy own shares

Generally Many jurisdictions prohibit a company from giving financial assistance to buy its own shares. The typical example would be where a bidder finances the acquisition of a target company by a loan and after the takeover arranges for the target to guarantee the loan and charge its assets to secure the guarantee. The commercial effect is similar to the repayment of the share capital of the target before its creditors are paid. Shareholders should be subordinated to creditors.

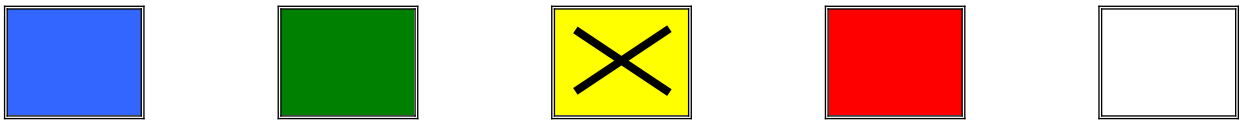
The prohibition therefore favours creditors against shareholders of the target.

The Delaware regime does not prohibit financial assistance. The traditional English regime has a wide prohibition (not England any more). Most Roman-Germanic regimes are against it, with Napoleonic regimes hesitant. The EU has a prohibition against financial assistance by public companies. Some countries allow financial assistance by private companies if solvency is established.

A contravening transaction is usually a criminal offence and void, thereby exacerbating legal risk.

Q5 India permits a company to grant financial assistance for the purchase of its own shares.

True **False** **Can't say**



Comment: No public company and no private company which is a subsidiary of a public company shall give whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company, or in its holding company.

This restriction does not apply to private companies or to any company for the purchase of shares in its subsidiary. However, there are certain conditions that all companies (including private companies) must comply with for the purchase of its own shares leading to a reduction in capital. There are also exceptions for lending of money by a banking business in the ordinary course of business, lending of money to employees for ESOPs: (s 77, Companies Act 1956). Buyback of its own securities by a company is permitted but is subject to compliance with certain conditions (s 77A, Companies Act 1956. These restrictions are applicable to all companies, public or private.

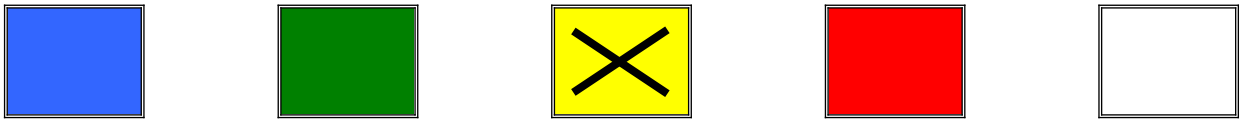
Public takeover regime

Generally A public takeover regime which is free and open tends to favour managers who can guard against takeovers by poison pills and the like and who have relative freedom to acquire other companies. An example is the Delaware regime. A restrictive regime on the lines of the British system tends to favour shareholders.

The chief features of a restrictive regime are: (1) the bidder must make a mandatory bid in cash when a threshold of shares in the target is reached, eg 30%; (2) the bidder must pay the same price to all shareholders (sharing the control premium); (3) no partial bids (getting control on the cheap); (4) proof of certain funds to implement the offer; (5) compulsory acquisition of dissenting minorities (squeeze-out); (6) fixed timetable; (7) no ability of the managers to frustrate a bid by poison pills without shareholder approval; and (8) control of the content of circulars, especially forecasts.

Q6 The public takeover regime in India is open and has few restrictions.

True **False** **Can't say**



Comment: According to the SEBI's new Takeover Code 2011, mandatory public offers must be made for 26% of the float in case an investor wishes to acquire more than a 25% shareholding in a listed company. The mode of payment need not necessarily be in case: Regulation 9. The bidder must pay the same price to all shareholders, subject to a few exceptions: Regulation 8(10). Following the public announcement, the acquirer must create an escrow account as security for performance of the obligation under the Code and deposit into the escrow account such amounts as are provided in the Code. This can be in the form of cash, bank guarantees or equity shares: Regulation 17.

Under the SEBI (Issue of Capital and Disclosure Requirements) Regulation 2009, issuing shares at a discount and warrants which convert to shares at a discount is not possible as the minimum issue price is determined with reference to the market price of the shares on the date of issue or upon the date of exercise of the option against the warrants – therefore poison pills effectively become impossible. Squeeze-outs are available if nine-tenths of the minority shareholders agree to squeeze out the remaining *dissenting* shareholders (s 395, Companies Act 1956). However, for listed companies, approval of the SEBI is required prior to effect a squeeze-out scheme.

Therefore, several elements of a restrictive regime are present, not to mention the enormous practical difficulties in actually carrying out a public takeover in India. Also, squeeze-out schemes are typically challenged by minority shareholders in India.

Other indicators

Other important indicators are corporate governance (difficult to measure), free ability to merge companies by fusion, the one-share-one-vote rule, and, to a lesser extent, minority protections. Other indicators relate to quick and cheap incorporation, the *ultra vires* rule, maintenance of capital, no par value shares, shareholder liability, substantive consolidation on insolvency and disclosure. These are not measured here.

Commercial contracts

Introduction

Contract is at the heart of commercial life, and is everywhere. In fact, the main tenets of contract law across the main families of jurisdictions are consistent - it is in the fields of insolvency and property law where the main differences emerge. It is true that there are contract differences, for example, between writing requirements, open offers, the letterbox rule and specific performance, but often these differences are of lesser significance in practice in the business field.

The key indicators the survey chooses all tend to symbolise whether the approach of the jurisdiction to contract is hard or soft. If the approach is hard, then the jurisdiction tends to support predictability in

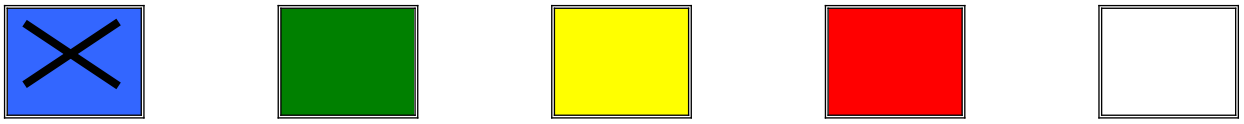
business contracts so that certainty and freedom of contract are valued more than mitigating the risk of occasionally abusive behaviour and unfair results, especially for weaker parties.

Exclusion of contract formation

Generally Commercial parties often wish to be able to negotiate heads of terms commercially without being bound by a contract. In some jurisdictions, the courts are ready to infer that the parties are bound if the terms are sufficiently clear, even if they have said expressly that they do not intend to be bound. Legal risk is increased if parties are committed when they did not intend to be.

Q7 In India, parties are not bound to heads of terms if they expressly state that the terms are "subject to contract" or some such clear phrase.

True **False** **Can't say**



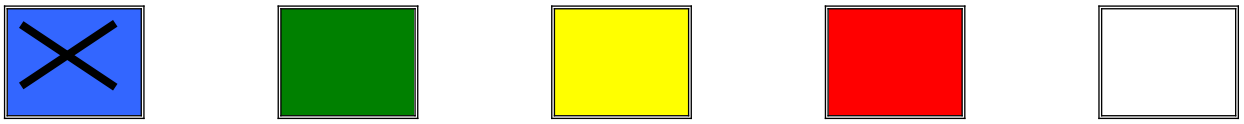
Comment: It depends on the intent of the parties and if they agree that heads of terms are binding, then it can be binding. Even if the parties have reached agreement on all the terms of the proposed contract, they may nevertheless intend that the contract shall not become binding until some further condition has been fulfilled. That is the ordinary "subject to contract" case. Alternatively, they may intend that the contract will not become binding until some further term or terms have been agreed (see *Nasir Husain Films Pvt Ltd v Saregama India Ltd*, MANU/MH/1570/2008; *Trimex International FZE Ltd v Vedanta Aluminium Ltd*, (2010) 3 SCC 1.

Termination clauses

Generally Many contracts, especially loan contracts, leases of goods and long-term sales contracts, contain events of default on the occurrence of which one party can terminate the contract. Jurisdictions which uphold freedom of contract and the literal interpretation of contract give effect to these clauses and do not rewrite the contract according to the court's notions of what is fair. We ignore consumer contracts - where there may be consumer protections.

Q8 In India, a termination clause in a loan or sale of goods contract between sophisticated companies (not individuals) providing for the termination of the contract immediately on certain events is usually upheld, even if the event concerned is relatively trivial.

True **False** **Can't say**



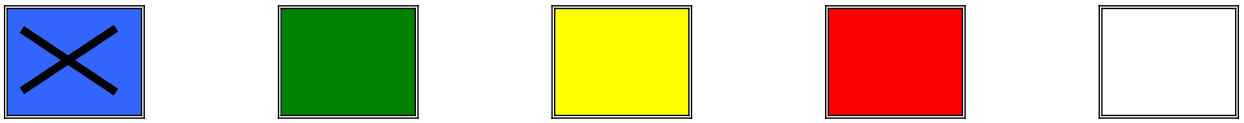
Comment: There is, as of today, no general statutory provision in the Indian Contract Act 1872 or the Sale of Goods Act 1930 whereby the courts can give relief to the consumer/weaker party by holding such terms in contracts as void on the ground of their being unreasonable, unconscionable or unfair (see Law Commission of India 199th Report on Unfair (Procedural and Substantive) Terms in Contract). The Supreme Court has struck down certain public service employment contracts as violative of Art. 14, but it has reiterated that arbitrariness will not be extended to commercial contracts.

Exclusion clauses

Generally Contracting parties often seek to exclude their liability for defective performance of the contract. So the issue is whether these exclusion clauses are generally upheld if they are clear and whether freedom of contract is allowed in this area. An ineffective clause increases legal risk.

Q9 In India, exclusions of liability in most commercial contracts between sophisticated companies, such as a sale of goods contract, are generally upheld if they are clear.

True **False** **Can't say**



Comment: It is considered that the Indian courts would uphold such a clause.

However, strict or absolute liability cannot be excluded even if the contract provides for exclusion. While the doctrine of strict liability provides for certain exceptions, the Supreme Court of India has formulated a stricter principle of absolute liability and a person may be held responsible for loss arising on account of hazardous/dangerous activities even if there was no negligence on the part of the person undertaking it or even if such person had undertaken reasonable care (*MC Mehta v Union of India* 1987 AIR 1086).

Other indicators

Other contract indicators not assessed here include writing formalities, open offers, mistake, frustration, damages, specific performance and whether notice of assignment of the contract to the debtor is mandatory if the assignment is to be valid on the insolvency of the assignor.

Litigation

Introduction

The first three key indicators of governing law, jurisdiction and arbitration, tend to show whether the jurisdiction does or does not place a high value on international comity and freedom of contract as opposed to an insistence on national primacy.

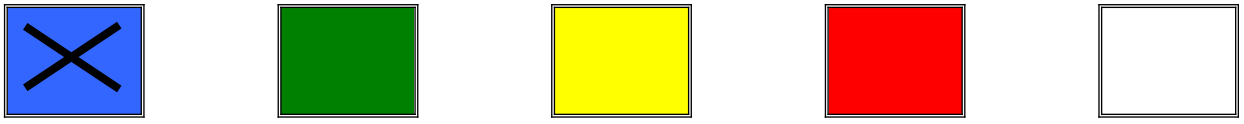
The indicator on class actions tends to show whether or not the jurisdiction's litigation system is orientated towards plaintiffs, especially mass plaintiffs in product liability cases. This indicator may also show the attitude of the jurisdiction to the protection of individual parties as against business parties, both in terms of the incidence of costs and enforcement.

Governing law clauses

Generally Most countries apply a foreign governing law of a contract even if there is no connection between the contract and the jurisdiction. If the courts do not uphold the governing law, the effect is that legal risks are unexpectedly different.

Q10 The Indian courts will apply an express choice of a foreign law in a loan or sale of goods contract between sophisticated companies, even though the contract has no connection with the foreign jurisdiction, but subject to Indian public policy and mandatory statutes.

True **False** **Can't say**



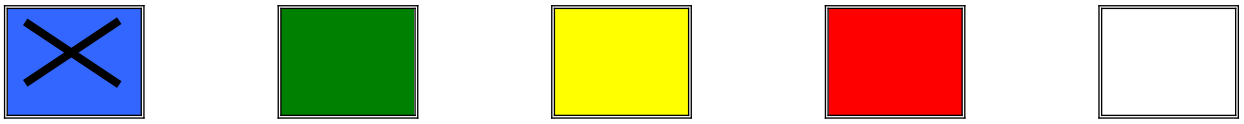
Comment: In a 2002 decision, the Bombay High Court upheld the validity of a contract wherein the parties had expressly agreed that the disputes would be settled under English law in English courts. The court held that, even when the agreement was signed by some of the parties in France, a country to which none of the parties belonged, the parties would be governed by the law which they chose under the agreement: *Rhodia Ltd. v Neon Laboratories Ltd*, AIR 2002 Bombay 50. The court cited the Indian Supreme Court's decision in *National Thermal Power Corporation v Singer Company*, AIR 1993 SC 998 to hold that the express intention of the parties is generally decisive in determining the "proper law of the contract".

Foreign jurisdiction clauses

Generally Many contracts confer jurisdiction, sometimes exclusive, on the courts of a foreign jurisdiction, usually accompanied by a choice of foreign governing law.

Q11 The Indian courts will generally uphold a clear submission in a loan or sale of goods contract between sophisticated companies to the exclusive jurisdiction of the courts of a foreign country, even if there is no connection between that country and the contract.

True **False** **Can't say**



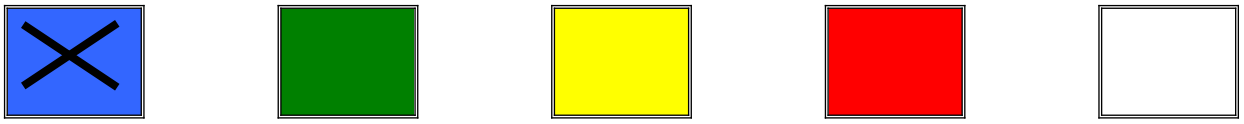
Comment: In India, while the parties to a contract can confer jurisdiction on a foreign court which is a "neutral court" or a "court of choice", they cannot confer jurisdiction on an Indian court which is not a court of natural or concurrent jurisdiction under the provisions of Civil Procedure Code [CPC]. Where the parties to a contract choose the neutral forum in preference to the natural forum, they would be bound by the jurisdiction of the neutral forum unless extraordinary and unforeseen circumstances exist, which would justify a party claiming relief from its bargain of a non-exclusive jurisdiction clause, but certainly not on the ground of inconvenience such as expenses and hardship of getting witnesses to the agreed forum. It is a well-settled principle that by agreement the parties cannot confer jurisdiction, where none exists, on a court to which the CPC applies, but this principle does not apply when the parties agree to submit to the exclusive or non-exclusive jurisdiction of a foreign court: *Modi Entertainment Network v WSG Cricket Pvt Ltd*, 2003 AIR SCW 733.

Arbitration recognition

Generally Contracting parties, especially in trading and construction contracts, but less so in loan contracts, wish to submit disputes to arbitration, sometimes in a foreign country. The resulting award is often enforceable locally under the New York Arbitration Convention of 1958, to which most countries have adhered.

Q12 In India, the courts allow sophisticated contracting parties to submit contract disputes to a foreign arbitral tribunal to the exclusion of the Indian courts.

True **False** **Can't say**



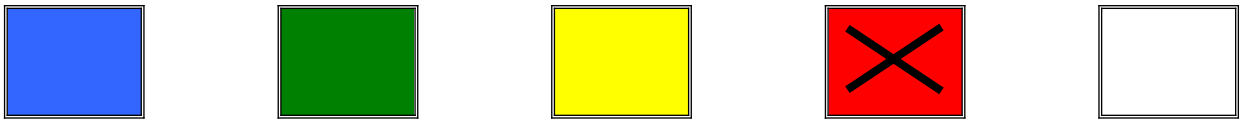
Comment: A two-judge bench of the Supreme Court issuing its judgment in *Videocon Industries Ltd v Union of India* (Civil Appeal 4269/2011) clarified that the application of Part I of the Arbitration and Conciliation Act 1996 will be held to have been excluded by the parties to an arbitration agreement who had agreed that the arbitration agreement will be governed by foreign law. The Supreme Court in *Dozco India Private Ltd v Doosan Infracore Co. Ltd.* [(2011) 6 SCC 179] reiterated this - where the governing law of the contract was that of South Korea and the seat of arbitration was Seoul, adjudicating upon an application filed under Part I of the Act for appointment of arbitrators, - since the parties had already decided on Seoul as the seat of arbitration, the curial law determining the procedural aspect in question was to be determined by the laws of South Korea, and accordingly, the provisions of Part I of the Act stood impliedly excluded.

Class actions

Generally In some countries, such as the United States, a plaintiff can be authorised by the court to sue on behalf of all claimants who are similarly situated. Claimants have to opt out or they are bound. The result can be enormous liabilities.

Q13 In India, class actions where the class is bound if they do not opt out are generally not allowed.

True **False** **Can't say**



Comment: Indian courts have relaxed requirements of *locus standi* to permit filing of suits on behalf of deprived sections by public-minded individuals. Unlike the class action in the US, this suit arises out of the writ jurisdiction of courts under Articles. 32 and 226 of the CPC. Over and above this, there is a provision for representative suits under Order 1, Rule 8 of the CPC. This allows one or more persons to file a suit on behalf of themselves and other persons having a common interest in a suit arising from a common object and a common grievance for which a relief is sought that is beneficial to all. Its provisions are not applicable in public internet litigation, so that defendants who claim to have been unaware of the case cannot be held to be not bound by the judgment. Further, the Companies Bill 2011 in Clause 245 allows a derivative action on behalf of the company by members to restrain the company and its directors from acting in breach of or *ultra vires* to the memorandum or articles of association or to seek compensation for unlawful/fraudulent conduct from the company and its directors or gatekeepers, like auditors. The minimum number of members represented must be 100 or such other number as may be prescribed.

Other indicators

Other indicators not covered by this survey include contingent costs, loser pays the costs of the winner, prejudgment freezes or arrests, appeals, disclosure (discovery of documents), efficacy of waivers of sovereign immunity and the enforceability of foreign judgments.

Real property

Security of land title and land registers

Generally Many jurisdictions improve the security of title to land by a registration system which, although not necessarily state-guaranteed, has high reliability. An example is the Torrens system developed in Australia and used in many other countries, eg Canada and England.

Most countries in the civil code groups do not have a title register but instead require documents concerning land to be notarised and filed at the registry so that they can be searched. The United States does not generally have title registers for land although there may be mortgage registers. They rely on title registration companies which provide title insurance.

The risk of losses is increased if title to land is unstable.

Q14 Most land in India is registered in a land register which records most major interests in land, eg ownership, mortgages and longer-term leases.

True			False	Can't say
☒	☐	☐	☐	☐

Comment: Section 17(1)(b) of the Registration Act 1908 provides that non-testamentary instruments which purport or operate to create, declare, assign, limit or extinguish, whether in the present or in future, any right, title or interest, whether vested or contingent, of the value of one hundred rupees and upwards, to or in immovable property, is to be registered. Similarly, s 59 of the Transfer of Property Act TP Act, 1882 states that all mortgages other than mortgage by deposit of title deeds where the value of the principal money secured is one hundred rupees or upwards must be done by way of a registered deed. Section 54 of the TP Act 1882 provides that transfer of ownership in case of tangible immovable property of the value of one hundred rupees and upwards and in case of intangible property can be made only by a registered instrument. Section 107 of the TP Act of the TP Act requires registration of leases exceeding one year. Registration raises a presumption of title, but does not rule out the possibility of a challenge to title. However, this is set to change with the implementation of the National Land Record Modernisation Programme that will provide conclusiveness to title by the application of the Torrens Title System.

Under the Seventh Schedule of the Constitution, all matters relating to land are within the exclusive legislative and administrative jurisdiction of States. As in common law, the State holds title to all land which is not private property. The Land Revenue Code/Act of the respective States is the substantive law which administers the "record of rights" of land/property ownership and occupation.

Land development restrictions

Generally Many countries restrict development and the change of use of land and require permits to be obtained for any development or change of use.

Q15 In India, apart from environmental controls (dealt with later), the control of commercial development and the change of use of land is very light and, where required, permits are quick and cheap to obtain.

True			False	Can't say
			X	

Comment: While laws and procedures vary across States, there is a large amount of documentation requirements, mostly associated with proving ownership, Also, disclosure of procedures, easy access to forms, documentation requirements, etc. lead to very high levels of information asymmetry. This creates a complex regulatory landscape as well as giving rise to administrative red tape. While provisions for deemed approvals by efflux of time exist, in practice they are rarely effective in ensuring time-bound approvals. The eventual development plan is expected to be laid out at the time of conversion, making the process lengthy as enforcement of development control is purely an urban planning function, while procedures require it to be routed through the Revenue Department. The burden of compliance with the plethora of laws related to the environment, development control, etc. are all embedded into the land use change process, making it very unwieldy.

Other indicators

Other indicators not surveyed include transfer costs, stamp duties and lessee protections.

Employment law

Generally The indicator here is whether it is easy or hard to hire and fire employees. The measures include high minimum wages, maximum hours, minimum holidays, maternity rights, equal pay for equal work (non-discrimination) and severance costs.

Violation may lead to large liabilities. The legal risks increase costs.

Q16 In India, there are few controls on hiring and firing employees or on the terms of employment.

True			False	Can't say
			X	

Comment: The body of legislation that shapes the industrial and labour environment in India is a huge criss-crossing network of chaotic, strangulating, overlapping and often contradictory laws that are crying out for overhaul.

The single most important labour law is arguably the Industrial Disputes Act (IDA) 1947. The IDA makes it very hard for firms to fire workers. In fact an amendment made to the IDA in the mid-1980s, resulting in the inclusion of Chapter V-B, requires that any factory, plantation or mine employing more than 100 workers gets permission from the appropriate government (either state or central depending on the nature of the establishment) before retrenching workers (and in practice that permission is seldom given). What is remarkable about this and many other Indian labour laws is that they leave no room for free contracting. Some recent data compiled by the World Bank collates the level of rigidity of hiring and firing rules in different nations -100 being the score of the highest conceivable rigidity. India is among the most rigid countries with a score of 48. The fact that the less rigid nations also have more efficient economies, higher wages and a smaller share of labourers who are long-term unemployed may not be entirely a matter of coincidence.

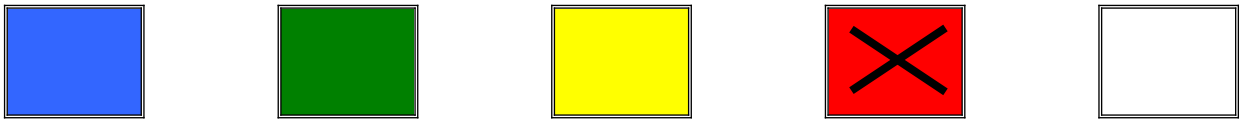
An important negative effect of Chapter V-B is that foreign investors who are keen on investing in labour-intensive countries are deterred from investing in India, whereas other labour-intensive countries that have a strong export orientation have benefitted in terms of more foreign investment in their countries and creation of high quality employment based on exports: Report of Task Force, Planning Commission, 2001.

Section 9 A of the Act has also been a cause of concern. It lays down conditions for service rules, according to which workmen should be given at least 21 days' notice before modifying various conditions of service like wages, other allowances, hours of work, rest intervals and leave. It has been said that this could cause problems when employees have to be redeployed quickly to meet certain time-bound targets and also could constrain industrial restructuring and technological upgrading.

Environmental restrictions

Q17 In India the rules governing the environment and liability for clean-up are very light and relaxed.

True **False** **Can't say**



Comment: The environmental law regime in India is complex and varied with a multi-tier set-up of regulations. The chief statutes governing the field are the Water (Prevention and Control of Pollution) Act 1974, the Air (Pollution and Control of Pollution) Act 1981 and the Environment (Protection) Act 1986. The former two establish authorities at the federal and state levels with powers for the prevention and control of water and air pollution, and prescribe penalties for pollution. Chapter II of the latter vests vast powers in the federal government to prescribe and enforce standards for preventing environmental pollution. This has been carried out through a vast body of delegated legislation, prominent among which are the Hazardous Wastes (Management and Handling) Rules 1989, which prescribe strict requirements for the handling and disposal of hazardous waste.

In addition, the judiciary has provided that an enterprise that is engaged in a hazardous or inherently dangerous activity which results in harm to anyone is absolutely liable to compensate all those affected by the accident: *M.C. Mehta v Union of India*, AIR 1987 SC 1086. The judiciary has further adopted the 'polluter pays principle' to strengthen the absolute liability regime in India by making enterprises liable to not just compensate the victims of pollution but also to pay the cost of restoration of the degraded environment [Indian Council for Enviro-Legal Action and Ors. v Union of India, AIR 1996 SC 1446]. This has also been reflected in subsequent legislation including s 3 of the Public Liability Insurance Act 1991 and s 20 of the National Green Tribunal Act 2010. All of these collectively establish a strict environmental regime.

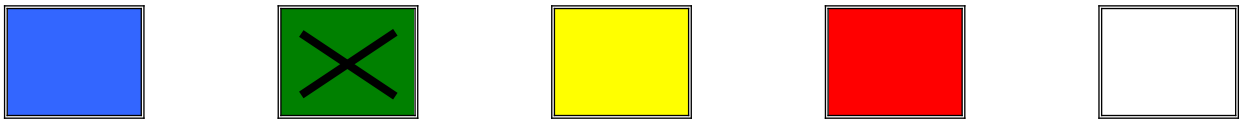
Openness to foreign business

Generally These indicators measure the degree to which the country is open to foreign businesses. The indicators are quite generic and therefore subjective.

Foreign direct investment

Q18 In India foreigners may freely own and control local companies outside protected industries, such as media, banks and defence.

True **False** **Can't say**



Comment: Foreign investment in India is subject to policy guidelines framed by the Government of India from time to time in accordance with its Industrial Policy. In terms of the Industrial Policy announced by the Government of India on 24 July 1991 followed by subsequent guidelines issued by them, foreign equity up to the permissible limit is permitted under the Automatic Route of the Government in specified industries/service sectors. Applications which do not conform to the parameters of the Automatic Route for investment in sectors where FDI is permitted are required to seek Government approval.

Foreign institutional investors are permitted to invest in most types of securities in primary and secondary markets in India as per guidelines issued by the Ministry of Finance, Government of India, subject to certain conditions and caps. Unfortunately the investor inflows look for short-term opportunities and flow out of the Indian market whenever the return arbitrages occur.

As per section 6.1 of the Consolidated FDI Policy released in April 2012 by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India (**FDI Policy**), foreign direct investment is prohibited in nine areas or sectors such as trading in transferable development rights, gambling and betting, including casinos etc). Section 6.2 of the FDI Policy lists out sectoral FDI limits for certain sectors where foreign direct investment is permitted, and also specifies that in all other sectors, FDI up to 100% through the Automatic Route is permitted. These are subject to other conditions laid down in the FDI Policy, including minimum capitalisation, Governmental approval and pricing for issuance- transfer of shares. The FDI Policy also provides for certain sectors such as defence, air transport service, etc where FDI is permitted subject to sectoral caps and prior approval of the Government.

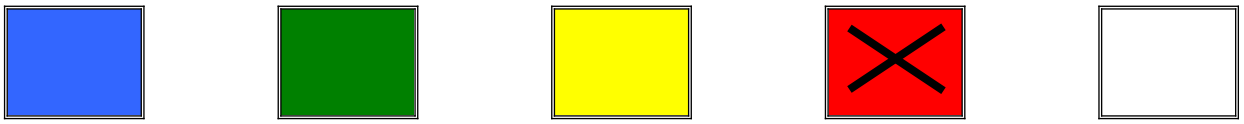
Hence, the foreign investment regime, even in respect of industries other than protected industries, is subject to a number of regulations and restrictions. The non-committal approach (there is no indication/proactive action espousing Government thinking on FDI in retail, insurance or defence) creates jitters in the minds of potential investors as they are not sure of the Government's stance.

The renewed debate on FDI has been provoked by a simple fact: FDI coming into India has been falling drastically. According to Reserve Bank of India (**RBI**) data, FDI fell more than 25% during April 2010-February 2011. The first 11 months of 2011 saw US$25.95 billion in FDI inflows, compared to US$36.55 billion a year earlier. Portfolio investment, ie, money brought in by foreign institutional investors, can be taken out practically overnight, while FDI, to talk policy decisions which is normally invested for a longer investment horizon, is far more stable. In various sectors including insurance, retail and others, the Government has taken far too long to take policy decisions. This is holding back the inflows into the economy through this route.

Exchange controls

Q19 In India, there are no exchange controls. Businesses may therefore have foreign bank deposit accounts in foreign currency, borrow in foreign currency and repatriate profits to foreign shareholders in foreign currency.

True **False** **Can't say**



Comment: Foreign exchange controls exist in India and are administered by the RBI under the Foreign Exchange Management Act 1999 (**FEMA**) as well as various regulations and guidelines issued by it from time to time. FEMA employs a prohibitive regime with transactions in foreign currency being regulated under s 3 of the Act and restricted to authorised persons. Further, under s 4, possession or transfer of foreign exchange or securities outside the country is possible only to the extent permitted by, and in the manner regulated under, the terms of the Act and regulations framed by the RBI. There are further restrictions that the RBI is empowered to impose under the Act, as well as detailed reporting and prior permission requirements.

Alien ownership of land

Q20 In India, foreign-controlled companies can own and lease land in India without a permit.

True			False	Can't say
		X		

Comment: A foreign company which has established a branch office or other place of business in India, in accordance with the Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations 2000, can acquire any immovable property in India, which is necessary for or incidental to carrying on such activity. However, if the foreign company has established a Liaison Office in India, it cannot acquire immovable property. In such cases, Liaison Offices can acquire property by way of lease not exceeding five years.

Further, even though foreign direct investment is prohibited in real estate business, the definition of "real estate business" does not include development of townships, construction of residential/commercial premises, roads or bridges. FDI is permitted in companies engaged in such activities subject to certain pre-requisites and guidelines.

Application of the law

Generally These indicators deal with the application of the law, as opposed to what the law actually says. They are bound to be generic and subjective, a matter of impression.

Unpredictability and arbitrariness in the application of the law can increase legal risks.

Q21 In India, the higher courts usually treat big businesses as fairly as they treat individuals and do not favour local interests over foreigners.

True			False	Can't say
	X			

Comment: A simple and definite answer to this question is complicated both by its multiple dimensions as well as the absence of empirical data indicating a clear trend in either direction. In India, big businesses are treated on a par with individuals in certain kinds of litigation (criminal law, taxation etc), while in other areas (environmental law, consumer protection etc), courts tend to treat corporations more strictly than individuals or favour local interests over foreigners, taking into consideration "deep-pocket syndrome", or "public

health". A number of cases can be cited in favour of or against the proposition, but given the variance in their subject - matter and context, it is difficult to draw any definite conclusion in this regard.

Costs and delays of commercial litigation

Q22 The costs and delays of commercial litigation in the higher courts in India are not considered materially greater than in developed countries.

True			False	Can't say
		X		

Comment: Delays in litigation in the Indian judicial system have been an issue of concern for quite some time. As of 2011, nearly 55,000 cases were pending before the Supreme Court of India, with another 4.2 million pending before the various High Courts. The resulting costs and delays would be greater than in developed countries which have far better rates of disposal of cases and less pendency.

It should be noted that the Law Commission of India, in its 188th Report in 2003, had suggested that a Commercial Division be established at all High Courts to handle commercial cases above a certain pecuniary value, so as to reduce the costs and delays in commercial litigation in India and assure foreign investors of speedy and efficient dispute resolution. In furtherance of this, the Government has proposed The Commercial Division of High Courts Bill 2009, which is at present pending before Parliament.

Overall ranking

This overall ranking is achieved by a survey of all the rankings as shown this table:

	Question	Rating
1.	Insolvency set-off	
2.	Security interest	
3.	Universal trusts	
4.	Director liability for deepening insolvency	
5.	Financial assistance to buy own shares	
6.	Public takeover regime	
7.	Exclusion of contract formation	
8.	Termination clauses	
9.	Exclusion clauses	
10.	Governing law clauses	
11.	Foreign jurisdiction clauses	
12.	Arbitration recognition	
13.	Class action	
14.	Security of land title and land registers	
15.	Land development restrictions	
16.	Employment law	
17.	Environmental restrictions	
18.	Foreign direct investment	
19.	Exchange controls	
20.	Alien ownership of land	
21.	Court treatment of foreign big business	Can't say
22.	Costs and delays of commercial litigation	

True **False** **Can't say**

Commentary and suggestions for change

Post-liberalisation in the early 1990s economic conditions in India have improved and capital markets have become more developed. There is reasonable protection of enterprise and finance and high standards of fairness and efficacy in the higher courts in disputes between large businesses, so that legitimate expectations are met. Nevertheless, businesses face problems pertaining to red tape, nepotism and perceptions of corruption.

Government authorisation is required to retrench workers in many cases, and no reforms perceived as weakening worker rights are likely to gain traction. In India today, labour is the most important area crying out for reform. Suppose a company wants to manufacture a product that has volatile demand - like fashion garments. This company may want to offer workers higher wages but make it clear to them that they could be given a month's notice and asked to leave. Such a contract will have no legal standing because the IDA (Industrial Disputes Act) specifies how and when workers may and may not be retrenched. Hence we do not see such contracts. This law also keeps hundreds of thousands of workers unemployed as companies, held to ransom by the fact that they will not be able to offload them, do not hire in the first place. Also, in areas of volatile demand, many companies have not even come into existence because they realise that India's current legal regime makes them non-viable. A legal regime whereby companies can write different kinds of contracts with their workers depending on their needs, is urgently needed - and at the same time, should protect workers from being fired at will without sufficient cause. Flexibility in labour market regulation can attract foreign capital, create jobs and unleash higher growth.

Foreign direct investment decisions are politically sensitive and would take considerable time to be reformed. FDI inflows are significantly linked to the reform process. Government policies influence FDI inflows. One way to attract more FDI is to open up more areas to foreign investment and re-examine the ceilings. There is a need to improve the ease of doing business in the country. The instability of policy, perceptions of rent seeking behaviour, and lack of transparency dampen the ‘herd-mentality’. Implementing 'single-window' in its true spirit will cut down the multiplicity of regulations and there is a need to have a consistent and continuous fiscal policy.

Per RBI data, FDIs being a fraction of the total investment in India is not such a game-changer. It is roughly in the 10-15% range of gross fixed capital formation. But its implications are different because of the kind of investment it brings in and the technology linkages it offers. Also, looking ahead, in the 12th Plan (2007-2012), India expects to invest about a trillion dollars in infrastructure. Much of it is expected to come from abroad. Hence, clarity is needed on FDI matters. This is not just for the quantitative aspect but for the qualitative aspect that FDI brings with it. Qualitatively, FDI is a powerful tool for modernising the Indian economy. When foreign players enter the market, Indian players are forced to improve their technologies and all aspects of their performance.

Property disputes are common, as are unclear rules and obstructive bureaucrats. Quite a few laws are redundant or non-existent. The revision of laws takes a few years. For instance, the Companies Bill 2011 has been pending for a couple of years awaiting parliamentary approval. Laws like the Sick Industrial Companies Act and the SARFAESI Act have not served their intended purpose and have had a poor track record. On the other hand, several recent proposals are starting to emerge (the Commercial Division of High Courts and establishing land title registers) which, if backed by policy initiatives and greater judicial clarity (on issues like exclusion/termination clauses), would change perceptions about investing in India.

Among the positives, the country’s political system is stable and its legal system is relatively impartial, though slow. An "activist judiciary" at the helm has been able to fill in the loopholes but has led to less predictability in terms of decisions on areas like the environmental control and regulations. In conclusion, it

can be seen that areas governed by private contract law are respected and have significantly lower risks than those purely under the hands of the public administration.

The survey was carried out by the following students:

Manish G - Ganga is a fourth year student at the National Law School of India University, Nagarbhavi, Bangalore. Manish's areas of interest include economic and legal policy analysis, statistics, law reform and judicial systems and processes.

Anees Backer is a fourth year student of the B.A. LL.B. (Hons.) course at NALSAR University of Law, Hyderabad. He has great interest in commercial law, particularly M&A, Finance and IPR.

Aritra Roy is a fourth year student at the National Law University, Jodhpur, pursuing the B.A. LLB course with an honours degree in International Trade and Investment Law.

Subhayu Chakraborty is a fifth year student at the National University of Juridical Sciences (NUJS), Kolkata (India), pursuing B.A LL.B (Hons.) Post graduation.

Allen & Overy Global Law Intelligence Unit

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Philip Wood is one of the world's leading comparative lawyers and practitioners. He has written about 18 books on financial law. He was formerly a partner and head of the banking department of Allen & Overy. For many years he has been developing innovative and pioneering methodologies for assessing legal jurisdictions and has produced a book of maps of world financial law. His university textbook on the Law and Practice of International Finance has been translated into Chinese and a Japanese version is forthcoming..

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