CONTRACTS IN OUTSOURCING: A STUDY OF DATA PROTECTION AND PROCESSING

Dissertation submitted to Jawaharlal Nehru University in partial fulfilment of the requirements for the award of the degree of

MASTER OF PHILOSOPHY

PHRANGSNGI PYRTUH

CENTRE FOR THE STUDY OF LAW AND GOVERNANCE
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI-110067

2009

CENTRE FOR THE STUDY OF
LAW AND GOVERNANCE
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI-110067 INDIA

Date: .....

Declaration

I declare that the dissertation entitled "Contracts in Outsourcing: A Study of Data Protection and Processing" submitted by me in partial fulfillment of the requirements for the award of the degree of Master of Philosophy of Jawaharlal Nehru University is my own work. The dissertation has not been submitted for any other degree of this University or any other University.

PHRANGSNGI PYRTUH

CERTIFICATE

We recommend that this dissertation be placed before the examiners for evaluation.

Prof. Niraja Gopal Jayal
(Chairperson)

Chairperson
Centre for the Study of
Law and governance
Jawaharlal Nehru University

Dr. Jaivir Singh
(Supervisor)

ACKNOWLEDGEMENT

At the outset, I am honestly grateful to God who had blessed me abundantly in health and spirit throughout the course of my work. He has showered me with his blessing and knowledge which enable me to focus and work hard despite many shortcomings.

There are many people that I must mention for their unconditional support through their presence and prayers. This research has been a fulfilling journey which was not smooth to start with. There were times when I falter and commit many mistakes which at times discourage my progress. So I would like to take this opportunity to thank some of those people without which I would not be able to complete this work.

I cannot proceed without expressing my gratefulness to a good friend who has been a strong companion throughout, Tasaduq Hussain Beigh. He has been an inspiration in times of doubt and difficulty and I am certain that his support and presence would continue to inspire me to new challenges in life. For Mum and Dad and my Sisters and Brothers, thank you for your love, unconditional support and prayers which keep me on my toes. Thank you Raphael, Aiban, James, Stephen and many other friends as well.

And for my supervisor Dr. Jaivir Singh, for his insight and direction which was an incredible experience in itself. His presence and support allow me not to lose sight of what I need to do and accomplished. I hope to work and progress as a Research Scholar under his supervision in the future as well.

Phrangsngi Pyrtuh.

CONTENTS

JUDGEMENTS OF COURTS

Potluri v Rajeswara Rao MANU/AP/0367/2000

International Investor KCSC v Sanghi Polyesters Ltd MANU/ AP/ 1278/ 2002

Abhinav Gupta v State of Haryana MANU/PH/0790/2008

Nivedita Sharma v Bharti Televentures, ICICI Bank Ltd, American Express Bank Ltd and Ors 2006 Indlaw SC Del 69

Avnish Bajaj v State 2004 Indlaw Del 711

Burlington Home Shopping Pvt. Ltd vs. Rajnish Chibber MANU/DE/0718/1995.

INTRODUCTION

Global trade has seen increasing volume of data transaction between business firms in various countries. Cross border data flow is of phenomenal volume that trade of goods and services have assumed a new meaning altogether. The buzz word in the business world is outsourcing or what Bhagwati (1984) called "long-distance", purchase of services abroad principally through electronic mediums such as telephone, fax and the Internet. Bhagwati and others have implicitly recognized and accept the role that technology plays in facilitating this flow of trade and services. Outsourcing is a new type of trade, though Bhagwati and Srinivasan argued that it is fundamentally just a trade phenomenon with the usual trade gains and its effect on jobs and wages are no different from those of a conventional trade (Bhagwati and Srinivasan, 2004).

Outsourcing follows a pattern that is synonymous with international trade of goods and services but whose nature of transaction is different from the conventional understanding of trade and exchange of goods. The paradigm on which Outsourcing operates involves relocating manufacturing process and production between different countries and regions. Increasing openness and liberalization of domestic economies not only stimulate foreign investment but also provides a platform for major companies and service firms to take advantage of new markets which are generally characterized by low wages and abundant human resources. Outsourcing ventures have increases exponentially in the last decade with increasing number of firms outsourcing most of their business non-core activities to exploit these new resources to maximize their profits. Despite the controversies surrounding Outsourcing, such as job losses and non-compliance, it has flourished and is destined to shape future business model on efficient service delivery.

Outsourcing incurs unprecedented transfer of data particularly in the Information Technology (IT) and Information Technology Enabled Services (ITES) sector. Technology has made such transfers plausible and enables the growth of Offshoring and outsourcing business which was previously never thought of. Data transfer has never assume so much importance until firms initiate such transfers through collaboration and business agreements with firms located in different countries. To ensure strict compliance and protect data, statutory protection for data

processing is of paramount importance. Unrestricted data flow without adequate safeguard measures would be detrimental to the interest of the data subject and also violate basic rights of the individual subject. In the absence of a data protection policy, ITES companies have implemented processes like BS 7799 and ISO 17799 standards on information security management which restrict the quantity of data flow to Indian Companies and call centers. This study is an effort to understand the need for data protection and examine the various laws and regulations prevalent both at the global and domestic level in the context of India.

This research work is divided into four parts. Chapter I is an analysis of the business structure that was widely practice as a corporate strategy to minimize cost known as Vertical Integration. The role of the firm has change markedly due to increasing complexity in the environment it operates. To counter these problems, the firm adopts an ingenious strategy of integrating its business units. This section examine the various environmental complexities which resulted in a momentum shift to a more unconventional form of business strategy, Outsourcing. Vertical integration was seen as a more cost-effective governance structure for transactions involving assets specificity. However, though market transaction provides strong incentives for firms to maximize value it is unable to insulate transaction specific investment from opportunism and bargaining costs. The firm then resorts to a different strategic approach of contracting business across the boundary of the firm.

The theory on transaction costs is important to understand in depth why firms choose a particular form of business strategy to meet firm objectives of cost minimization and economies of scale. There are different factors which compel firms to integrate such as uncertainty in demand and market volatility. Implicit in this discussion is the important role of technology and how firms craft innovative strategy such as contracting non-strategic units to meet their objectives. This section also discusses why firms are more guided by cost minimization as a strategy to meet its objectives than cost regulated mechanism (in lieu of Integration). This allows a firm to experiment with a different approach by exploring hitherto unconventional business operation to meet suppliers and buyers expectation such as Outsourcing.

Increasing competition from rival and new firms brought about through liberalization has strengthened the need for disintegration in favor of outsourcing strategy as the latter not only provides more service at less cost but also enable the firm to expend less resource. This is important to understand why contracts are

important in an outsourcing relationship and how it simultaneously acts as an alternative governance mechanism to govern the relationship between two contracting parties. We also contemplate why markets are not ideal governance structure for allocation of resources.

Chapter II is a theoretical discussion on contract formation and property rights. We assert that contracts are mostly incomplete due to various unforeseen contingencies explicated by the Principal-Agent theory. We contemplate the theories on Property rights and Agency Cost as some of the most important factor which drive contracts. Property Rights approach is employ to distinguish the ownership and control of assets in order to mitigate contractual hazards such as opportunism. The performance of the contract depend on the ability to mitigate costs and contractual hazards and this section study how asset ownership and contractual separation of control discourage agents to shirk work and allows the principal to provide incentives for the agent to do so. Proper delineating of rights provides further incentives for contractual performance and avoids costs such as bargaining costs of surplus sharing.

According to the Transaction cost literature, efficient allocation of property rights is achieved through proper allocation of ownership which will reduce costs. This section discusses the problems in the enforcement of rights and the recognition of ownership rights particularly in a dynamic setting such as outsourcing. While Property Rights are legally enforceable they cannot be fragmented to cater to specific uses, Contracts on the other hand are more easily verified and can be enforceable across the spectrum. Once delineated, contracts become ideal mechanism for binding contractual arrangement between parties.

This chapter emphasizes the enormous role that law could play in safeguarding property rights through the contracts. Legal intervention is necessary when there are breach and unauthorized access of data violating property rights of the individual. The law provides assistance through legal remedies such as damage measures. The constitutive nature of the law allows the contract to assume custodian protection of rights of the individual. Therefore contractual rights become synonymous with property rights and the former is an important device to ensure the protection of the property rights.

Chapter III is an observation on the Indian legal system embedded in legislated Laws, Acts and different Statutes relating to different variety of legal disputes in Outsourcing. This section also allows us to understand how private

international laws, though not codified, is applicable to different branch of law which enable proceedings that are unconventional such as foreign judgement and arbitration award. With increasing cross border investment and Outsourcing, foreign law is poised to streamline legal disputes by furnishing resolution through various mechanisms such as the arbitration tribunal. We analyze the choice of law as specified in the Indian Contract Act 1872 along with different other Acts that would be useful to provide us with an anecdote of the operation on the choice of law and choice of forum clauses.

There is an inherent conflict between the laws operating in the country vis-à-vis international law. Such a conflict is exacerbated when the courts have to decide cases involving a contract that agrees to bind its commitment to the law prevailing in a different country. The challenge for domestic law is to decide if a law that prevails in another country is conclusive and therefore binding in a foreign land. This section briefly discusses procedural law and how they conflict with substantive law of the state in an area where conflict occurs the most viz, conflict in the enforcement of foreign awards and arbitration. The Indian Courts have taken an approach that is based on public policy to determine the conclusiveness and validity of a law, whether foreign or domestic. Most domestic courts, while deciding foreign law and arbitration, have rely less on procedures reinforcing the belief that the states generally prefer substantive to procedural policies.

This section would enlighten the readers with an anecdote on the legal remedies which the legal system supports. This section also examines case studies of Supreme Court and High Courts, though not intrinsically related to the outsourcing contracts; these case studies offer an insight for an outsourcing provider to consider when drafting a contract. Different laws are examined in this discussion pertaining to the proper law of contract, arbitration clause, foreign laws and their validity in the context of India. Data protection is important in the Outsourcing world compelling most countries to initiate legislations on Data Protection and Processing. Chapter IV examines existing laws and statutory legislation of India vis-à-vis the European Union (EU). Data Protection Directive and the United Kingdom (UK) Data Protection require that data transfer only takes place to countries that provide an "adequate" level of privacy protection. The EU needs to be satisfied that a country where data is exported possess "adequate" data protection policies. In this chapter we discuss how contractual obligation is an alternative to meet this requirement though not a

substitute in lieu of a statutory data act. It is unfortunate that India being an important hub of outsourcing business in the world does not possess a statutory data protection act.

In conformity with the EU's Directive on privacy protection regarding data, this research adduce the need for a statutory data protection Act since data protection is not accorded much importance even with the only piece of legislation that was enacted in 2000, the Information Technology Act. It was more concerned and intended to cope with e-commerce and focuses on computer abuse and evidentiary matters relating to computer-related cases. In this chapter we examine the proposed amendment of the Act proposed in 2006 by the Expert Committee which is not sufficient considering the enormity of data business and trade. The focus of the recommendation was oriented to aligned legal intervention on data breach and fraud towards a criminal procedure. We cited and study court cases that would assist us to understand the legal implication concerning data breach, fraud and other unauthorized access of information and database such as copyright infringement.

CHAPTER 1

FROM VERTICAL INTEGRATION TO OUTSOURCING

1.1 Introduction

Contemporary business had to face tremendous challenges as customer preferences changes, new firms and competitors developed innovative strategies, regulation changes, and technology improves and so forth. These have compel firms in the last few decades to alter their business objective of meeting profit and cost minimization to other more factual and realistic goals allowing firms to diversify their business operations and streamline in-house operation. An ever changing dynamic market environment also induces firms to change their strategies of operation in securing not only surplus profits but also to assure supply of inputs to meet a growing business environment.

The firm is the central operating unit whose challenge is to adapt to these changes some of which are foreseen and predictable while others are unforeseen and difficult to fathom.[1] Failure or success to adapt will determine the future of the operations. There are various other factors as well. New firms in a competitive market not only face problems and stiff competition from established firms in terms of cost/investment efficiency, quality of the product/services as well as market power but most importantly they encounter problems such as supply constrains in terms of raw materials and high cost of production.

According to Stigler, new young industries tend to be vertically integrated because the set up costs incurred to carry out activities subject to scale economies may be too high to make emergence of specialized suppliers profitable. Existing firms encounters dilemma of different kind which is different from those of new entrant firms. These firms face risks and uncertainty such as demand variation, volatile competition, technological changes etc. They also face external diseconomies and their challenge is to service more at less cost.

---

[1]When markets transaction involves recurring exchange becomes hazardous for transaction specific investment, the firm provides an alternative, that of common ownership of physical capital to discourage opportunism between separate owners. The firm also provides efficient information transfer and long-term ties between the firm and its employees. (Levy, 'The Transaction Cost Approach to Vertical Integration: An Empirical Examination', *The Review of Economics and Statistics*, vol. 37, no.3, Aug, 1985, p 438)

1.2 The concept of vertical Integration as a Corporate Strategy

A conservative approach of encountering these challenges to meeting business objectives is by integrating business units.[2] Traditionally vertical integration are those integrated units presuming 100% ownership, physically interconnected and supply 100% of a firm's need for particular goods or industries. This is made possible where one downstream asset is jointly owned with the upstream asset. The concept of vertical integration has been expanded to encompass a variety of arrangements by which the firm can use outsiders (as well as its own business units) to forge an optimal vertical system for supplying goods, services, and capabilities. The advantages of vertical integration include the ability to secure supplies and future orders. This can also mean that the part of the business sheltered from competition can become less efficient as they are no longer subject to the discipline of competing in an open market. However, it is most often justified when it leads to either operational efficiencies or some other source of strategic advantage.

Kathryn Rude Harrigan pointed out that though vertical integration is a corporate strategy; it has been misunderstood as a tool for effective strategy. Vertical operation as a corporate strategy has significant impact on a firm's cost differentiation and other significant issues.[3] Vertical integration is an important managerial innovation and a necessary technological step in developing certain industries which is different for other emerging industries where firms must provide their own infrastructure and other supplies. As a corporate strategy it has long been a key force in the development of high productivity and managerial sophistication in American business.[4] Harrigan is of the opinion that the use of vertical integration changes as industries evolve and argues that the presence (or absence) of certain environmental

---

[2] Initially Vertical integration as a business strategy was initially view with skepticism. It was viewed as suspicious by antitrust enforcers and as anomalous by economists. Various Antitrust laws have been enacted to discourage mergers, collusion and takeovers on the ground that vertical integration would affect competition, restrict output and raise the final product prices even though it improves supply reliability (Carlton, 1979), eliminates monopoly distortion and erect barriers to entry.(Hamilton, 1986) Williamson is convinced that transaction cost considerations underlie the need for vertical integration to eliminate monopoly distortion, technical complementarities, supply reliability and economies in the acquisition of information.

[3] Firms will choose integration depending on the phase of industry development (sales growth etc), industry volatility (concentration and height of exit barriers), and asymmetries in bargaining position vis-à-vis suppliers, distributors, competitors integration strategies and firms strategy objectives. (Harrigan, 'Vertical Integration and Corporate Strategy', *The Academy of Management Journal*, 28, no 2, June 1985) pp. 402-403.

[4] Harrigan, Ruth Kathryn, 'Formulating Vertical Strategies', *Academy of Management Review*, 1984, Vol 9, No. 4, 638-640.

characteristic should mitigate (or enhance) the use of vertical integration. This ability to evolve has led to a resurgence in interest on integration vis-à-vis non-integration such as outsourcing such that certain firms simultaneously pursue integration and strategic outsourcing.[5] This research however traces the momentum shift which induces firms to pro-actively adopt non-integration more intensely than ever before. For corporate, vertical integration would involve a variety of decisions concerning whether they should provide certain goods or services in-house, through their own business units, or purchase them from outsiders instead.

Vertical integration assists Corporate on decisions to whether to retain business acquired firms (acquisitions) which are vertically related, to encourage intra-firm commerce or whether to encourage vertical relationships between in-house units. Vertical acquisition of leading enterprises or/and leading service providers improves the position of the firm in the marketplace and enable them to save costs through supply chain coordination and creating access to various downstream distribution channels that otherwise would be inaccessible, captures upstream and downstream profits margins etc. Therefore, Vertical integration requires the cooperation of its Strategic Business Units (SBUs), whether they are integrally connected or through other forms of ownership control, and may sometimes requires temporary subsidization of one business unit at the expense of the other but in the process of integration firms need to ensure that they do not lose out on the opportunities of scale economies and cost advantages. To meet this objective, it is important that firms define the boundaries of the SBUs such as the breadth and degree of integration particularly in situation of demand uncertainty and volatile competition. Therefore economies of scale and cost reduction provide incentives for vertical integration.

1.3 Market Cost of Transactions

Firms integrate to take advantage of economies of scale to reduce cost. Cost acts as a barrier to market exchange and may compel firms to strategize its operational strategy differently to minimize costs. According to Arrow, transaction costs are "the cost of organizing the economic system". Transaction costs make market exchange risky while incurring uncertainty to the exchange particularly if the transaction is

[5] See Rothaermel, Hitt & Jobb, 'Balancing Vertical Integration and Strategic Outsourcing: Effects on Product Portfolio, Product Success and Firm Performance', *Strategic Management Journal*, Vol.27

continuous or frequent.[6] Williamson argues that uncertainty raises the costs of executing market transactions since opportunism are inherent in such transactions and render transaction specific investment as risky.[7]

Williamson (1983) has identified four different types of transaction specific investment. They are site specificity, physical asset specificity, human-capital specificity and dedicated assets. These investments generate potential appropriate quasi rent and create incentives for one party to 'holdup' the other party ex post and lead to costly haggling. Contractual holdup engenders difficult for identifying productive incentives and risk bearing (Shavell, 2007). To avoid such costs, the firm will integrate those activities which incur costly market transactions through governance structure that will reduce the incentive for either party to exploit them ex post.[8] However, Klein favors contractual alternatives to integration to mitigate these costs, which may include shared ownership of assets to organize these costs ranging from simple contracts to long term contracts.

Vertical integration is meant to assuage asset specific investment by mitigating risks and uncertainty associated to risky transactions. The transaction cost theory of the firm has been conceived to examine the uncertainty and other costs which create an incentive for the firm to integrate. Managers need a business arrangement that can control risks and uncertainty. However, they need to contemplate on certain issues when deciding whether to vertically integrate, one is the cost aspect and the other is control of assets. First, transaction exchange depends on the cost of market transactions between firms vis-à-vis the cost of administering the same activities internally within a single firm. According to Coase, transaction can take place in the firm or across markets. The firm will integrate those production processes if the cost of transacting over markets outweighs internal costs of management. Since market

---

[6] According to David Weber and Gordon Walker, a transaction which is continuous or frequent create concern for the efficient use of resources involved in two aspects, one the uncertainty associated with the executing the transaction and the specificity of the assets associated with the goods or services transacted. (Walker and Weber, 'A Transaction Cost Approach to Make-or-Buy Decisions', *Administrative Science Quarterly*, September, 1984) pp 373-374.

[7] Uncertainty is intrinsic on bounded rationality. Bounded rationality is limited by asymmetric information and uncertainty of the future. Decision making surrounding an exchange is thus difficult to specify ex ante (i.e. environmental uncertainty) while not easily verifiable ex post (i.e. behavioral uncertainty). Bounded rationality not only interferes with the efficient operation of transactions but also limits the capability of markets and simple contracts to handle asset specificity.

[8] Transactions can be organized in a range of governance structure ranging from anonymous spot markets to fully integrated firms (under a unified control) where transaction can be modified by managerial fiat. In between there are contracts of different duration and complexity ranging between short term to Relational contracts.

transaction across firms cause bargaining problems, firms will integrate to avoid 'small numbers bargains'.[9]

Market transaction becomes costly when such exchange involves transaction specific investment/assets which enable firms to appropriate quasi rents due to lack of alternative sources of supply or product demand. The lack of incentives arises when there are economies of scale relative to industry demand in upstream and downstream markets inducing firms to integrate to avoid 'small numbers bargaining problem.'[10] Therefore small numbers bargaining problems creates an incentive for firms to vertically integrate and avoid the cost of market transaction of its subsidiaries. The decision to integrate not only depends on the cost of market transaction but also on the extent to which the firm can monitor and evaluate its employees by discovering and conveying information. This is the internal cost of producing within the firm. To a large extend the ability of the firms to perform these capabilities are affected by the size and the type of organizational structure. It is argued that monitoring is easier and less costly if firms were to integrate.

The second factor is the impact of asset control. Vertical integration is determined by the extent to which a firm controls its inputs and distribution of products and services. A firm's control of its inputs/supplies is known as backward integration and the firm's control of its distribution is known as forward integration. Firms can either integrate backward or forward depending on the factors such as variation in demand. For example, firms integrate backward to satisfy the high probability demand and use the input market to satisfy their low probability demand. In other words, firm integrate backward to assure stable sources of supply.[11]

Complete integration occurs when a firm either acquires a supplier and/or a distributor or when a firm expands its operation. Expanding operation means performing activities traditionally undertaken by suppliers or distributors. In other words, integration expansion enables a firm to centralize its control over other subsidiary units. Complete control bestows the firm the ability to control its

---

[9] Small numbers bargaining arise either due to small number of firms in the market (ex ante) or sunken investments which create lock-in between buyer and seller (ex post).

[10] Once asset specificity investment is made, buyer and seller are both committed to a symmetrical bilateral relation. The supplier is effectively 'locked-in' to the transaction for a significant degree while the buyer is also committed to the transaction as he cannot turn to alternative sources of supply as the cost of unspecialized capital is great.

[11] See Lieberman, 'Determinants of Vertical Integration: An Empirical Test', *Journal of Industrial Economics*, vol. 39, No. 5, 1991, pp 451-452.

subsidiaries and supplying units thereby streamlining production in a manner that will maximize production. This form of integration allows a firm to influence on barriers to entry and assure cooperation of key value-adding players, for instance increased entry barriers to potential competitors enables a firm to gain sole access to a scare resource.[12] Complete integration enhances ownership control which improves supply chain coordination. It also provides more opportunities for the firm to differentiate distributional requirements by means of increased control over inputs.[13] It also facilitates investment in highly specialized assets in which upstream or downstream players may be reluctant to invest.

The property rights theory of Grossman and Hart defines a firm as a set of ownership or control. According to this theory relationship-specific investment is distorted due to hold-up problem which arises from the inability to fully reward investment under incomplete contract. Ownership and control should be allocated to minimize the loss in surplus due to such distortions in investments. Delegation of authority should be allocated to the party that can use it for most surplus generation. Ownership of assets is fundamental to each party's incentive to invest which determine the residual rights of control of each party. Enforceable agreement cannot curtail such distortions since such agreements only takes place ex-post or after investment is sunk. Once surplus is achieved, efficient bargaining decides the parties' share of the surplus from their specific investments.

1.4 Transaction cost approach to Integration: Asset Specificity and Uncertainty

The transaction cost approach to vertical integration has been advocated by Coase, Williamson, Klein, Goldberg and others. Transaction costs economics have been applied to a wide range of business and organizational phenomenon including vertical integration, regulation and deregulation, the organization of work, multinational firms, corporate finance and others.[14] Williamson is the strongest

[12] Firms vertically integrate to build entry barriers, facilitate investments in specialized assets, protect product quality and improve scheduling and coordination. (Williamson, 1975; Chandler, 1977; Harrigan, 1984) Vertical integration enable a firm to secure more profits through higher prices as a result of barriers to entry, price discrimination, reduction of service and advertising externalities etc.

[13] The firm captures emerging markets to ensure efficient distribution and prohibit the entry of some which enable it to secure hitherto inaccess profits.

[14] The theory of transaction cost economics was applied to backward or forward integration as a means of total cost reduction. It is cheaper for the firm to perform the role of suppliers and distributions than to spend time and cost by interacting with other parties for the same operation. This change in

proponent for applying the notion of transaction cost to the boundary theory of the firm. His notion of a 'governance structure' as a distribution of property rights provides appropriate incentives to govern a relationship.

The organization of transactions or "governance structure," affects transaction costs of the firm, both internal and external.[15] A transaction for allocation of resources occurs with in the firm or across firms (the market) and could either be a continuous or a frequent transaction. There are certain factors which affect the efficient allocation of resources; one is uncertainty and the other asset specificity.[16] Uncertainty and asset specificity either increase or decrease the contract length. An optimal contract length will increase with the profitability of transaction-specific investments and decrease when uncertainty escalates. As uncertainty rises, contracts become difficult to write.[17] Moreover, transaction specific investments exacerbate transaction costs particularly when the seller/buyer relationship breaks down. Sine the value of transaction-specific assets depends on the continued existence of this relationship, the party that has not invested may expropriate the value of the investment by threatening to walk away. If the investor is not assured of the full value of his investment, efficient investment to reduce production cost may not be made, resulting to higher costs to both the parties thus impeding efficient allocation of resources. Uncertainty impinging a transaction would hinder contract specification of contingencies against opportunism. Thus Williamson (1979) argued that uncertainty raises the cost of executing market transaction only when opportunism is present.

The influence of transaction costs on decisions to make or buy components can be examined indirectly through the effects of supplier market competition and two types of uncertainty- volume and technological (Walker and Weber, 1984). Technological Uncertainty such as changes in component design and volume uncertainty such as demand variability may exacerbate transaction costs. As technological uncertainty increases, the likelihood of making rather than buy decision

---

operational shift also induces an inclination to a more robust operational device for further cost reduction by consolidating the operation of the firm. This created incentive for outsourcing.

[15] This discussion of transaction cost theory is based on Williamson (1989)

[16] Asset specificity once invested cannot be deployed for alternative uses. Specificity induces opportunistic behavior and induces "appropriate quasi rents". If asset specific investment increases. transaction cost also increase. Asset specificity exacerbates holdup problem once investment is sunk. According to Shavell, contractual holdup justify legal intervention.(2007)

[17] If markets are stable, appropriation problem can be resolved through a contingent claims contract (Williamson, 1975). But as uncertainty rises regarding a buyer's future requirements and a supplier's adjustment costs, contracts becomes costly to write inducing a firm to produce a component in house (Williamson, 1979)

increases. So also is the case when volume uncertainty increases. Market transactions are characterized by uncertainty and high asset specificity which makes the transaction risky and exacerbate opportunistic bargaining and behavior.

To Coase and Williamson, uncertainty and asset specificity exacerbate transaction costs. The boundary of the firm is determined so as to minimize transaction cost and the latter is reduced by giving one party control over both sides of the transaction within a hierarchical firm rather than operating through the market.[18] The presence of transaction specific investment induces a firm in one stage of production to appropriate the quasi-rents earned by firms at another stage (due to lack of alternative source of supply or product demand), which ensue problems of small numbers bargaining.[19] Quasi rents, as a result of transaction specific investment, exacerbate socially destructive haggling.[20] Therefore, the transaction cost theory says that incentives for vertical integration stem from the problems of small number bargaining due to lack of alternatives when economies of scale exist relative to industry demand in upstream or downstream markets. Firms therefore integrate to avoid bargaining problem arising from ex-post lock-in which leads to potential hold-up problem if future contingencies are not adequately specified.[21]

The make-or-buy decision of the firm emphasized that under such circumstances, the buyer can reduce high uncertainty and supplier opportunism by producing the component in-house.[22] If opportunism perseveres, firms will be

---

[18] According to Transaction Cost Economics ,though markets transactions are preferred governance structure for many types of transactions as they provide 'high-powered incentives', they face difficulty dealing with some transaction due to asset specificity, bounded rationality and opportunistic behavior by the parties to the transaction, that is, market transaction do not insulate firms from opportunism when transaction-specific investment assets are involved

[19] The effect of small numbers bargaining on transaction costs centered on transaction specific assets or switching costs but according to Walker and Weber (1987) neither is necessary for the transaction cost of market contracting to rise as long as the supplier is not constrained from behaving opportunistically by the presence of other firms competing for a buyer's business.

[20] In the rent seeking theory of the firm advanced by Williamson, Klein, Crawford and Alchian, integration can stop socially destructive haggling over "appropriate quasi rent" or AQRs. Larger AQRs increase likelihood of more integration. In rent seeking theory of the firm, either contractible or non-contractible specific investments could create AQRs. If integration is not opted when AQRs escalates, inefficient haggling will hinder socially efficient outcome.

[21] Apparently outsourcing, which is perceived to possess advantages over vertical integration, is equally prone to uncertainty and unforeseen contingencies. We will examine if contracts in outsourcing describes these contingencies and possible states of nature.

[22] Make –or-buy decisions will specify which operations the firm will engage in and which it will contract out to a supplier. According to Masten, the make-or-buy decisions determine the choice of procurement which maximizes the producer's expected profit by internalizing his transactions or procure his inputs externally. (Masten, 'Institutional Choice and the Organization of Production: The Make or Buy Decisions', *Journal of Institutional and Theoretical Economics*, vol 142, 1986, pp 502-505). In addition to vertical integration, Williamson's model of efficient boundaries infer the possibility

reluctant to invest in specific assets unless protective governance structure evolved such as point ownership, or strategic alliances. Nicholas Argyres suggest that differential production costs play an important, independent role in make-or-buy decisions. Cost differentials arise from different firm specific capabilities rather than from economies of scale.[23] As relative capability change, firm boundaries are adjusted accordingly and this adaptation is the reason why firms integrate when transaction-specific assets are subject to opportunistic expropriation by a buyer or supplier. Other reasons for integration are to prevent leakage of proprietary knowledge to a competitor and to overcome the problem of measuring the attributes of goods.

Apart from Asset Specificity, Uncertainty is another factor which determines the firm's level of integration. Transaction cost economics argues that uncertainty is a key strategic factor which affects the firm's scope of activity and vertical integration. Uncertainty arises in the market due to factor supplies and technological changes. Markets are not prone to uncertainty since they are highly unstable; a view endorsed and explicated by Carlton when he pointed out that uncertainty in the market may arise in term of supply of inputs. Chandler and DuPont also argue that vertical integration is a result of uncertainty in factor supplies and externalities in market condition. Uncertainty may arise due to the riskiness of committing to high degree of vertical integration prematurely or because of technological change at some stage in the vertical chain of processing.[24] Uncertainty in market competition (such as a

---

of shifting the performance of an activity from the firm to a supplier in the market (vertical disintegration) particularly if the administrative structure and technological base of the firm or the supplier market changes and provided the supplier does not behave opportunistically by the presence of other firms competing for the buyer's business.

[23] Cost differentials of a firm occur due to greater production experience and/or organizational skills. Matured firm possess both or one of the two allowing them flexibility to choose among various production options to either minimize cost or earn profits. The capability approach recognize that since different firms have different production capability, they may operate the same activity with different production costs, therefore economizing firms will take this into account while deciding whether to perform the activity in-house or on a contract basis with another firm. (Argyres, Nicolas, 'Evidence on the Role of Firm Capabilities in Vertical Integration Decisions', *Strategic Management Journal* ,vol 17, no 2 Feb 1996, pp. 129- 131)

[24] By internalizing technological capabilities, suppliers are assured access to the knowledge necessary to build a portfolio of products based on cutting-edge technology (Rothaermel, Hitt & Jobb, 2006). Gold listed nine major categories of current and emerging technological developments such as improvement in automation and control devices, programming automation etc which improve the performance of vertically integrated firms (Gold, Bela. 'Technological Change and Vertical Integration', *Managerial and Decision Economics*, vol.7, no. 3, 1986, pp. 172-176). However, extensive integration makes it difficult to assimilate technological flexibility when the need arises, the firm having to make do with obsolete technology (Harrigan. 1984). This result in the loss of strategic

reliable suppliers market) increases the incentive to integrate when transaction costs exacerbates particularly for firms who enter a contract, as unexpected change in volume requirements will raise contracting cost if there is no competition among suppliers or if the supplier's market competition is low.

The supplier opportunistically charges the buyer a premium in accommodating its technological changes. The absence of alternative vendors therefore compels the buyer to increase its efforts to expend more on contract specification and monitoring. In such case, transactions increases and this attract the firm to produce in-house as an alternative. If market condition remains stable, contracts can be stipulated between the buyers and the suppliers to anticipate the formers' future requirement and the latter's potential adjustment costs, otherwise contracts become expensive and difficult to write if conditions are not stable. Production cost (Argyres, 1996) and demand variability (walker and Weber (1984) also determine whether the firm makes or buy a good or service.[25] Variability in demand increases the riskiness for the firms which escalate into uncertainty. Uncertainty therefore affects the make-or-buy decision of the firm and as transaction cost increases so does the attractiveness of producing the component in-house.

1.5 Vertical integration replaced by Disintegration Strategies

As long as transactions do not involve transaction specific investment, vertical integration is an ideal arrangement for the firm to capitalize on the growing market, anticipated demand etc. When cost minimizing transactions involving transaction specific investments occurs, alternatives to vertical integration arises such as disintegration, taper integration etc. As business environment change, Williamson and Klein consider contractual alternatives to vertical integration when transaction costs are pertinent. In Outsourcing, contracts are of different kinds and complexities such as the Legacy contracts which are rigid necessitating the need for renegotiation.[26] However, according to Williamson the performance implications of outsourcing

---

flexibility and increase in bureaucratic costs, when the latter outweighs the former, diminishing returns set in.

[25] Lieberman agued that demand variability plus other market imperfection such as imperfect competition, imperfect information, transaction costs etc provides incentives for firms to integrate. (See M.Lieberman, 'Determinants of Vertical Integration: An Empirical Test', *Journal of Industrial Economics*, vol 39, No.5, Sep 1991) pp 453- 454.

[26] Robinson, Mark H and Stan Lepeak, "Renegotiating Your Outsourcing Contract", www.bpoindia.org/columns/equaterra/renegotiating-your-outsourcing-contract.shtml

versus vertical integration depend upon the alignment between the chosen governance structure and the attributes of the transaction and its contracting environment.[27]

Outsourcing contracts is discernible as a business strategy in assimilate significant changes in the field of technology which was limited if the firm was to integrate. Vertical integration is beneficial if there are conducive factors such as economies of scale, external market factors etc. Firms are increasingly abdicating vertical integration as a business strategy choosing for instance vertical disintegration due to corporate restructuring and intense competition in most industries. Vertical integration does not allow flexibility in business maneuvering to take advantage of new business avenues in the market. The decision of the firm to integrate requires committing significant amount of resource to a course of action in order to generate or maintain competitive advantage; however such commitments while forgoing numerous advantages associated with the marketplace, are costly to reverse particularly when technological and organizational dispersion of knowledge have made this decision more complex and competition more volatile. This volatility would benefit firms coping with these challenges as the market opens up new avenues for low cost managerial strategy and new markets.

The boundary theory of the firm explicates that industry's structure and firm's capability are limits for it to integrate (Argyres, 1996) however transaction cost economics assumed that firms can alter their boundaries based on managerial discretion. (Williamson, 1975, 1985). Extensive integration is costly and inefficient as it exacerbate managerial and coordination costs over multiple stages of the value chain, possibility of excess capacity or underutilized resources increases because of uneven balanced productivity across different value chain activities, technological obsolescence, strategic inflexibility, lack of information and feedback from suppliers and distributors, among other problems. It is argued that many critical capabilities reside outside the boundary of the firm (with minimal appropriation cost). Moreover, integration along the value chain poses significant strategic challenges as some integration is extremely difficult depending on the industry structure and the capabilities held by the integrating firm. In some dynamic industries continual

[27] For complex exchange relationship which involves transaction specific investment, a firm that selects a simple governance structure lacking adequate safeguards will be exposed to moral hazard and hold up problems. On the contrary adoption of a complex governance mechanism for a simple relationship results to loss in flexibility and decision making efficiency due to bureaucratic control. (Williamson 1991, 'Strategy research: Governance and Competence Perspectives', *Strategic Management Journal*, vol 20 no 12).

innovation is possible only if the firm expand beyond its boundary, in network of alliances that are commonly prevalent in the IT and ITES industries. Access to such knowledge enriches a firm's absorptive capacity allowing a firm to build a broader and larger portfolio of related products and maintain competitive advantage.

Specialization through outsourcing preclude contracting hazards and enhance performance by allowing suppliers to exploit economies of scale and focusing on limited number of well-defined activities. The widespread use of technology and communication information may have minimized transaction costs between market participants but a vertically integrated firm is prone to technological obsolescence since its access to new technology is reduced which negatively affects the firm's strategic flexibility to respond to changing technologies and other contingencies in its environment. This affects costs particularly production costs as it will be comparatively more expensive and may discourage the firm to exploit opportunities such as product diversification, knowledge spillover arising from the use of new technology; economies of scale etc.[28]

As opposed to vertical integration, disintegration broke up production process into separate units each performing a limited subset of activities to create a final product. By separating production into separate units, disintegration induces risk sharing by all units especially when operating in volatile markets. By sharing vertical control of production with other firms through vertical disintegration, firms may be able to secure a more flexible and less risky production organization particularly in some stages of the production process which may require substantial bearing of relevant sunk costs. By preserving some vertical control of the process of production (by producing in-house part of the input or by simply preserving the ability to make it) the firm can reduce the risk involve in outsourcing the production of an input. By doing so the firm may also reverse the Offshoring decision by bringing back some of the value chain activity if circumstance requires so.

[28] Technological and market uncertainties provide entrepreneurial opportunities which firms can exploit by developing new technologies and products that satisfy market requirements such as product diversification which is necessary to maintain a competitive advantage. (Rothaermel, Hitt and Jobe, 'Balancing Vertical Integration And Strategic Outsourcing: Effects on Product Portfolio, Product Success, And Firm Performance', *Strategic Management Journal*, vol 27 2006, 1033-1056).

1.6 Technological Innovation and Outsourcing

In the last few decades, an increase in the performance-to-price ratio of information technology has led to widespread and innovative use of technology compelling firms to resort to different business strategy in lieu of integration (such as outsourcing) to take advantages of a new dynamic business venture.[29] The advent of increasing cross border investment and business ventures have open new areas for firms to expand their production. Firms are in constant struggle to maintain or increase their power in the marketplace. In a fiercely competitive environment firms have resorted to strategic alliance such as partnership, collaborations and other business arrangements with third parties for better service delivery (at lower price to maximize profit) by contracting out specific line of business or non-core activities.[30]

Cost-saving has assumed importance for firms to not only exploit new opportunities/markets but has become an important factor determining this unconventional strategic diversification. Other drivers include wage rates, skill resources, infrastructural facilities etc.[31] Communication revolution and the reduction in international trade barriers have allowed business to globalize and regions to specialize. These factors compel businesses to outsource their operations to different countries abandoning vertical integration for streamlining production and distribution of services. This is more relevant in the manufacturing and services industry where contractual and productive integration ensure that firms remain competitive by

---

[29] There are two factors which can be accounted for this strategic choice to new business management. One, rapid technological innovation has made existing technology obsolete. Firms face resource constrain (human and equipment) as existing do not fit the new strategic direction to meet up to date technology and price competition. Non-strategic/core status/activities of many information systems function allow them to be candidate for outsourcing. Technological change also allows the separation of the management, operation and delivery of information services. which further expands the choice for outsourcing. Two, the geographic and organizational dispersion of knowledge made possible because of improvement in technology and communication.

[30] Gulati defined such strategic alliance as 'voluntary arrangements between firms involving exchange, sharing, co-development of products, technologies or services' (Gulati, 'Alliance and networks', *Strategic Management Journal*, 1998: 293). Outsourcing has now spread from previously specialized repetitive tasks such as logistics to more visible and sensitive functions such as customer service, R&D and manufacturing. Outsourcing is extremely competitive provided an incentive for firms to capitalize on new markets, new product lines etc. Therefore, various types of outsourcing arrangements have been observed in the market including joint ventures where the client and the vendor share capital, in which the client has 100%, share of the vendor's capital.

[31] Outsourcing allow a parent company substantial bargaining power on cost factors such as wage rates and service delivery in terms of time and resources which were not so relevant when the firm is compel to produce the good in-house (for instance the firm normally face stiff challenge from labor unions for wage cuts)

accomplishing more with fewer resources.[32] As outsourcing is increasingly seen as an efficient and low-cost service delivery, many corporations have abandoned hitherto cost regulated system such as vertical integration and substituting outsourcing instead. Some of the fundamental factors inducing outsourcing decisions are relationship-specific investment, incomplete contracts and search and matching.

Outsourcing requires specialization of production to the needs of the buyer or vice versa. An outsourcing contract is incomplete if the supplier undertakes relationship-specific investment for such specialization (to meet the needs of the buyer), and the contract cannot be written conditional on the level of investment. In this context, the significance of search and matching in outsourcing is important since a final good producer needs to match with a suitable supplier of a specialized input for production to take place. If matching is plausible, the advantage of vertical integration over outsourcing is reduced especially for non-integrated final good producers where the matching with a supplier meets its technological requirements. The relevance of relationship-specific investment is different in outsourcing than normally used by transaction cost economics to explain the theory of the firm. Firms engage in outsourcing to obtain complementary resources while focusing on core competencies. Relational specificity (as different from transactional specificity) refers to the extent to which an outsourcing client adapts to the particular requirement of its vendor. The client also engages in specific investment to adjust to the vendor. Specific investment increases switching costs and the size of damage in case of hold-up while on the other hand, they increase value to the partner, making it more captive and reducing the probability of hold-up. Outsourcing contract is directly related to asset specificity. More asset specificity increases the complexity of the contract.

Outsourcing in India started in the early/mid 1990s[33] (although the IT industry existed since 1980s). One of the first outsourced services was medical transcription, but outsourcing of business processes like data processing, medical billing and customer support began towards the end of the 1990s when MNCs established

[32] Core activities however remains with the firms through in-house operations while non-core activities are outsourced. Core activities are rare, difficult to imitate and difficult to substitute are not outsourced as the firms may risk competitive advantage. Such core activities (or strategic SBUs) are most vulnerable to demand uncertainty and environmental complexity and firms are ready to bear costs on these units because of their importance. (Harrigan, 1985).

[33] Business operations are increasingly outsourced to India because India's advantage and strength lays in skill-intensive tradable services, including software development, information technology (IT)-enabled services, product/project engineering and design amongst many others.

subsidiaries catering to the offshore requirements of their parent companies. American Express, GE Capital and British Airways were some of the earliest players in the Indian Outsourcing market. There are many factors responsible for relying on international outsourcing to procure specialized inputs or services: lower cost of foreign production, reduced cost on international transactions due to greater integration in world market and improvement in foreign institutions or international communications.

However, certain requirements still remain which need urgent attention in order for India to remain an outsourcing hub of the world. One of them is to strengthen data protection to make global data flow to India more reliable. This requires a firm to familiarize with the law in which the business is stipulated for operations. This knowledge is important since any contractual agreements and resolution need to consider legal compliance. Data flow is sensitive to the operation of the Outsourcing business and any breach or violation should be immediately resolved (more on this in subsequent discussion). Contracts are important for delineating this responsibility between the client and the service provider. Regulation on contracts compliance is costly as Monitoring and policing rarely ensures compliance. Contracts obligation are not panacea to the problems faced in outsourcing such as data breach, however legal compliance can resolve most of the problems. The latter would also warrant legal intervention from time to time. Moreover, problems such as increasing regulatory pressure have made contract management a daunting task.[34] Contract formation is not easy which forms the next set of discussion.

1.7 Conclusion

A firm in modern business has to choose between integration and outsourcing to remain competitive. This is made easier considering that outsourcing has been actively pursued as an effective strategy for cost minimization (because of lower labor costs) coupled with governmental support.[35] Traditionally the objective of the firm is

[34] Term negotiations are lengthy and unpredictable. Contract life cycle from authoring and negotiation through implementation, enforcement, evaluation and close out is fraud with hazards and costs. Due to uncertainty contractual clauses are more complex which provides opportunism for constant renegotiation.

[35] For example Tax breaks in the United States for Clients and no or less tax for Indian Service Providers in India. According to Grossman and Helpman, it is not just lower labor costs that induce vertical (crossborder and domestic) disintegration, but also by the need to concentrate on fewer stages of production.

to ensure reliable supply of inputs to meet the requirements of its integrated units and capturing markets by acquisition and other means. In today's competitive environment firms are compel to diversify their operation and products. Vertical integration seems unattractive as a strategy for absorbing and adapting to a technologically dynamic environment.[36] Disintegration or outsourcing is the new mantra and firms are encouragingly resorting to this unconventional strategy to take advantage of low cost factors such as wage rates and abundant human resources.

Cost saving is increasing deciding firms to outsource their value chain and supply units to third parties who can provide services and finished product at a much lower cost. Other factors include better productivity and more strategic use of scarce resources within the firm. Teece asserts that the increasing rapidity of technological change and the increasing dispersion of knowledge suggest a conducive environment for an increasing role of outsourcing but will not completely displace vertical integration. Technological advancement may have favored firms to outsource rather than integrate, however since outsourcing is vulnerable to external shocks, firms are reluctant to completely outsourced their value chain production and distribution.

There are remarkably substantial prohibiting transaction costs in outsourcing relationship but this has not stop growing number of firms and companies to practiced and imitate outsourcing model of contracting and subcontracting which puzzles the understanding of the internal mechanism in the operation of the firm. Recent events unfolding such as the financial crisis (2008) which shook the world economy is an experience which will further shape the strategy of the firms outsourcing their business abroad.[37] The major drivers of the current outsourcing phenomenon have been those related to cost-savings factors such as wage rates, abundant resources and legal expertise etc. Firms are ever evolving and so are its boundaries. A firm adapt to different challenges differently. This ability of the firm to adjust and conceal it from external and unprecedented events is an area which needs further studies. Integration

[36] Traditional patterns of vertical integration have been broadened to include alternatives to ownership some of which are as follows, joint ownership, long term contracts with suppliers, joint production planning between suppliers and buyers to minimize inventories of both and ensure production continuity and joint planning by suppliers and industrial customers to support adjustment in their production technologies (Gold, Bela " Technological Change and Vertical Integration" , *Managerial and Decision Economics*, Vol 7, no.3, Sept 1986, pp 169-170.)

[37] The Indian Outsourcing industry is facing slower growth and lower profits as the financial recession is resulting to a fundamental restructuring of financial services. (Arpit Kaushik, Offshore Outsourcing: What role will recession play? www.inforworld.com/.../Offshore - Outsourcing-what-role-will-recession-play-108-)

and its aberrated "outsourcing" form is one of the many camouflaging image of the firm keeping in tune with the changing time such as demand volatility, technological improvement etc.

CHAPTER 2

A FRAMEWORK ON CONTRACTS AND PROPERTY RIGHTS

2.1 Introduction

Theory on contracts has evolved through time and scholarly treatment of contract formation and execution varies and is as old as Coase's theory of transaction costs. In the previous chapter we discuss why firms strategize their business in tune with changing times such as technological dynamics and increasing uncertainty. In this section we would be discussing how contracts evolved and their importance in today's outsourcing relationship. Implicit in this argument is the structuring of contracts in facilitating allocation of property rights.

The transaction cost theory assumes that there is a strong incentive to structure contracts to minimize reliance on the legal system. Such reliance is not only costly but also confronts problem in distinguishing promised behavior from "bad behavior" or opportunism. Therefore the role of the court as enforcer of contracts is pertinent so long as disputes occur in contractual arrangements such as breach of contract. According to Joskow contractual arrangement should "at least evolve in the shadow of the law".[38] However, contractual formulation is costly and incomplete due to various unforeseen contingencies discuss below. Since outsourcing contracts not only involve transfer of data but also transfer of assets, the disposition of this section is to examine why transfer of assets occur and what are the implications for the firm's strategic decision in the context of outsourcing. In this section we would review theory on property rights and how contracts facilitates property rights to assume flexibility in taking various forms underlying a fundamental aspect of this research of contractual rights on data protection and processing.

2.2 Contracts are mostly incomplete

A contract is an agreement between two or more parties and legally enforced. According to contract law, a contract signifies a promise which is legally enforced if

[38] Joskow. Paul, 'Vertical Integration and Long- Term Contracts: The Case of Coal Burning Electric Generating Plants', *Journal of Law, Economics and Organization*, Vol.1, No.1, (Spring. 1985), pp 39

it is given as part of a bargain otherwise such a promise is unenforceable.[39] A contract characterizes an exchange that is based on cooperation and commitment. However contractual exchange is inhibited by uncertainties, risks and other unforeseen contingencies. Most contracts are incomplete in the sense that they leave something out or are ambiguous.[40] And they will remain so as long as problems of verification, renegotiation, agency costs, ex ante risks and ex post losses/bargaining etc plagued contract execution. In the previous chapter we had mentioned that markets provide high powered incentives to maximize value. Though contracts do not provide strong incentives (like the markets), they are preferred as governance structure since transaction specific assets are insulated from opportunism by tying both the parties together for a specified period.[41] However most contracts are not complete as contracting on all possible contingencies is impossible and costly.

A Complete contract is equivalent to an optimal contract and an optimal contract corresponds to a complete absence of contract. In such a situation the allocation of ownership matters little for the organization of economic activity; hence any profitable venture which requires participation of several parties is only plausible by drafting a suitable contract specifying the participants' rights and obligation under every conceivable circumstance. Many of the contingencies are not foreseen and if foreseen would be prohibitively expensive to draft in a contract encompassing all of them. Since many of these contingencies are not foreseen, they cannot be specifically addressed in contracts making them incomplete.

According to Maskin and Tirole, contractual incompleteness is due to the transaction cost of describing the possible state of nature in advance. Tirole describes four types of "transaction costs" which creates a complex environment and is

---

[39] In the late nineteenth and early twentieth centuries, Anglo-American courts and legal commentators developed the 'bargain theory of contracts' which expounded that the law must enforce promises arising from a bargain. Eventually an alternative theory evolved which is based on Pareto efficiency which asserts that contractual exchange is efficiently possible if the promisor and promisee both wanted enforceability when it was made. (Cooter & Ulen, 'Law and Economics', *An Economic Theory of Contract*, pp 182-184)

[40] Contracts are not perfect since each party will not anticipate present and future contingencies as well as the associated risks. This inability to extract information regarding unforeseen contingencies makes contract inefficient (with the result that resource allocation and mutual gain such as gainsharing become difficult). Incomplete contracts can arise because of unforeseen contingencies, the excessive cost of specification of a large number of contingencies, or the inability of the courts to enforce the contract as discussed by Tirole, Grossman, Hart and others.

[41] Since contracts focus on the terms of the relationship rather than the scope of work, they can be renegotiated if the need arise. Contracts of different kinds allows firm to organized flexible transactions which are customized to a particular business unit. Within this context, outsourcing represents a move away from vertical integration strategy to one of the contracting options.

significant for explaining contractual incompleteness. They are enforcement costs, unforeseen contingencies, writing costs and renegotiation.[42] The inability of parties to forecast possible trades ex ante and the cost of describing them ex post impose additional constrains on contracting making contract formulation ambiguous and incomplete. According to the transaction cost theory of the firm, complex governance structures (such as complex contracts) are required to eliminate or attenuate costly bargaining over profits from specialized assets.[43]

Contracting parties may also make ex ante efforts to screen contracting parties in terms of reliability or reputation or/and design ex post safeguards to protect transaction-specific investments. However, bounded rationality precludes comprehensive ex ante contracting which would have specify how the contracting parties behave in all possible circumstances. Thus bounded rationality makes contracts inherently incomplete and impedes efficient economic exchange. Parties may then resort to opportunistic behavior if they perceive potential gains from such behavior particularly post-contractual opportunistic behavior.[44] This research emphasizes that more complex governance mechanism should be evolved to fill gaps in the contract, settle disputes[45] and adapt to emerging conditions.

2.3 Agency Problems and Contract Formulation

In the first chapter of this research, we have mention how the firm's capability to integrate depends on its ability to discover, monitor and convey information determined its internal cost of production. In this section we examined how the principal's ability to extract and convey information affects the structure and performance of contracts. We also examine why contracts are convenient for ensuring transaction continuity when a firm disintegrates or outsourced.

---

[42] See Maskin & Tirole Chapter 2, 'Unforeseen Contingencies and Incomplete Contracts', *The Economics of Contracting: Foundations, Applications and Empirical Investigations* (edn), pp 17-59.

[43] Business process assets are dedicated once a value chain activity is outsourced and they remain specific to that particular use. These assets must be protected against the potential opportunism of the vendor. Hence; specific relational assets lead to more complex outsourcing contracts as there are factors that complicate outsourcing contracts such as environmental uncertainty. According to Williamson, hybrid governance form such as outsourcing is sensitive to external uncertainty. (Williamson, Oliver, 'Transaction-Cost Economics: The Governance of Contractual Relations', *Journal of Law and Economics*, vol 22 no 2, Oct 1979, pp., 237-238)

[44] Long term contracts, in principle, can solve opportunistic behavior but they are very costly. They entail costs of specifying possible contingencies, policing and litigation costs of/on detecting violations and enforcing the contract in the court.

[45] Disputes in contracts are mostly compliance related and protocol breach such as non-conformity to data protection policies or lack of safeguard measure to prevent mishaps from occurring.

(A) Principal-Agent theory in the context of Contracts

Agents are boundedly rational in formulating and solving complex problems and in processing information. Agency problems are frequently encountered during the structuring of contracts.[46] And they arise because contracts are costly and difficult to enforce[47]. In the principal-agent theory, moral hazard and adverse selection inhibit contractual performance; hence it is imperative for the principal to discourage agents from resorting to opportunism which contributes to agency cost through costly monitoring. As discussed in the previous chapter, a contract is ideally seen as a mechanism which serves to decrease such costs through various contractual stipulations such as monitoring and revelation mechanism to mitigate asymmetric information. For example a contract through monitoring mechanism can secure and extract information regarding the agents which can minimize 'free rider' problem since such information about the agent will raise the risk of detection such as shirking, non-performance, capability etc.

According to Aghion and Dewatripont, information about the agent can often be acquired through revelation mechanism.[48] Even if information does not allow the principal to detect all free riding, it will deter agents as long as they are risk averse. This information is useful for initiating and inducing the agent to perform and avoid shirking work. The information extracted is valuable to the contractual performance as the benefits from reduced risks and shirking exceeds the cost of monitoring such an activity. Sometimes the principal experiment with delegation of authority and purposely leaves contracts incomplete through adaptive contracting so that agents

[46] Williamson distinguishes between bounded rationality and opportunism and that opportunism is a key attribute while examining intertemporal contracting. Fama and Jensen concur otherwise, that agency problem is more significant and that bounded rationality and opportunism are part of agency costs. (Williamson. O, 'Organizational Form, Residual Claimants, and Corporate Control', *Journal of Law and Economics*, vol 26, no 2 , Corporation and Private Property: A Conference sponsored by the Hoover Institutions, June 1983)

[47] Contracts are costly to enforce because of cost of structuring, monitoring, conflicting interest amongst parties and residual claim loss which refers to contract's enforcement cost which exceed the benefits of enforcement. (Jensen and Fama, 'Agency Problems and Residual Control', *Journal of Law and Economics*, vol 26, no 2, Corporations and Private Property: A Conference sponsored by the Hoover Institution, June 1983)

[48] Revelation mechanism allows an agent to reveal critical information regarding his willingness to cooperate with the principal. This is required to transfer control from the principal to the agent (Dewatripont, Rey and Aghion, 'Transferable Control' in Mathias Dewatripont (ed.,) , *The Economics of Contracting, Foundations, Application and Empirical Investigations, 1999*, pp., 139-161)

would possess authority to decide matters not specified in the contract. It also enables the principal to extract information from the agents.[49]

Another device to secure the information of the agent is by transferring control to the agent in order for the latter to reveal information regarding his ability and willingness to cooperate with the principal. The allocation of control is either contractible or non-contractible (precluding ex post bargaining). While the former is necessary for the agent to reveal his information, the latter is optimal when control is transferable unconditionally to learn from the way in which the agent exercises control.

A contractual exchange cannot function without the cooperation and commitment of the agent, however if agents resort to moral hazards or adverse selection, contract between the principal and the agent will be non-performable, so it is important to provide strong incentives or agents not to engage in moral hazards or adverse selection[50]. The contract structure should limit the risk undertaken by most agents through incentives which are tied to specific measure of performance.

(B) Contractual Separation of Ownership

The performance of the contract is conditional on the ability to mitigate costs and hazards that are associated with the structuring of the contract. Contracting cost and agency cost can be mitigated through contractual separation of ownership and control.[51] In the property rights theory of Grossman and Hart, ownership should be given to whoever can raise surplus (to minimize loss in surplus due to investment distortions). The property rights approach therefore implies that ownership and control should be separated and usually separation takes place through a contractual arrangement. The primary benefit arising from this contractual separation of

[49] Adaptive contracting was favored even by Williamson to save on transaction costs in a setting with limited resources to write contracts. (Williamson, 1979, 1985). However according to Schultz and Bennedsen, adaptive contract is significant since it generates information about the agent's response to increased authority. (Schultz and Bennedsen, 'Adaptive Contracting: the trial-and-error approach to Outsourcing', *Economic Theory*, vol. 25, No.1 (Jan 2005)

[50] Either in the form of Fixed Payoffs or Incentive Payoffs. Any form of incentives linked to performance is bound to have a positive impact on the ability of the agent to work and cooperate with the principal.

[51] To Demsetz, the ownership structure of the firm is an endogenous outcome of a maximizing process in which more is at stake than just accommodating to the shirking problem. Ownership should be structured to maximize the value of the firm's assets which depends on technology of the task required, desired scale of operation and managerial ability. (Demsetz , Harold, 'The Structure of Ownership and the Theory of the Firm', *Journal of Law and Economics*, vol 26, no 2, Corporation and Private Property: A Conference sponsored by the Hoover Institutions, June 1983) pp 375-376.

ownership and control is to encourage risk sharing,[52] and to prevent "contractual holdup" which create several types of incentive problems and impact risk bearing.[53]

Risk sharing also mitigates performance hazards and discourages shirking and cheating. Such separation significantly affects factors that are critical to the operation of the firm such as incentive structure, asset partitioning, agency problems etc. While the property rights theory explicates ownership and control between the agent and the principal in order to share the surplus; the agency theory on the other hand, lucidly reflects efficient structure of agency problems to optimize incentive structure and asset ownership. This requires not only strong incentives for the agent to perform (or the ability of the principal to control the agent's incentives) but also delineating asset ownership to the agent to maximize the use of assets.

Since the value of asset is not contractible, having the agent owned the asset provides incentives which cannot be replicated via a contract. However if the contract can provide incentives to the agent to increase the value of the asset, without impeding the principal's effort to create incentives via contract, the principal should own the asset while delineating incentive mechanism which provides the agents with initiative to enhance the use of assets. Once incentives are created, the agent would be discouraged from engaging in hazards that would undermine the initiative to create incentives. This agent is committed to enhance the use of assets conditional on the principal's fulfillment in providing those incentives.

(C) Asset Ownership

Assets provide security while signing a contract for two reasons, one the terms of the contract is greatly influenced by legal rules of asset seizure, asset division or partitioning.[54] Second, claims on asset will determine ownership rights of the signatory to the contract with regards to investment, bargaining power and ex post

[52] Fama and Jensen hypothesized that "separation of residual risk bearing from decision management leads to decision systems that separate decision management from decision control". Williamson however argued that separation of residual risk from management is not a sufficient condition for the separation of operating from strategic decisions to appear or the M-form structures where operating and strategic decision structures are sharply distinguish (Williamson. O, 'Organizational Form. Residual Claimants, and Corporate Control', *Journal of Law and Economics*, vol 26, no 2 . Corporation and Private Property: A Conference sponsored by the Hoover Institutions, June 1983) pp 351-366.

[53] Shavell, 'Contractual Holdup and Legal Intervention', *Journal of Legal Studies*, vol. 36, June 2007, p 325-351.

[54] Entity shielding is a special rule of property law which protects firm's assets from its creditors. (Hansmann, Kraakman & Squire, 'Law and the Rise of the Firm', *Harvard Law Review*, vol. 119: 1335-1403)

division of surplus. Though contracts are incomplete and costly to write, the property rights approach proposes ownership as a solution to this problem. Property rights, through the contract, grant ownership of an asset to allow remaining states of the world (which are not contractually specified) and corresponding actions concerning the asset, to become the responsibility of one of the party to the contract. For instance investment and output are observable and verifiable. Therefore, contracts could contain clauses describing property rights rather than detailing the investments that should be made in creating those assets. Therefore contracts allow the delineation of rights and specification of ownership. Ownership of asset also determines efficient allocation of surplus and value created through the use of assets.

Claims to asset may be misused or underused if the parties fall short in delineating its property rights which implies that ownership of assets needs to be properly delineated to avoid costs (such as litigation and disputes) if problems arise such as non-compliance/performance of contract. In other words, the party concerned should possess a well defined property rights so that assets are utilized productively. A well defined property right also provides insight in the allocation of residual control rights over assets (ownership and control rights).

According to the Transaction cost literature, efficient allocation of property rights is achieved through proper allocation of ownership which will reduce costs. These costs are search and information costs, bargaining and decision costs, policing and enforcement costs. Property rights approach proposes ownership to the problem on sharing of surplus value and quasi rent. The existence of a quasi rent leads to inefficiencies as each firm realized that it may not get the full benefit of its investment due to opportunism and others already discussed (quasi rent cannot be contracted ex ante). Since the property rights approach proposes ownership to that firm whose investment in an asset creates the most value, the one who owns the asset will receive the entire value when firm engage in ex post bargaining over the quasi rent.

2.4 Property and Contractual Rights to Asset Ownership

A property right on an asset, that is, its ownership is a bundle of decision rights. Property rights are bundles of rights where the owners of assets/resources

freely exercise as they see fit without third party interference.[55] Property rights are derived from the 'unitary theory of property rights' which prevails in Europe since the 19th century which recognize property rights as those that are only concentrated with a single owner.[56] Fragmentation of rights of a single asset among two or more different persons may increase the possibility that transaction costs and holdout problems will occur and make the use of the property inefficient. From this emerge the numerus clausus doctrine which argued that divided interest in property must be strictly confined to a small number of well-defined rights since divided property rights reduces the value of creating partial property rights.

According to the numerus clauses doctrine, the number of absolute rights and their content is closed. Ownership is the most absolute right and can exist only in the form of a non-fragmented unitary right. This doctrine discourages the division or fragmentation of rights into partial rights between two or more parties except in few specified exemptions. These exemptions are specified for only those that belong to the following, cotenancy, servitudes on real property, mortgages on real property and security interest on personal property. The number, content, creation, transfer and extinction of absolute rights are regulated by law.[57]

Contract is important for the following reason. Contracts allow parties to pledge their assets. Just like property law, contractual claims on assets can become fragmented; however since contract rights do not run with the asset, cost and anticommons problems can be eliminated by simply selling the asset or transfer and liquidating all claims on it. The contract facilitates nonpossessory rights in an asset that will bind third party transfers as well. The explicit recognition by the law of particular types of property rights reduces the costs of establishing these rights.

---

[55] Hart has explicitly expressed that "ownership of an asset goes together with the possession of residual rights of control over the asset; the owner has the right use the asset in any way not inconsistent with a prior contract, custom or law" (Hart. O, 1989, 'An Economist's Perspective on the Theory of the Firm', *Columbia Law Review*, 89, p. 1765)

[56] In Europe, the Civil law considers the numerus clausus doctrine to be fundamental part of its property law and trace its root in the feudal social relations that was widely prevalent in feudal Europe. (Hansmaan & Kraakman, 'Property, Contract and Verification: The "Numerus Clauses" Problem and the Divisibility of Rights', *The Journal of Legal Studies*, 31, no.2, Part 2: The Evolution of Property Rights, 2002) pp. 374-375.

[57] *Ibid*

The law delineates property rights through proper allocation of ownership. Usually the law can easily delineate rights for tangible and immovable property.[58] Delineation of ownership rights is however difficult for resources that are intangible such as ideas, data processing etc since they are not restricted by any boundary. Verification of ownership in such circumstance is not easy. Legal resort is an option which is plausible provided law is able to verify and substantiate the importance of ownership of such resources. The economic benefit of creating new right should outweigh the cost of informing the parties concerned regarding the new right. According to Hansmann and Kraakman, as long as the utility of partitioning of rights to an asset outweighs the cost of notice, rights are enforceable against subsequent transferees of other rights in as 'asset'.

Property rights that are clearly delineated facilitate bargaining and voluntary exchange. Those rights that are alienable can be exchange through bargaining while those that are not alienable may be delegated through the ambit of a contract (or a series of contracts). The law's role to contractual rights is simply of regulating the terms of the contract. Property rights of an asset can be enforced against subsequent transferees in the asset through a valid contract since contract rights served primarily to regulate or govern the use of an asset and are therefore negotiable to the extent of the regulation. A property right is enforceable not just against the original holder but also against other persons to whom the possession of the asset or other rights in the asset is subsequently transferred.[59]

A contract law, like property law, provides the parties with a variety of standard forms and default rules to facilitate communication but contract law is less restrictive in the sense that the parties are free to deviate from the standards forms (that hinders deviation of property rights) and create new contractual right of any form and complexity as the need be. This means that contractual rights only operate within a dimension of existing standards which primarily involved overseeing use and distribution of the assets committed to the contracts. Any deviation from the set standards or contractual agreements may results to either a lapse on the duration of the contract or complete termination. Contractual rights also possess limited time-frame

[58] The presence of property rights is verified either by labeling (as in Copyright) or registry for immovables such as land records registration. For movables, information is provided through possession. (Hansmann & Kraakman, 2002)

[59] The burden of property right "runs with the asset" see Henry Hansmann and Reinier Kraakman, 'Property, Contract and Verification: The "Numerus Clausus" Problems and the Divisibility of Rights', *The Journal of Legal Studies* p., 374.

and duration after which they expire. Property rights are evolving rights and as the law evolved so will property rights particularly in areas concerning ownership such as data protection or software technology. The use of contractual clauses ensures that such rights are verified and enforceable.

The limitation of law on property rights has been view differently by different writers. Merrill and Smith indicate that such limits is necessary to reduce the information-processing costs in purchasing property rights, while Hansmann and Kraakman concur that the limit of law on property rights serves to facilitate verification of ownership rights[60]. According to Hansmann , it is important for both parties to understand each other's rights (the acquirer of rights needs to understand the nature of those rights) and not asserts rights opportunistically that belong to the other party. Property rights require proper means of verification which is necessary to solve the coordination and enforcement problem[61].

Coordination and enforcement are two problems that hinder claims on rights. The absence of understanding in sharing certain rights results to problems of coordination while enforcement problems arose if one party in the contract tries to opportunistically assert rights that belong to another (even if coordination is achieved). The more effectively the parties agree to solve the coordination and enforcement problems the less likely the scope for mistakes and opportunism to occur and this will discourage parties to initiate costly actions in order to protect their rights. This will also mitigate other transaction costs and facilitate the law recognition of new rights.

According to Demsetz the purpose of property rights is to concentrate the benefits and the costs of the use of the resource on the user. To set up a resource as property right one needs to know what the resource is and what actions are allowed in respect of that resource (one needs to infer as much information as possible) which is necessary to avoid problems related to disputes on usage rights. One needs to gather information on costs, benefits and other information prior to using the resource. In the

---

[60] A Partitioning of Property right between more than one owner is enforceable if there is adequate notice of that partitioning to persons whom it might affect and such partitioning should be regulated through adequate notice to parties concerned. *Ibid* pp., 374-382.

[61] Coordination problem is solved by mutual understanding of each other rights with one party opportunistically asserting rights of the other, enforcement problems requires a third party such as a court to ensure enforcement of rights. Legros and Newman however see the role of the court as enforcer of contracts as imperfect due to renegotiation among the parties, court's commitment problem as well as limited amount of information the court can extract.

absence of transaction costs, the use of resources could be costlessly measured and there would be no need to distinguish between property-like and contract-like rights, therefore each use would be metered at no cost and rights could be defined in terms of the exact level of impact on the use value of the resource.[62] It is also important that right should display efficiency when the use of the resource is in question.

One parameter to measure this is through investment. Appropriate investment ensures that rights are efficient. Investment transfers the ownership of resource to the investor. However pre-emptive investment precludes the efficient transfer of ownership on new rights making them socially inefficient and costly. This is usually the case when claims of ownership on property arise when uneconomic investments is created to preempt others from obtaining ownership rights. Preemption hinders claims on ownership. According to Demsetz if claims on resource are not tied to ownership, implying that the resource does not possess ownership titles and the same resource is open to use by everyone, preemptive investment does not arise. However if claim on ownership is not established this will exacerbate the difficulty of establishing and verifying ownership rights and make ex post bargaining of sharing surplus difficult. If resources and ownership are not perfectly delineated and there still remain substantial undefined gap regarding the ownership structure and extend to which its uses can be employed, creation of such right will not be beneficial socially and will be costly instead.[63]

2.5 Verification to Ownership Rights

Verification is intrinsic to ownership rights (Hansmann and Kraakman stipulated the condition that a given right in an asset runs with the asset). The law employs different rules of verification such as the rule of possession or tied ownership.[64] Verification is more difficult in the case of property rights than in

---

[62] See Smith, Henry, 'Exclusion versus Governance: Two Strategies for Delineating Property Rights'. *The Journal of Legal Studies*, vol 31, no 2, part 2: The Evolution of Property rights, June 2002.

[63] Demsetz hypothesized that property rights emerge when the social benefits of establishing such rights exceed the social costs and that legal rules change over time if such changes provide net benefit to the relevant community. (Merrill Thomas W, 'Introduction: The Demsetz Thesis and the Evolution of Property Rights', *The Journal of Legal Studies*, 32, no 2, Part 2: The Evolution of Property Rights, p., 331)

[64] It states that verification could only be based on possession. The rule of possession applied to the legal maxim 'first in time, first in right'. This rule has been used to establish ownership rights for centuries for example in the American Southwest. The state law allowed a person to obtain a right to water in a stream by being the first to tap it for use in mining or irrigation. (Cooter & Ulen, 'Topics in the Economics of Property Law', *Law and Economics*, 2000, pp., 120-122)

contractual rights for the simple reason that the holders of property rights in a given asset may not be in privity of contract. Those that are stipulated in the contract encounters no verification problem as the contract is the principal means of verification. Therefore, contractual stipulation of ownership rights is plausible.

Unlike contract, verification for property rights of an asset is not easy which requires the law to limit the types of rights which can be created. Problems of coordination and enforcement (and hence verification) arise not only with the running of the burden of a claim on an asset but it also arise when that claim (including a claim against a given person) is transferable. This is usually the case of contracts but since the Contract is adequate to serve as means of verification (since it can be transferred from B to C when A and B are already in privity of the contract with the assurance that the contract between A and B suffice the transfer) any contractual claim can be made transferable and there is no reason to regulate the types of such contractual claims.

Verification is costly but it is important for assets and property to be verified (and determine ownership) to reduce uncertainties in exchange transactions. It is more difficult if a transfer of the right to an asset involves a third party occurs, who is not part of the original arrangement in the claims of rights. If verification in such case is not possible then one of the parties may be misled or misinformed out of mistake or opportunism increases. Law assists in the verification of rights as well as enforcing those rights. However not all claims are enforceable. Some rights are not alterable or enforceable even through a contract, since such alteration may unknowingly leave the party bereft of their rights that they are retaining or giving up. Other claims on rights are only transferable through the provision of a contract which may or may not be binding on a third party (another set of contractual agreement is needed with a third party to bind it to the contract). In situation where verification is impossible, rights cannot be enforced.

However, most claims are enforceable provided ownership right of an asset is delineated including transfers of assets. A transfer of rights is contractually verified and such transfers will be legally binding on third parties as well. Since the contract is principal means of verification, the law acts as a facilitator by providing legal rules binding each party to the contract (as per the terms expressed in it). The law enforces claims on rights by acting as a medium of defining legally standardized form of rights and does not recognize any deviation from the set standards. The role of the law, apart

from acting as a facilitator in the creation of new property rights and abolishes old ones that are redundant, is to conformed property rights to a high standard of social efficiency. In doing so, it should assist those property rights with high utility and low costs of verification.

2.6 Right to Use and Exclude

Based on the discussion so far, we can postulate that contracts are suitable mechanism for ensuring rights allocated to the use of assets is appropriately utilized. Hence, we can propose the following: the contract assigned two kinds of property rights: the right to use and the right to exclude. The right to use allows the owner to deploy the asset to generate profit. The right of exclusion is necessary for proper delineation of property rights and this right is implicit in contractual formulation which allows only specified parties, who are signatories to the contract, to processed or use or handled the resources at their discretion.[65] In other words, excludability allows the owner to charge or limit access to the asset. In physical or human assets, this distinction is unambiguous. The use of such an asset results in its exclusion from another.

Contracts prohibit the occurrence of what is known as the 'tragedy of the commons' where everyone in an open access regime has access to the property/asset which imposes external cost and externality on other users. The framework on this research is that data protection in outsourcing contract deploys excludability to protect data and other forms of processing from unauthorized access. Therefore it is mandatory to describe ownership of assets in data protection ownership as excludability becomes important while dealing with data processing. We have mentioned that the law employs different rules of verification such as rule of possession to determine ownership. While ownership and possession clearly demarcates physical assets, such analogy becomes meaningless in data protection since ownership characteristic in outsourcing and IT related field are conceptual and defined by law. A contract may allow ownership to be reconceptualized differently. The right to use should be separated from the right to exclude. A contract set a boundary in which certain uses are permissible while others are not. A contract is

[65] While ownership is generally conceived as a bundle of differential rights Hart and Moore meticulously conceived the ownership of asset to the right to exclude others from using the asset. (Hart & Moore, 'Property Rights and the Nature of the Firm', *Journal of Political Economy* , vol. 98: 1119-58)

synonymous to a fence or invisible barrier which prevents the intrusion of rights by other parties who are not permitted to handle or process the data (excludability).

The framework of this research is to understand the application of the law invoking the right to use and exclude when ownership is delineated to an asset holder in the context of data protection. Property rights are discernible to the protection of data through contractual stipulation of ownership claims such as privacy rights. Privacy right is a part of property rights which is substantially missing in Indian legal jurisprudence particularly in the area of data protection. Noting this, we also contemplate on the operation of rights in Outsourcing contracts and how existing law is fragmented to address problems of rights and ownership in contracts. Economic approaches to outsourcing have focused largely on ownership of physical property where physical or legal rules act as constrains. This approach emphasize data protection as an important contractual clause (which may be complete or incomplete) in outsourcing relationship.

The approach of law to data protection is obviously different and does not follow the same physical laws as it does for physical property. Contemporary laws stipulating outsourcing relationship draws inspiration from the right to privacy embedded in different legal provisions and constitution. A reconceptualization of ownership on data protection needs to either consolidating existing laws since the existing fragmented set up of laws is intermittent related to privacy rights. The few that have been interpreted have not been impressive for the law-makers to realize the importance of privacy rights in data protection.

The gamut on which the Indian legal framework of data protection operates is less based on privacy rights, on the contrary legislation on data protection/processing is dragging the law to compartmentalized offences related to contractual and data breach as criminals which does not forebode well for the development of legal jurisprudence on data protection as far as other aspect of law is concern such as tort laws. We would be contemplating on this more in the subsequent chapters of this research.

Contracts in outsourcing are important for data protection and processing. The contract is only a legal binding document which specifies certain agreements between the Data controller and the Data processor. The right of the data owner to access his data and seek information for the manner in which the data is processed and used cannot be denied. Any data breach is therefore a breach of the contractual

commitments for which the cost involved will result to legal and punitive actions. However, enforcement of contracts is not easy particularly since contracts encounters problems of non-cooperation and non-commitment thereby escalating uncertainty and risks for parties in privy of the contract. The law could mitigate uncertainty and risks by encouraging cooperation and commitment through various legal devices and remedies. Here, the role of the judicial system and structure becomes important.

In this discussion, the role of the court as enforcer of contract cannot be ignored though there are limits to the court's ability to enforce contracts.[66] Legal intervention in contracts is based on two standard reasons: asymmetric information and externality. Court intervention should be an important aspect of contract law in order to provide remedies for breach of contracts differentiating them from those of externalities in the form of nuisance.[67] Nuisance could either be private or public. If the nuisance is private few parties are affected by it and the cost of bargaining is low. When bargaining is low the parties will normally reached an efficient agreement. If the nuisance is public, bargaining fails as it requires the cooperation of all affected parties. For the court to determine whether injunction or damages is appropriate as a remedy prescription it has to examine the number of people affected by the externality.[68] We would discuss the implication of legal remedies in outsourcing contracts in subsequent chapters.

2.7 Conclusion

The successful completion of the contract hinges not only on the cooperation and commitment of parties to the contract but also the extent to which outsourcing contractual clauses are built in the contract to permit adjustments as event unfolds.[69]

---

[66] The court may have a commitment problem or there may be limit to the amount of information the court can extract or enforcement is simply limited by the fact that both parties to the contract choose not to call on the court, or they decide to ignore the court's decision after agreeing to another set of contracts, therefore the contract is not enforced. Interference in court proceedings also affects the courts ability to enforce contracts (Legros and Newman, 'Courts, Contracts and Interference' in Mathias Dewatripont (ed.,) , *The Economics of Contracting: Foundations, Application and Empirical Investigations*, 1999, pp., 127-129)

[67] Economic contracting literature assume that court do not intervene in contract modification as they do not get the required information and secondly it is assumed that contractual holdup during contract modification is assumed to be addressed by the parties themselves through renegotiation mechanism. (Aghion, Dewatripont & Rey, 1994, Tirole, 1999)

[68] (Cooter and Ulen, 'An Economic Theory of Contract', *'Law and Economics'*,2000, pp., 178-182)

[69] Most contracts are incomplete due to unforeseen contingencies due to changing environment and opportunism. Law and Economics literature have identified the following types of contractual clauses that are paramount in outsourcing contracts, control clauses, incentive clauses, price clauses, evolution clauses and end of contract clauses.

A performing contract will enhance the assets of the firms or parties involved, while a non-performing contract will obliterate assets ownership and exacerbate transaction costs and opportunism which hinder contractual enforcement. The challenge for the law is to recognize the creation of new rights with benefits that outweigh the cost. The law restricts the creation of certain rights but does not prohibit the creation of certain specified rights. Prohibition on new rights may not be efficient as it may hinder the use of law as a tool for changing practices.

Law reinforces rights by creating condition for creation of rights such as property and contractual rights through constitutive rules and constrains infringement of rights through protective rules. Tort laws offer protection to large number of different interests through remedies and remedial rules. Therefore law enforces rights through legal protection; it also governs the enforcement of contracts. Therefore contracts offer protection for property rights through the intermediary of the law.

The focal point in this discussion is to differentiate between rights belonging to an owner and those that are contracted. One needs to understand that ownership in an area such as outsourcing is an emerging problem not only in the field of economics or Information Technology but also an ongoing discussion in the field of law. Property rights could be delineated and fixed legally but how does one delineate contractual clause into rights as contracts themselves possess limited time-frame.

Contractual rights only last as long as the contract last. Once the contract is completed or invalidated so does the ownership rights that are delegated. In outsourcing, Contracts allow the possibility of more regulation and monitoring particularly when data are transferred across countries. Though contractual stipulations may not eliminate opportunism and agency costs entirely, they will continue to be the principal means of ensuring compliance and mitigating certain costs (such as shirking) through better monitoring. To discern contractual alternatives is not easy, till then legal framework and future research would have to ensure that contracts would be less imperfect as much as possible.

CHAPTER 3

CONFLICT OF LAW AND LEGAL IMPLICATION ON OUTSOURCING CONTRACTS IN INDIA

3.1 Introduction

In the previous section we have discussed how contractual rights are intrinsically related to ownership; implicit in the discussion are the costs that hinder partitioning of ownership rights when transfer occurs. These costs are externalities and prohibit the establishment of new rights. Contract law is poised to significantly mitigate such costs enabling the establishment and partitioning of different types of rights. Property law, just like any other law, is an evolving law and the legal system is important to not only define property rights but also to arbitrate disputes and contractual holdup (Shavell, 2007). Property law is just one part of a range of other laws operating in the system. There are domestic and international laws with each different from the other in nature and complexity. These laws stipulate settlement of disputes through mediation or arbitration. International law is a set of rules and legal instruments regarded and accepted as binding agreements between nations and are generally divided between public international and private international law.

Private international law or commonly known as conflict of laws in common law countries are domestic in nature though they originate in international instruments. Private international rules are decided by each state and basically regulate the court's jurisdiction over disputes falling within its jurisdiction by examining what country's law should it apply to settle disputes between countries and under what circumstances it may recognize and/or enforce a foreign judgement. Public international law is basically concerned with legally binding rules and principles relating to the regulation of the relationship between sovereign states such laws of treaties and issues of territory. However, it also does include rules regarding when a State's court can claim jurisdiction such as adjudicative and enforcement jurisdiction. The rules and principles of both do overlap and are therefore connected. However we would be more concerned with private international law in the context of outsourcing. In this section we examine the conflict of laws as embodied in existing laws in the country vis-à-vis outsourcing contracts.

3.2 Conflict of law and Contractual Stipulation

Conflict of laws (or private international law) is that branch of international law which regulate all lawsuits involving a foreign law element where different judgements occurs depending on which jurisdiction laws are applied. Private international law is a body of domestic law dealing with cases involving one or more foreign elements which includes international civil procedure and international commercial arbitration. Private International law also covers various other issues such as contracts and property, family relations, legal procedure and jurisdiction, religious conversion etc. However in this study, we examine conflict of laws with regards to contracts. The conflict of law is likely to be of growing importance in India as there is increasing trade, cross-border investments etc due to changing macro and economic paradigm brought about by liberalization and open-economy particularly on the growing digitalization of technology such as the internet which enables unprecedented transmission of data enhancing the role and functions of outsourcing service providers and other intermediaries.

Conflict of law is a doctrine that enquires to the proper law of contract for parties to choose (choice of law) before pursuing a transaction. The law so chosen, to govern a contract, will determine the lex contractus. However when parties have not expressed any intention on the law for the contract, the law of the country with which the contract has the most real connection will apply. In common law systems, conflict of law determines which of the competing state's laws are to be applied to resolve the dispute. This is significant as it determine the proper procedure for arbitration in the absence of contractual stipulation.[70]

Conflict of law rules are different from the substantive principles of domestic law and are applicable only for the purpose of determining which appropriate law should be the proper law of contract. Its primary objective is to achieve substantial uniformity of results in deciding legal problems irrespective of the origin of the litigation,[71] and to avoid the uncertainty of general law in the international sphere. It

---

[70] We have mentioned in the previous section that contracts, in solving opportunistic problems, are costly such as policing and litigation costs. A contractual provision specifying compulsory arbitration is an alternative often employed to economize on litigation costs apart from creating flexibility without specifying every possible contingency. (Klein, Crawford & Alchian, 'Vertical Integration, Appropriate Rents, and the Competitive Contracting Process', *Journal of Law and Economics*, vol. 21, no.2, Oct 1978)

[71] According to David Stern, limited research devoted to this study has result to 'disservice' principally related to commercial arbitration such as failure to differentiate between contract in general and arbitration clause in the contract, failure to develop a set of rules applicable to the enforcement of

also aspire to ensure, as far as possible, that disputes involving foreign elements are determined by the court best placed to do so in the interests of justice for the parties, and that selection of the forum clause should not affect the substantive outcome of the dispute, that is choice of forum clause should not vitiate disputes and conflict resolution between two contracting parties.

In India the conflict of law rules is part of private international law and can be determined only through the analysis of case law with regards to the choice of proper law of the contract between parties of different countries [72]. Private international law is concerned with disputes between individuals or companies of different countries or between individuals/companies and the state. The function of private international law is to delineate jurisdiction for municipal courts over cases with foreign elements as opposed to those which do not. Private international law does not deal with only one branch of law; it is concerned with every branch of law. Hence, knowledge of Indian private international law is important for parties in outsourcing contracts to enable them to select the law most applicable to the contract. As noted by the Supreme Court of India, the rules of private international law are scattered in different pieces of legislation such as the Civil Procedure Code (CPC), the Indian Contract Act, 1872, the Indian Succession Act 1925, the Indian Divorce Act 1869 and the Special Marriage Act 1954.

The autonomy of the parties is a fundamental principle of private international law. This enables the parties to choose a law applicable to their contract (*lex contractus*). Indian courts follows well-established principles of private international law which recognize the autonomy of parties and allow contracting parties of different countries to choose the proper law of contract. An example is the arbitration clause. Under section 20(1) of the Arbitration and Conciliation Act, 1996, the parties are free to agree on the place of arbitration. If the contract does not contain a clause selecting the place of the arbitration, the venue shall be determined by the arbitral tribunal having regards to the circumstances of the case, including the convenience of the

---

foreign judgements based on arbitral awards and the failure to develop complete and adequate due process in the commercial arbitration. (Stern, 'The conflicts of Laws in Commercial Arbitration'. *Law and Contemporary Problems*, vol.17, no 2, Commercial Arbitration Part I, 1952, pp 567-579)

[72] Rules of private international law are not codified, for example, the Indian Contract Act 1872 does not deal with the question of what is the proper law applicable to a contract between two different countries. Therefore the solution to the conflicts between parties of different countries due to the absence of conflict of laws lies in the interpretation of various laws that are fragmented in the country's legal jurisprudence allowing for autonomy in choosing the choice of law.

party. If the parties do not express their intention about the law that will govern the contract, the law of the country with which the contract has the real most connection will apply.

The choice of law chosen between the parties is limited by contractual stipulation, but for the choice of law chosen by the parties to be conclusive, the expressed choice of law by the parties must be bona fide and legal and not opposed to public policy. As would be obvious in the following discussion, Indian laws have increasingly been accommodating foreign awards and decree passed by arbitral tribunal or foreign courts (provided they meet certain grounds for their validity) resulting to complexity in the application of appropriate laws. In such conflicts, the Indian law prevails in so far as they do not violate public policy and is bona fide, conclusive and is a prima facie evidence of the lex contractus.

3.3 Choice of Law Rules in the Absence of Contractual Stipulations is conclusive

An outsourcing relationship occurs between the service provider and the client, with the latter usually located in the foreign locations such as U.S, U.K and other foreign clients. This relationship is managed through a contract which is usually governed by the laws of the foreign country for e.g. the US laws. The start of an outsourcing relationship between the service provider and the foreign client is preceded first by the selection of proper law of contract.[73] As mentioned earlier, the choice of law of the parties expressed in the contract is conclusive provided that it is bona fide, legal and is not opposed to public policy.[74] Thus, Indian courts permit a contractual stipulation which enable parties to choose their proper law of contract, is conclusive provided that it is bona fide, legal and not opposed to public policy. The expressed intention of the parties is generally decisive in determining the 'proper law of the contract.' The proper law is the law which the parties expressly or impliedly

[73] The general view prevailing is that the law so chosen need not possess connection with the transaction in question, i.e., the parties can choose a law in the contract even though it has no connection with the contract. Indian Courts have held that the law selected must have a connection with the transaction.

[74] The parties should not indulge in 'law shopping' by altering claims that the provision of the proper law is subject to another legal system when the first is void. Also it is required that only a single proper law of contract should govern all aspects of the underlying contract. Therefore no separate law can be specified for formation of the underlying contract and another law for interpreting the contract. (Vishwanathan A, 'Conflict of Law Rules in India', *Outsourcing to India: Cross Border Legal Issues*, LexisNexis Butterworths', 2008 , pp 11-12)

choose or which is imputed to them by reason of its closest and most intimate connection with the contract.[75]

In the absence of a contractual stipulation, either of the following would apply; the law of presumption which operates through the *contractus* (the proper law is the place where the contract was made), the *lex loci solutionis* (the place of performance of the contract) or the "objective test" also known as 'the closest and the most real connection test'.[76] The Supreme Court stated the following factors for determining the system of law (in the absence of contractual stipulations) with which the transaction has its closest and most real connection;[77] these includes the place where the contract was made, place of performance, subject matter of the contract, facts that certain stipulation is valid under one law but void under another, the place of residence or business of the parties, reference to the Courts having jurisdiction and such other links.[78]

Vishwanathan had summarized the relevant factors for determining which system of law needs to prevail where transaction possesses its closest and most real connection as follows; place where the contract is made, place of performance, place of domicile (residence or business of the parties), national character of the corporation and where its principal place of business is situated, subject matter of contract, facts that certain stipulation is valid under one law but void under another, generally all surrounding facts which help to localize the contract. She noted that in choosing the choice of rules for the contract, it is important to specify the following, the law applicable to the underlying contract on the substantive rights and obligations of the parties, the law applicable to the arbitration agreements which govern rights and obligations of the parties, the proper law which regulate the individual reference to

---

[75] *National Thermal Power Corporation v. Singer Company AIR 1993 SC 998.*

[76] This test deems that in the absence of contractual clause the applicable law is the law which has the most significant relationship to the transaction and to the parties. This theory evolved in England, Germany and France and gradually replaces the theory of presumption.(Vishwanathan A, Outsourcing to India, pp 12-15)

[77] In 1955 the Supreme Court delivers its first verdict by applying the 'closest and most real connection' in the Delhi Cloth and General Mills Co Ltd v Harnam Singh (AIR *1955 SC 590 (1955) 2 SCR 402).* The Substantial connection was later applied by the Supreme Court in its 1922 judgement in the National Thermal Power Corp case. (*National Thermal Power Company and Ors* AIR 1993 SC 998; (1992) 3 SCC 551)

[78] (Vishwanathan A, *Outsourcing to India: Cross Border Legal Issues*, LexisNexis Butterworths, 2000, pp., 14)

arbitration and the curial law which govern the arbitration proceedings themselves, i.e., procedural law governing power and duties of the arbitrators.[79]

As long as parties to the contract agree to the sole jurisdiction of court where the dispute does not violate s 28 of the Indian Contract Act 1872, is proper and the right to determine a dispute in the ordinary tribunals cannot be denied except where there is a valid and binding arbitration clause. Under section 28 of the Indian Contract Act 1872, provides that a choice of forum clauses which confer exclusive jurisdiction on Courts outside India is void under Indian Law. It is a standard practice to select a law (a choice of law clause) which expresses the contractual stipulation encompassing all aspect of the contract such as validity, interpretation, effect and how it is discharge.

3.4 Important Outsourcing Clauses

An outsourcing contract is an agreement containing different contractual clauses. Most of these are explicit performance related clauses such as pricing and service related requirements. Indemnity clauses are also important contractual clauses of outsourcing agreements. The service level agreement is a list of service which would be supplied on a regular basis which includes volumes, response times and quantitative/qualitative descriptions of these. They are intrinsic to the functioning of the outsourcing contract. The other part of the Outsourcing clauses is cost controlling mechanism. In light of the unforeseen contingency, Outsourcing contracts needs to be sufficiently flexible to accommodate changes that are unexpected and which may have a bearing on the contractual performance.

Most Outsourcing firms incorporate a benchmarking clause in the contract based on fairness and price-appropriateness of the anticipated value, agreed by both the parties. These are internal clauses determined mostly through bargaining and negotiations based on the reliability of the firm, past experiences etc. There are numerous other details which encompass the legalistic part of the agreements. In this section, we would discuss various contractual clauses and legal implication of an outsourcing agreement particularly when the business is located in a different country possessing a different legal framework.

---

[79] (*Ibid.*, pp 15-16)

(A) Forum Selection Clause in Outsourcing Contracts

An important clause in an outsourcing contract is a choice of forum clause where parties decide to confer jurisdiction on any claims arising under the contract on particular courts in a certain country. Indian courts have held that where two courts have jurisdiction to file a suit, there is nothing contrary to public policy if the parties chose to do so in one of the courts, however parties will have to confer jurisdiction on a court which possess jurisdiction.[80] As per section 28 of the Indian Contract Act 1872 (the Contract Act) a choice of forum clause which confers exclusive jurisdiction on courts outside India is void under Indian law. Therefore, an Indian court will not enforce a contractual provision which completely bars or excludes the jurisdiction of Indian courts. The choice of forum clause is valid if the jurisdiction extends to one of the several competent courts in India.

Under section 20(C) of the CPC, an Indian court possess jurisdiction to entertain a suit if the cause of action arises wholly or in part within its local limits of jurisdiction. Additionally, an Indian court has jurisdiction to try all cases of civil nature, unless expressly or impliedly barred from doing so as per section 9 of the CPC. However, Choice of forum rules for arbitration is excluded from s 28 of the Indian Contract Act as there are separate rules for arbitral proceedings which we would discuss in this section. Choice of forum clause is one of the many clauses in outsourcing contract; others are enforcements of foreign judgements and foreign arbitral awards which encumbered the choice of law in outsourcing contract.

(B) Foreign Judgement Enforcements

Foreign judgements significantly impact outsourcing relations between the parent country and the host country where the service provider is located. As discussed above, Indian laws like most countries of the commonwealth concur recognition to foreign judgements.[81] A foreign judgement is a judgement of a foreign court as per the definition of the Code of Civil Procedure 1908 (CPC).[82] A foreign

---

[80] *National Petroleum Co Ltd v Meghraj AIR 1937 Nag 334, Patel Roadways v. Prasad Trading Company AIR 1992 SC 1514.*

[81] While most European countries place much reliance on the rule of reciprocity, English law recognized comity law (i.e., courtesy) as opposed to obligation. However, comity ensures that there will be reciprocity. Indian courts have applied both the principle of comity and the obligation theories as the basis of the enforcement of foreign judgement. (Vishwanathan A, *Outsourcing to India: Cross Border Legal Issues*, LexisNexis Butterworths, pp 37)

[82] The CPC defines a 'foreign judgement or decree' as the judgement of a foreign court. Code of Civil Procedure 1980, s 2(6)

court is a court located outside India and not established or continued by the authority of the Central Government.[83] A decree means any decree or judgement of such a court other than arbitration award, under which a sum of money is payable and the sum, does not include taxes or other charges such as a fine or penalty. A foreign judgement is enforceable in India provided it is passed from a 'reciprocating country'[84]. According to s 44A of the CPC, the decree passed by any superior courts of any reciprocating territory or country can be executed by the district court in India provided certified copies of the decree is produced which states the extend of the decree, and upon such submission the certified copy becomes a conclusive proof of the extend of such satisfaction.

Therefore enforcement proceedings is initiated only when a certified copy of the decree of the superior court concerned, is filed in the district court in India, the certificate so filed should state the extent to which the decree has been satisfied or adjusted and the decree of the superior court should not fall within any of the exception which is mentioned in s 13 (a) to (f) of the CPC.[85] Under section 13 of the CPC a foreign judgement is conclusive under the principle of res judicata on matters relating to adjudication between the same parties. This section does not apply to the enforcement of an interim order of an interlocutory relief of a foreign judgement. Therefore. even if the judgement evolve from a reciprocating country, it has to comply with the various test set forth in sections 13(a)-(f) of the CPC otherwise it becomes unenforceable.[86]

---

[83] *Ibid.*, s 2(5)

[84] There are few reciprocating countries and therefore the majority of foreign judgements are not enforceable in India. Instead a fresh suit would have to be filed on the judgement or on the same cause of action. (for detail number of these countries see Vishwanathan A, *Outsourcing to India: Cross Border Legal Issues*, LexisNexis Butterworths, 2000, pp., 38)

[85] Under section 13 of the CPC a foreign judgement between two parties is not conclusive if it has not been pronounced by a court of competent authority, s 13(a), if the judgement has been given on the merits of the case to enable it to operate as res judicata, s 13(b), if a foreign judgement is founded on an incorrect view of international law or a refusal to recognize Indian laws, s 13 (c), if the proceedings in which the foreign judgement is obtained is opposed to natural justice, s 13 (d), where the foreign judgement is obtained by fraud, s 13 (e) and where the foreign judgement sustains a claim founded on a breach of any law in force in India, s 13 (f). (Vishwanathan A, *Outsourcing to India: Cross Border Legal Issues*, LexisNexis Butterworths, 2000, pp., 38-48)

[86] Most of the cases on enforcement of foreign judgement concerns personal and matrimonial cases with none relating to outsourcing disputes. (*Y Narasinha Roa v Y Venkata Lakshmi (1991) 3 SCC 451, Potluri v Rajeswara Rao MANU/AP/0367/2000*)

(C) Enforcement of Foreign Awards in Contractual Disputes

Enforcement of a foreign judgement is difficult in India since litigation in Indian courts involves protracted delays. Moreover, if the need for such enforcement arises a separate suit is warranted. An alternative to foreign judgement is the enforcement of foreign arbitral awards in dispute resolutions. The Indian Arbitration and Conciliation Act, 1996 is the governing arbitration statute in India and is based on the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law (UNCITRAL), 1985. The Code of Civil Procedure, 1908 governs the execution of decrees, whether foreign or domestic.

The supreme court have recognized that separate proceedings for enforcing and execution of awards only contribute to protracting delays, the provision of the Arbitration Act 1996 contained in sections 46 to 49 avoid such difficultly and unnecessary costs to the "litigant in terms of money, time and energy".[87] The advantage of foreign arbitral award is that unlike court judgements, arbitration awards are enforceable world wide in accordance with the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The Arbitration and Conciliation Act 1996, section 49, equates a final arbitral award as equivalent and equally binding as arising from a 'decree of court'.

The act no longer requires a party to file an application in a court for making an award a rule of court, i.e., a party seeking enforcement of the award may immediately commence execution proceedings. Any challenge to the enforcement of the award is limited and is primarily restricted to procedural fairness, whether the arbitrator was biased,[88] or whether the award was contrary to public policy.[89] Sections 34 and 38, Part 1 of the Act would apply to all arbitrations including international commercial arbitrations and to all proceedings relating thereto.[90]

---

[87] *Fuerst Day Lawson Ltd v Jindal Exports Ltd AIR (2001) SC 2293, International Investor KCSC v Sanghi Polyesters Ltd MANU/ AP/ 1278/ 2002.*

[88] *Bihar State Mineral Development Corporation v. Encon Builders Pvt Ltd, AIR 2003 SC 3688: 2003 (6) Supreme 1.*

[89] Section 48 of the Indian Arbitration Act lays down the condition for enforcement and refusal of a foreign arbitration award.

[90] *Venture Global Engineering v. Satyam Computer Service Ltd. and another, AIR 2008 SC 1061: 2008 AIR SCW 667: 2008 (4) SCC 190: 2008(1) Scale 214.*

(D) The New York and Geneva Convention

India has been a signatory of the New York Convention which was a landmark development in cross border enforcement of arbitration awards since 1961.[91] It is also a member of the Geneva Convention since 1937.[92] Both the Convention emphasize that an award should be 'commercial' and should be issued or subject to the jurisdiction of the countries to which either the New York Convention or the Geneva Convention applies. However, the success and popularity of the New York Convention imply that the Geneva Convention is rarely utilized in practice. The expression 'commercial' has been widely interpreted by the Indian Supreme Court. It cited the UNCITRAL model law for aid in construing the expression as including 'commercial representation or agency' and 'consulting'.[93]

To challenge an arbitral award as per the New York Convention, the 'burden of proof' shifts to the defendant who is seeking to resist enforcement while in the Geneva Convention, the 'burden of proof' lies with the claimant seeking the enforcement. Upon fulfillment of the criteria seeking enforcement of the award, the New York and Geneva Convention shift the burden to the defendant or party seeking to enforce or resist the enforcement of the foreign award. As per the New York Convention the defendant who seeks to resist enforcement must bear the burden of proof, following which the court may refuse enforcement.

In contract under the Geneva Convention the claimant seeking enforcement of the award, has a substantial showing to produce that the award (is final) has been made pursuant to a legally valid submission to arbitration and that the tribunal has been constituted in conformity with the agreement of the parties or with law.[94] The

---

[91] New York Convention, supra note 27, Article II (3) requires national courts to "refer parties to arbitration" in respect of matters covered by an agreement to arbitrate. Its principal focus is on foreign awards but the Convention also covers awards "not considered as domestic" which includes awards arising from disputes that directly implicate international commerce.

[92] The principles which apply to the recognition and enforcement of foreign award under these two conventions were incorporated into Indian law. The Geneva Protocol of 1923 and the Geneva Convention of 1927 were implemented and incorporated into Indian law by the Indian parliament in the Arbitration (Protocol and Convention) Act 1937. The New York Convention of 1958 was incorporated in Indian law by the Foreign Awards (Recognition and Enforcement) Act 1961. These two Acts have been consolidated in Part II of the Arbitration and Conciliation Act 1996 under Chapter I and II respectively.

[93] *RM Investment & Trading Co Pvt Ltd v Boeing Co AIR 1994 SC 1136.*

[94] This also means that evidence necessary to proved the award is fulfilled as required under clause (a) and (c) of sub-s(1) of 57. Clause (a) of s 57 (1) provides that the award has been made in pursuant of a submission to arbitration which is valid under the law applicable thereto, and clause (c) provides that the award has been made by the arbitral tribunal provided for in the submission to arbitration or constituted in the manner agreed upon by the parties and in conformity with the law governing the

Geneva Convention further stipulated that the court must refuse enforcement of the award, even if the claimants to enforce it has satisfied all the requirements listed in s 57(1) by shifting the burden to the claimants upon which the court is mandated to refuse the enforcement of the award on certain grounds.[95]

Vishwanathan had detailed the requirement under which the claims to refuse enforcement and application for enforcement under the New York Convention and the Geneva Convention occur. While the former leaves the question of enforcement to the court, the latter mandates the court to refuse enforcement if it finds any ground for such refusal. However in India, the enforcement of an arbitral award focuses on whether the award is contrary to public policy.[96]

3.4 Public Policy and Arbitration award

The term contrary to Public policy meant opposition to the fundamental policy of Indian law, the interests of India or justice or morality and not a foreign state.[97] However, the Supreme Court interprets a wider meaning as contrary to public policy in the Oil & Natural Gas Corporation Ltd (ONGC) v Saw Pipes under section 34 of the arbitration act. The Supreme Court held that if the arbitral tribunal has not followed the mandatory procedure prescribed under the Act, it has acted beyond its jurisdiction and thereby the award would be set aside under section 34 of the Arbitration and Conciliation Act 1996 as such an award would promote injustice. By not following the mandatory procedure the tribunal acted beyond its jurisdiction and the court set aside the award. In the ONGC v Saw Pipes,[98] the court held that a foreign award is "patently illegal" if it is against the statutory provisions of substantive law of India, or against the terms of the contract, or is passed without giving an opportunity of hearing to the parties. Such an award is against the public policy of India.[99] Moreover, The Foreign Awards (Recognition and Enforcement Act, 1961) specify that a foreign award is not enforceable if the Court is satisfied that the subject matter of difference is not capable of settlement by arbitration under the law of India and its enforcement culminates to contradicting public policy.

---

arbitration procedure.(Vishwanathan A, *Outsourcing to India: Cross Border Legal Issues*, LexisNexis Butterworths, 2000, pp., 55-56)

[95] *Ibid.*, pp 54-56

[96] *Oil & Natural Gas Corporation Ltd (ONGC) v Saw Pipes AIR 2003 SC 2629: 2003 (3) Supreme 148.*

[97] *Renusagar Power Co Ltd v General Electric Company AIR 1994 SC 860.*

[98] *AIR 2003 SC 2629: 2003 (3) Supreme 148.*

[99] The Foreign Awards (Recognition and Enforcement) Act 1961.

(A) Substantive Law and Enforcement of Arbitration Award in Indian Jurisprudence

Traditionally the attitude of the court towards enforcement of arbitration award has been hostile which has vitiated execution of such awards. The debate centered on the method of law to be employed in validating arbitration, whether it is procedural or substantive. Arbitration disputes normally involve investment of bilateral nature. Most bilateral investment treaties (BITs) leaves the definition of 'investment dispute' entirely to the law of the contracting state in whose territory the investment is made.[100] Most arbitration (investment) is implicit in dispute resolution and substantive provisions of international treaties based on international law, which corroborate enforceability of international arbitration awards in countries irrespective of the domestic law. Though, no case of disputes involving outsourcing has emerged in India this should not be construed as courts being impartial to arbitration.

The proceedings on arbitration awards in India have seen the Indian court refusing the enforcement of awards on ground relating to public policy. Since Indian Courts have equated the doctrine as strict compliance with statutory provisions (widely interpreted subsequent to the evolution of patently illegal as public policy), hence if an award is against the statutory provisions of substantive law which is in force in India and against public policy, such an award is deemed unenforceable. Therefore, an arbitral award which has been passed after following a procedure not strictly contemplated under Indian law is likely to be found unenforceable as a violation of public policy vis-à-vis the substantive nature of the arbitration act in operation in India.

(B) Enforcement of Arbitration Award as Substantive or Procedural

As mentioned above, Arbitration enforcement vis-à-vis superiority of domestic forum has been extensively debated particularly when courts dispense arbitration awards in arbitration dispute cases. Traditional debate surrounding the arbitration enforcement is whether such enforcement takes substantive or procedural form, or more generally whether the procedural interests are subordinated to substantive interest. Arbitration enforcement is seen as a remedy or procedural stipulations and therefore courts would apply the law of the forum (lex fori) to all

[100] Article 25 of the International Centre for Settlement of Investment Disputes leaves it to the parties to establish for themselves whether their transaction involves an investment.

procedural matters. This is because of fear of the court that enforcement of arbitration agreement subjugates their jurisdiction.[101] This parochial stance of the judiciary has encumbered the enforcement of arbitration agreements and limits the role of foreign law.

However, if the courts perceive a litigation of substantive nature, it may endorse enforcement of arbitration agreements, particularly if the law which the judgement relates to is of substantive jurisdiction in the country where the judgement was pronounced. Thus the need arise for an arbitration statue since the existence of such a statute will not only validate the choice of law of the parties (and end non-enforcement of such agreements) it will also enable courts to enforce arbitral agreements, irrespective of whether the rule is remedial or procedural, which will less likely induce courts to oppose such enforcement on grounds of public policy.

The enforcement of an arbitral agreement or award implies that rules that determine the validity or enforceability of the main agreement should also be applied to determine the validity and enforceability of the arbitration provision and this is made easier when arbitration statutory under its policies validate such enforcement.[102] Besides, other issues still exist such as the wide definition accorded to the term procedure which substantially limits the application of foreign law, since all matters of procedure are submitted to the law of the forum irrespective of the nature of the party or the cause brought before it, enabling courts to strike down on such enforcement. Opposing this temperament, Kramer argues that the modern thinking in law defines "substance" and "procedural" differently from the First Restatement (of Conflict of Laws) and rules that were procedural have assumed substantive form such as rule of privileges.[103]

The purpose of procedural law is to implement substantive law accurately and efficiently which implicitly applies that forum law is subservient to the state's substantive policies in cases where a conflict between the two occurs, however most

---

[101] The myth prevailing for some time is that arbitration agreements subjugate and oust the jurisdiction of the courts which was pointed out by Lorenzo. The attitude of the U.S courts resonate hostility to arbitration. Stern argued that if this notion of ouster exists, the conflict of laws would not function in its normal way and the need for legislation would increase. This is more so in the case where the procedural policies of the forum conflicts with the substantive policies of another state.

[102] Raymond Heilman cited the example of English Courts which after the English Arbitration Act 1889 stop resisting in validating arbitration agreements and make them enforceable.

[103] Joseph Beale's First Restatement provides that all matters of procedure are governed by the law of the forum and differentiate between laws that define a right which are 'substantive' for choices of law purposes and laws that define a 'remedy' which define a remedy (Kramer. L, 'Rethinking Choice of Law', *Columbia Law Review*, vol. 90. No 2 (1990), pp 277-345.)

scholars feel that if the forum has a legitimate procedural interest, forum law should apply otherwise the arbitration agreement becomes invalid. Sharing this view Prof. Lorenzen asserts the need for restricting the term 'procedure' to its proper significance as per the traditional rule in this subject, i.e., all matters of procedure is submitted to the law of the forum (or lex fori).[104] The sole objective of the rule is to assist courts in operating the judicial machinery in the customary manner since rules of procedures are regulatory and are designed to organize litigation process.

This discussion involve substantial study of which this research is not meant to cover, suffice to note that as law of forum widens the meaning of procedure, enforcement of arbitration will be procedural and this limits the field for the application of foreign law. In India, since public policy is equated to possessing a statutory nature, a foreign law which contradicts public policy is void, which that law as a substance supersede law as procedure. Accrual to this complex operation of law, a separate set of problem transpires between transnational rules and domestic rules. An award from an International arbitral tribunal operating on the principle of transnational public policy cannot be debunked by domestic rules on the pretext that such principles have not been integrated into the legal system or on constitutional ground. Resisting a transnational public policy will mean subjugating a set of agreed principles based on global consensus. This area of legal conflict is vast and beyond the scope of this research.

3.6 Legal Remedy for Breach of Contract

Contracts are detailed and complex set of agreements which encompasses important areas in the operation of the business such as price structure, billing and payment arrangements, price stability, payment terms, managements, conflict resolution, term expiration and renewal, vendor's responsibility, deliverables, Service Level Agreements (SLAs), Warranties, liabilities and confidentiality, enforcement of contract rights, security and privacy of data etc for which each requires a specific and detailed clauses which ensures that agreement of the contraet is met in letter and spirit. Even though most contracts are elaborate agreements they are still not

[104] Prof. Lorenzen noticed how the English Courts tend to assimilate and accepts any doctrines to widen the meaning of 'procedure' reducing the application of the 'foreign law' but they have not gone so far as to determine the validity and enforcement of arbitration stipulations as per the lex fori which disposes the belief that arbitration agreements are subject to procedural matters (possibly because of the existence of the arbitration act which favors arbitration)

completely contingent since external uncertainty and unforeseen states of the future exists. For instance, breach of contracts is unforeseen but common in a contractual relationship. A contractual provision can only specify the proper law to govern contractual disputes. A breach is not a dispute since it clearly reflects who violates the contract; distortion in the contract procreates the possibility for breach, however legal remedy and compensation is not easy to arrive at as this depends on the legal system prevailing in the country.

In this section we would discuss the various legal remedies that are available for the aggrieved party whose data is breach. One of these remedies is to approach the court for legal assistance.[105] The role of the court is important in governing the contract between private parties. It enforces parties to abide by agreements that they have voluntarily entered or by mandating terms of a contract. The latter can take two forms by either restricting the terms of private agreement to prevent 'inappropriate contract' or by specifying the action taken when contingency arises for which the contractual provision did not foresee by filling in these gaps.[106]

Distortions in the contract also arise when the contract is used to signal information. Either one of the party may not announce his intention completely in the contract. Since the courts are not engage in signaling, they possess an advantage in writing contracts under such circumstances. By restricting the set of possible contracts the courts can eliminate certain kinds of signaling and associated distortions, provided informational asymmetries arise prior to bargaining. It is important for contractual agreements to specify the obligation of the contracting parties and the payment to be made under each conceivable circumstance or 'contingency'.[107] When a breach occurs, the defaulting party must pay damages to the other party.

3.7 Legal Remedy for Damages

The amount of damage is determined either by law or regulation, by trade practice or custom, or a previous and explicit agreement of the parties' own device

---

[105] In previous chapters, we had noted Shavell's argument that contractual holdup justify the need for legal interference. (Shavell, 2007)

[106] (Hermalin and Katz , 'Judicial Modification of Contracts between Sophisticated Parties: A More Complete View of Incomplete Contracts and their Breach', *Journal of Law, Economics and Organization*, vol 9, no 2, Oct 1993) pp 230-231.

[107] However, contracts do not provide for such contractual contingencies since the cost of writing all such contingencies is expensive implicating all such contingencies in the contract is not feasible making contracts incomplete (Maskin and Tirole)

such as liquidated damages. When two parties agree on a damage measure in case of default, they would generally avoid risk and save time and legal costs by reaching an out of court agreement instead of approaching the court. Shavell had incorporated the following kind of damage measures in his study. Under the expectation measure, the defaulting party pays an amount that puts the other party in the position he would have been in, had the contract been performed. Under the reliance measure, the defaulting party compensates the other party for his reliance expenditure and also returning the payment made, under the restitution measure the defaulting party returns only the payment made to him. In addition he also considers the no damages, when the defaulting party pays nothing.[108] He distinguishes between damages and specific performance as a remedy for breach of contract.

In India remedies for breach of contract are classified into two parts, equitable remedies and legal remedy. The first includes the grant of an injunction or an order for specific performance (where the court orders execution of the contract by the service provider); on the contrary a legal remedy refers to an order for payment of monetary damages by the breaching party. A party has the right to sue for damages arising out of contract breach whereas the relief of specific performance depends on the discretion of the court. If an outsourcing contract is usually governed by foreign law, we need to consider whether an award or injunction from an Indian court is valid if the contract is governed by foreign law (as the law of the contract) and whether a court is likely to grant specific performance of outsourcing contracts.

(A) Injunction as a Remedy

Litigation in India is subject to extensive delays and as such it is important for parties to obtain injunctive relief at early stages of the litigation. An injunction is a judicial order whereby a party is required to do or refrain from doing any particular act. It is a discretionary remedy which is awarded by the court and such an intervention is necessary to protect the rights and interests of the applicant. An injunction could be temporary or permanent. A court can grant temporary injunctions on various ground and they are regulated in O XXXIV of the Code of Civil Procedure (CPC). It can grant temporary injunction to maintain and preserve the status quo at the time of the proceedings to prevent any changes in it till the final determination of the

[108] Shavell. S, 'Damage Measures for Breach of Contract', *The Bell Journal of Economics*, vol 11. No. 2, 1980, pp 471-472.

suit or to restrain the damage or alienation of any property in dispute where the defendants intends to defraud his creditors or seek to cause injury to the plaintiff in relation to any property in dispute. Temporary injunctions are also given to restrain repetition or continuance of breach of contract or other injury such as irreparable damage.[109]

Permanent injunctions are governed by the Specific Relief Act 1963 and can only be granted by a final decree based on the merits of the suit, an interlocutory application is not granted during the pendency of the suit. We know by now, that the choice of forum clause is important as it confer exclusive jurisdictions over any claims arising under a contract on particular courts in certain countries, it is also important for parties seeking equitable relief. However s 28 of the Indian Contract Act 1872 (the Contract Act) can invalidate as void under Indian law for making choice of forum clauses which confer exclusive jurisdiction on courts outside India. Moreover, the Indian court will most likely apply O XXXIX of the CPC before granting an injunction, irrespective of the choice of law clause. Court cases on injunction have examine on a variety of cases; whether the plaintiff has a prima facie case on the merit,[110] balance of convenience as both parties may suffer hardship,[111] obtaining ex-parte injunction without providing prior notice to the other party.[112]

(B) Specific Performance as a Legal Remedy

A specific performance is an equitable remedy in which a court requires a contracting party to do what he agreed by contract to undertake and it is the court's discretion to decide on whether specific relief should be given in case of breach. A party in outsourcing contract could either seek specific performance or damages for breach of contract. However, the remedy of specific performance differs from the remedy in law. Remedy for damages is the provision of pecuniary compensation for failure to comply with the contractual provisions. While specific performance is

---

[109] *Dalpat Kumar and another v. Prahlad Singh, 1992 (1) SCC 719: AIR 1993 SC 276; Mahendra and Mahendra Paper Mills Ltd. v. Mahindra and Mahindra Ltd. 2002(2) SCC 147: AIR 2002 SC 117: 2001 (8) Supreme 443.*

[110] *Suresh Jindal v.Rizsoli Carriere Della Sera Prodzioni T.V.S. p.a., 1991 Supp (2) SCC 3: AIR 1991 SC 2092.*

[111] *M/S. Gujarat Bottling Co. Ltd v. Coca Cola Company, 1995 (5) SCC 545: AIR 1995 SC 2372.*

[112] *Ibid.,*

usually contained in the CPC of common law countries, in India, the law on specific relief is contained in the Specific Relief Act 1963[113] and not in the CPC.

Specific relief is particularly significant for an outsourcing contract when a client needs a legal remedy to ensure that the supplier perform his contractual obligations. A monetary compensation is not adequate to cover for the damage done to an aggrieved party. If the service provider fails to comply with the contractual clauses, the reputation and business of the client could suffer and this type of damage cannot be compensated monetarily since the damages incurred may be irreparable which cannot be measured in monetary terms. Therefore it would be equitable for the client to seek the court to order the service provider to perform the outsourced contract services. In India, the Specific Relief Act 1963 spelt out the circumstances under which a contract is specifically enforceable.[114] However, there are limits to the use of specific remedy. Most of the time, specific performance becomes impossible as the party may no longer desire it, or it may not be of use, it is also difficult for the court to supervise an order of specific performance, that failure to comply with an order for specific performance may lead to charges of contempt and that it is too drastic a remedy in a civil action. Sometimes, the law generally encourages the parties to break the contract when the cost of its performance is greater than the value of performance.[115]

(C) Monetary Compensation as a Legal Remedy

Any claim for compensation (for loss or damage) for contract breach has been delineated under section 73 of the Indian Contract Act 1872. Only those loss or damage which naturally arose from such breach is to be compensated excluding any remote and indirect loss or damage sustained by reason of the breach[116]. The purpose of awarding damages is to compensate the non-breaching party for the gains that he may have obtained had the contract been performed. The common law has taken the approach that damages are the presumptive remedy for breach of contract. Under

[113] The Specific Relief Act 1963 replaced the Specific Relief Act of 1877 drafted on the basis of the New York Civil Code 1862.

[114] The Specific Relief Act 1963 spelt out the provision under which a contract is specifically enforceable as per section 10 of the Act and not specifically enforceable as per section 14 of the Act.

[115] See Pollock & Mulla, *Indian Contracts and Specific Relief Acts* (Vol 1 & 2), 2006, pp., 2422.

[116] Any loss on account of distress, vexation, mental agony or loss of enjoyment is not compensated under Indian act nor are punitive damages awarded for breach of contract but they are awarded in tort (Ghaziabad Development Authority v. Union of India, 2000 (6) SCC 113: AIR 2000 SC 2003).

section 62 of the Sale of Goods Act 1930, the parties to a contract can specify the measure of damages for breach in the contract itself or alternatively the parties may agree that in the event of a breach no compensation will be payable except for refund of amounts paid. Therefore in India, parties can exclude or limit liability for breach of contracts.

Under section 73 of the Indian Contract Act 1872, damages are calculated on the principal or whether they flow naturally from the breach or the parties know would likely result from the breach. The Supreme Court ruled that compensation, for breach of contract or for tort, should be given for the wrongful act and for all natural and direct consequences of the wrongful act.[117] The Supreme Court formulated two principles on which damages are calculated. The amount of damages cannot exceed the loss actually suffered by the claimant or which he is likely to suffer. This is the first principle which is to place the non-breaching party in the same position as he would have been in if he had not breached the contract. The measure of awarding damage in contract must be reasonable and proportionate to the benefit gained from its receipt in order to discourage economic waste. This principle is qualified by another principle which imposed on the plaintiff the duty to take all reasonable steps to mitigate the loss consequent on the breach and debars him from claiming damages if he fails to take such steps. According to section 74 of the Indian Contract Act 1872, two different kinds of damages may be stipulated in an outsourcing contract. One is a genuine pre-estimate of the loss which is 'liquidated damages' which is generally provided for in the contract in cases where it is not possible or difficult to measure the damage caused by a breach of contract. The party is entitled to claim such amount stipulated only.[118] The second measure of damages which is stipulated in a contract is a penalty. Hence, a court can either award liquidated damages or penalty depending on what is provided for in the contract. However, the amount awarded should be reasonable and should not exceed the amount stipulated in the contract. Both these awards differ in the manner of their functions as far as compensation is concerned. Pre-estimate of damages is the amount of money, which is specified in a contract to be awarded in the event of violation to

[117] *Trojan & Co v RMNN Nagappa Chettiar AIR 1953 SC 235.*
[118] *Sir Chunilal V. Mehta and Sons Ltd. v. Century Spinning and Manufacturing Co Ltd, 1972 Supp (3) SCR 549: AIR 1962 SC 1314.*

the terms of the agreement. A penalty is payment of money which is stipulated in the contract by the offending party and is clearly intended to be in excess of the amount.

The crucial difference between stipulating a clause for a penalty and a clause for liquidated damages is that if the contract provides for a penalty, the aggrieved party is still entitled to invoke the remedy of unliquidated damages which is not provided for in case the contract stipulates a clause for liquidated damages. According to the court, a party may be awarded liquidated damages even in the absence of actual loss or damages without proving the actual loss, which needs to be proved in case of a penalty. Stipulation in the contract for damages measures will make the award for damages less onerous. In Fateh Chand v Balkishan Das, 1964[119], the contract stipulated a penalty. According to the Supreme Court, the loss or damages suffered by the party in consequence of the breach committed by the defaulter had to be proved since the contract stipulated a penalty. In this case, the loss was not proved and the court held that compensation cannot be awarded.

This proposition was reiterated in the 2003 judgement of the Supreme Court of India in ONGC v SAW Pipes Ltd[120]whose contract also stipulated a penalty. When dispute arose and the matter referred to the arbitral tribunal, the latter concluded that the burden is on ONGC to prove that it has suffered a loss due to the breach. The plaintiff moved the Supreme Court who examined if the tribunal was right in holding that ONGV was not entitled to liquidated damages because it failed to establish the loss suffered. The court invokes sections 73 and 74 where parties complaining of breach are entitled to receive reasonable compensation (whether or not the actual loss is proved) to have been caused due to breach, the emphasis is on reasonable compensation and not proof of loss. It observed (following the Fateh Chand case),[121] the court found nothing on record that compensation contemplated by the parties was not reasonable and that the stipulated agreement was a pre-estimate of damages in case of breach and therefore not required for proof. Accordingly, the court set aside the award of the tribunal.

[119] *1964 (1) SCR 515: AIR 1963 SC 1405.*
[120] *AIR 2003 SC 2629: 2003 (3) Supreme 148.*
[121] *1964 (1) SCR 515: AIR 1963 SC 1405.*

3.8 Conclusion

In sum, conflict of law occurs at the international and domestic level and is exacerbated when enforcement of foreign judgement conflict with the statutory policy of a concerned country. International laws derived their legitimacy from international treaties and Conventions which endorsed arbitration as a standard legal practice of international commercial dispute resolution notably in emerging areas such as technology transfer, intellectual property, engineering and construction. Therefore it is much easier to enforce an arbitration award than a foreign judgement of a Court. So far no notable case of an Indian outsourcing firm resorting to an arbitration forum has appeared. Different conjectures have surfaced arbitration execution as a result of cumbersome procedural requirements vis-à-vis domestic law.

Arbitration award is not binding till both parties agree to the judgement. An arbitration award can be easily set aside if it is contrary to public policy. However, the advantage of an arbitration award is the possibility of a range of other remedies that can form part of the award, such as an injunction, an order of specific performance; order the payment of a sum of money etc. Though unusual, this may enable outsourcing firms to invoke arbitration proceedings to induce service providers and third parties to perform as per contractual obligations. This may to some extent mitigate opportunism and business hazards specifically breach of contractual obligation. Data breach is rampant in outsourcing though there is no reported case of major contractual disputes arising from outsourcing contracts. This has made it difficult to empirically study the magnitude of the damages which may be awarded by an Indian court in a suit of breach of an outsourcing contract.

Litigation in India is subject to protracted delay and a legal suit may lie pending for a long time. For an outsourcing firm such delays are a considerable waste and may discourage them from approaching the courts. At the same time, specific remedies/performance is an exceptional relief and unlikely to be available for breach of contracts. According to Aparna Vishwanathan, injunctive relief which prevents a service provider from disclosing confidential information, trade secrets or to prevent them from breaching the contract is likely to be the only available remedy on a practical basis. In the next section of our discussion we study the different legal mechanism of remedy availed by firms and corporations in India. This would provide us with hindsight of existing law and the need for changing some of them in tune with the changing times.

CHAPTER 4

LEGISLATION ON DATA PROTECTION AND PROCESSING - A CONTENTIOUS ISSUE

4.1 Introduction

In the previous section the discussion centered on the applicability of the proper law of contract in the context of contractual stipulations with particular references to Indian laws such as the Indian Contract Act 1872. We had discussed the relevance of the proper law of contract which is derived from private international law for contracting parties in two different countries. We had also contemplated how legal sanction is necessary to reduce contingent problems arising from contractual stipulations particularly in Outsourcing contracts while facilitating data transfer between countries. Legal problem arising from automatic data processing is essentially related to international and cross border flow of data. However, concerns are raised regarding the non-existence of a statutory data policy to facilitate smooth flow and processing of data between India and the rest of the world. The presence of a statutory regulating act would facilitate arbitration arising from contractual stipulation and enable the operation of foreign law wherever applicable.

Most countries of world have instituted data protection policies or statutory requirement one way or the other.[122] Data protection is seldom given priority in Indian jurisprudence given the absence of a statutory data protection act. Data protection is necessary to ensure that data are processed appropriately and accurately without infringing on the rights of the data subject. However, a step to meet this objective was initiated with the government proposing to amend the existing Information Technology Act 2000 which is to formulate proper procedure for data processing thereby ensuring data protection.[123] Prior to this, the IT Act was primarily meant for e-commerce and cyber crime related problems. In this section we would discuss legal

[122] Such as the EU Data Protection Directive or the UK Data Protection Act. The Information Technology Act, 2000 is considered outdated and lack enough teeth to counter the problem of data breach let alone assuring that data processing meet the objectives and purposes of protection and compliance in accordance with international regulation.

[123] A bill titled " The Personal Data Protection Bill, 2006" was introduced in the Rajya Sabha in December 8, 2006 which comprehensively outline collection, distribution and processing of personal data though its status is currently unclear.(Bill No. XCI of 2006)

framework on data protection with particular reference to the European Union (EU) Data Protection Directive. It is widely regarded as a comprehensive framework on data protection principles fundamental to cross border trade of data. Many other countries draw inspiration from this framework to set up their own data protection principles including India.

4.2 International Regulation on Data Protection and Processing

Different countries have expressed concern on the increasing data trade across border which needs to be regulated to ensure that they are not manhandled in unauthorized manner which may cause harm or unwanted inconvenience to the data subject. Different countries have therefore enacted different legislative acts which govern and regulate the flow of data- both internal and external. For example, The U.S follows the Safe Harbor policies which conform to the European Union Directive on data protection to assure compliance in data flow between them. The UK promulgated the Data Protection Act (DPA) which regulates data flow across the country. The underlying principle to the arrangement on data flow is the proportionality principle which regulates data processing, considering the amount, extent and purposes of data processing keeping the interest of the data subject.

(A) The EU Data Protection Directive 1995

In data processing a legal differentiation should be outline between 'data controller' and 'data processor'. The EU Data Protection Directive 1995 and the UK Data Protection Act unanimously concur that a 'data controller' is a person who determines the purposes for and the manner in any personal data. A 'data processor' means any person (other than an employee of the data controller) who processes the data on behalf of the data controller.[124] The EU Commission Decisions equates Data Controllers as Data Exporter and Data Processors as Data Importer.

The EU Data Protection Directive (1995) precedes the U.K Data processing and Protection Act 1998. We examine these two laws in an anecdote in our study of data processing. The EU Data Protection Directive (also known as Directive 95/46/EC) is a directive adopted by the European Union designed to protect the privacy and protection of all personal data collected of citizens of the EU and the

[124] Both the data controller and data processor can be an individual, group of individuals or organizations delineated in the standard contractual clauses as per Article 3 of the Directive 95/46/EC.

manner of processing, usage, or exchanging such data. This Directive encompasses article 8 of the European Convention on Human Rights, which states its intention to respect the rights of privacy in personal and family life. The Directive is based on the 1980 OECD "Recommendations of the Council concerning guidelines Governing the Protection of Privacy and Trans-Border Flows of Personal Data."

Article 25 of the EU Data Protection Directive, accords that the European Commission has the power to make findings that third country outside the European Union needs to ensure an "adequate level of protection" for personal data transferred from within the Member States of the European Union. The findings are binding on the Member States of the European Union, including the United Kingdom. It contains specific provision with relation to the transfer of data to a third country located outside the EEA. Article 25 (1) and (6) stipulate that adequate level of protection needs to be satisfied before data is transferred to a third country by reason of its domestic law or under its international obligations referred to as an adequacy findings in the Directive. In the absence of adequacy findings the data may still takes place if data subject consents to the transfer or the data controller is of the view that adequate safeguards are in place through the use of contractual clauses.

(B) The United Kingdom Data Protection Act (DPA) 1998

The Data Protection Act 1998 is landmark legislation in the field of data protection and processing. For the first time the UK Data Protection Act (DPA) applies to manually kept paper records and not only to those held on a computer. The Act covers all data systems either manually or electronically held, which have been initiated since October 24 1998. All other data processing which may have operated before October 1998 can benefit from a transition period up to October 2001, after which all systems must comply with the terms of the new Act.

Data processing covers wide meaning in the Act which includes obtaining, recording or holding information and the organization, alteration, retrieval, accessing, disclosure or even erasure or destruction of data, whether in a manual or electronic form. To process data, consent of the data subject is required but the EU Working Party describes four principles for processing data. The first principle specify that data should be processed for a specific purpose, the second mandated that data should be accurate, kept up-to-date and should be relevant, adequate and not excessive for which they are transferred or processed, the third principle makes data processing

transparent by providing the data subject with the necessary information, the identity of the data controller and other such information which ensures fairness except where such information proves impossible, the fourth principle is the most important which mandate the data controller to provide technical and organizational security.[125] None of the above principle found any place in Indian law.

Similar to the EU Directive, the DPA prohibits transfers of Personal data outside the European Economic Area, unless the destination countries possess an adequate level of privacy and data protection.[126] The DPA contains Eight Data Protection Principles which are binding on data controller.[127] These principles ensures that personal data transferred to a third country meets 'adequate level of protection' to ensure rights and freedom of data subjects in the processing of their personal data. There are several exceptions from the Eight Data Protection Principles numerated in Sch 4 to the DPA and article 26(1) of the Directive.

It is the Eight Principle which provides the exemption required for Transborder data flow. This exemption is applicable to outsourcing contract if the transfer is necessary for the performance of, or entering into, a contract between the data controller and a third party at the request, or in the interests of the data subject. Even if the outsourcing contract is not entered into at the request of the data subject, it is arguably in the interest of the data subject.[128] According to Vishwanathan, since most of the requirements do not comply with Indian laws, it is necessary to create a 'presumption of adequacy' for data protection to make data transfer to India legal under the Data Protection Directive to comply with the Eight Data Protection Principle. The method of creating a presumption of adequacy is through contractual solution as per article 26(2) of the Directive (including the Business Clauses) and corporate Privacy policies or Binding Corporate Rules (BCR) which we would briefly discuss in the next section.

---

[125] (see Vishwanathan, *Outsourcing to India, Cross Border Legal Issues*, Butterworths, 2008. pp., 337-338)

[126] Article 26 of EU Data Protection Directive gives the European Commission the power to decide certain standards and contractual clauses to safeguard data protection during the transfer of personal data to third countries (countries outside the European Union).

[127] UK Data Protection Act 1998, s 4(4)

[128] The EU Working Party and the UK Information Commissioner has interpreted this exemption to the effect that the data controller needs to show 'a close and substantial connection between the data subject's interest and the purpose of the contract'. If the connection is not established, the only method for ensuring adequacy would be the implementation of adequate safeguards such as contractual solutions or corporate privacy policies.

4.3 Contractual Solution or Model Clauses

Contractual solution outlines definitions and obligation of data controller/processor and the security measure to ensure data protection. These have been approved by the Commission for the transfer from controllers in the EEA to data controllers outside the EEA (controller–controller) as per Commission Decision (2001/497/EC) dated 15 June 2001,[129] transfers from data controllers in the EEA to data processors outside the EEA(controller-processor) as per Commission Decisions (2002/16/EC) dated 27 December 2001[130] and transfer from data controllers in the EEA to data controllers outside the EEA(business clauses) as per Commission Decisions (2004/915/EC) dated 27 December 2004.[131] The second Commission Decisions dated 27 December 2001 is particularly relevant to India where most of the Indian service providers are undoubtedly data processors.

The standard clauses must be contained in a written contract between the data controller and the data processor and under these clauses the data subject can enforce its rights against the data exporter/importer who is liable to the data subject for any breach. However, the data exporter can seek indemnity from the data importer (processor) if the breach was caused by the latter.

(A) The Second Decision Commission on Contractual Solution

The second Decision Commissions have set forth various definitions and obligations and security measures to be included in the contractual clauses of the data controller and processor. A brief discussion is necessary to understand the implication of these clauses on outsourcing contracts especially with relation to India. In the following we summarized the obligation and liability rights of the data subject as provided by the Second Decision Commission on Contractual Solution.

1 Obligation of Data Exporter and Data Importer

The data exporter is obliged to ensure that processing (including the transfer itself) of personal data is in accordance with the relevant provisions of the applicable data protection law after duly notifying the relevant authority where the data exporter

---

[129] OJEU L 181, 4 July 2001, 19-13 under Directive 95/46/EC

[130] *Ibid.*, L 6, 10 January 2001, 52-62 under Directive 95/46/EC

[131] Commission of the European Communities, Commission Staff Working Documents on the implementation of the Commission decisions on standard contractual clauses for the transfer of personal data to third countries (2001/497/EC and 2002/16/EC), p 7.

is established. The data exporter has instructed the data importer to only process data on its behalf and not anyone else. Complying with this provision, the data importer must agree that data is processed only on behalf of the data exporter. In addition, if the data importer is unable to comply with the instructions, he has to promptly inform the data exporter of his inability, in which case the data exporter is entitled to suspend the transfer of data and/or terminate the contract.

The data importer should have no reason to believe that legislation applicable to him prevents him from pursuing and complying with the instructions received, in which case the data exporter is entitled to suspend the transfer of data and/or terminate the contract. According to Vishwanathan, domestic laws and policies or the lack thereof, should not vitiate data importer to comply with this provision for ensuring data protection [132] The data exporter should provide sufficient guarantees in respect of technical and organizational security measures specified in the contract which are necessary to protect the personal data against accidental or unlawful destruction or accidental loss, alteration, unauthorized disclosure or access particularly when processing involves the transmission of data over a network and other unlawful forms of processing. In addition, it is expected that the data importer agrees to deposit a copy of the contract with the supervisory authority if so requested or if such deposit is mandatorily required under the applicable data protection law.

The data exporter needs to inform the data subject if data is transferred to a third country not providing adequate protection. Complying with this provision, the data importer has to implement the technical and organizational security measures specified in the appendix of the contract before processing the personal data transferred. The data importer shall promptly notify the data exporter if a legal request is sought for disclosure of personal data by a law enforcement authority unless otherwise prohibited such as prohibition under criminal law, it needs to inform of any accidental or unauthorized access and report to the data exporter if there is any request received from the data subject (without responding to it) unless the data importer has been authorized to do so. It is also required that the data importer should at the request of the data exporter submit his data processing facilities for audit which will be carried out by the data exporter or an inspection body (usually a third party), in

[132]Vishwanathan, *Outsourcing to India: Cross Border Legal Issues*, 2008, pp., 345-346.

agreement with the supervisory authority.[133] The absence of an inspection body and a supervisory authority under the Indian law makes it difficult for the Indian data importers to accept or meet this obligation.[134]

2 Rights of Data Subject and Liability

The contractual solution allows the data subject to enforce its rights against the data exporter who is liable for any breach to the data subject.[135] The following liability applies as per the Commission Decisions. The parties who has suffered damages as a result of any violation of the provisions to which his third party beneficiary rights extend is entitled to compensation from the data exporter. The Data subject can also enforce its right against the data importer.[136]

The data importer has to accept liability, where the data subject is not able to bring action against the data exporter because it has disappeared or ceased to exist or became insolvent; the data importer agrees that the data subject may issue a claim against the data importer as if he were the data exporter. This also means that if one party is held liable for a violation of the clauses committed by the other party, the latter, will to the extent to which it is liable, indemnify the first party for any cost, charges, damages, expenses or loss it has incurred.

Some of the provision of the DPA and the Directive principles are not easy to implement in India, for instance data subject possess no rights to compensation and third party beneficiary rights are not clearly provided under the Indian Contract Act.[137] It is difficult to impose liability on data importer (on behalf of data exporter) since the data subject does not have the right to bring any cause of action as per Indian law. In case of compensatory claims (including third party beneficiary rights) for damages, the data importer should accept the decision of the data subject to refer

---

[133] None of the Indian law or the IT Act 2000 provide for a supervisory authority for auditing and regulating the collected data or the manner of its processing.

[134] The proposed bill titled "The Personal Data Protection Bill, 2006" accords superintendence and adjudicatory jurisdiction over subjects covered by the bill (Data Protection Law in India, http://rajyasabha.nic.in/bills-ls-rs/2006/XCI_2006.pdf)

[135] The Data subject can enforce against the data exporter the following clause, Clause 4(b) to (h), Clause 5(a) to (e). and (g), Clause 6(1) and (2), Clause 7, Clause 8(2), and Clause 9, 10 and 11 as third-party beneficiary as per Commission Decision of 27 December 2001.

[136] Data subject can enforce against the data importer the following clause, Clause 5(a) to (e) and (g), Clause 6(1) and (2), Clause 7, Clause 8(2), and clauses 9,10 and 11, in cases where the data exporter has factually disappeared or has ceased to exist in law.

[137] Existing statutory provisions of the Information Technology Act 2000 does not stipulate rights to compensation or third party beneficiary rights. The IT Act 2000 protects privacy rights only from government action but it is not clear on protection rights against private actions.

the dispute to mediation, by an independent person or where applicable, by the supervisory authority or to refer the dispute to the courts in the member state in which the data exporter is established. Alternatively, both the data importer and the data subject can resolved a specific dispute by referring to an arbitration body if the data importer is established in a country which has ratified the New York Convention on enforcement of arbitration awards. It is difficult for a data subject to invoke a cause of action against the data importer in India when no such legal rights exist under Indian law.

The European Commission obliges that a contract should be governed by the law of the member state in which the data exporter is establish which also enables a third-party beneficiary to enforce a contract. Post-termination clauses requires that the data importer, at the choice of the data exporter, return or shall destroy all the personal data, copies and certify to the data exporter that he has done so. In case legislation prohibits the data importer from destroying or returning the data, it is warranted that he guarantees the confidentiality of the personal data transferred and actively stops processing the data.

(B) Third Commission Decision on Business Clauses

Despite the above standards which were expected to be followed, the EC realized that it was not as expected as most data controllers simply ignore implementing them. The EC then entered into a negotiation with representatives of data controllers which led to the so called 'business clauses' supported by data controllers and induce data controllers to comply with these standards to legitimize international data transfers.[138] The 'business clause' as per Decisions of 27 December 2004 applies to transfers from data controller to data controller and came into force on 1 April 2005.

Since then the data exporters and importers can choose between two different sets of model clauses, one for controller-to-controller and the other for controller-to-processor (discussed above). The business clauses laid down certain obligations for the data exporter and data importer. The presumption underlying these clauses is that

[138] Commission of the European Communities, Commission Staff Working Documents on the implementation of the Commission decisions on standard contractual clauses for the transfer of personal data to third countries (2001/497/EC and 2002/16/EC), p 7. The business clauses complement the two sets of clauses adopted in the Decisions of 15 June 2001 and 27 December 2001.

data controllers are more equipped and more likely to protect privacy rights of data than data processors.

The business clauses applicable to controller-to-controller transfers are much less onerous than those imposed on the data exporter in the 27 December 2001 standard clauses applicable to controller-to-processor transfers discussed above. For example, there are no provisions requiring the data exporter to provide sufficient guarantees in respect of technical or organizational security measures nor is there any obligation of the data exporter to state that the security measures are appropriate to protect personal data against accidental or unlawful destruction or accidental loss, alteration, unauthorized disclosure or access particularly if processing involves transmission of data over a network, and against all other unlawful forms of processing. Therefore, while the obligation for the data exporter is more lenient and therefore more controller friendly, the ones for the data importer are not substantially different from the obligations of the data importer specified in the Commission Decision of 27 December 2001.

The Business Clauses deviates from the other two clauses by providing an option for the data importer to select a third party data controller provided it becomes a signatory to the clauses and agreeing that data subject may object such transfers by third party controllers unless consent was given for such transfers. The third party while processing data must comply with a Commission Decision that such a country where it is established, provides adequate protection. This option for third party data controller is most likely to be accepted by service providers as it will be easy and practical for such third party service providers to also accept the standard clauses.

The Business Clauses also set forth the liability of the data exporter and the data importer to data subject, third parties and third party beneficiary rights. The data exporter and the data importer would be liable to the data subject if there is a breach in contractual obligation. The data exporter would be liable for not using reasonable efforts to determine that the data importer is able to satisfy its legal obligations and the data subject can take action against the data exporter for such failure. Liability is limited to actual damage suffered precluding punitive damages.

The Business Clauses also recognized the rights of third party beneficiaries of a data subject where the data exporter and data importer would be liable for any contractual breach. In case of breach, the data subject can enforce his rights directly against the data importer if the data exporter refused to take action against the data

importer after the data subject request for such an action. Thus the data subject can directly enforce its rights against the party responsible for the breach which will be difficult for an Indian service provider to accept considering that data subjects do not posses rights as per existing Indian laws. In case of disputes, the Business clauses reiterate non-binding mediation procedures and submission to the jurisdiction of the courts of the data exporter's country which are similar to the earlier Commission Decisions. The business clauses thus provides greater flexibility to comply with data protection law, however data transfers based on these clauses can more easily be suspended than those based on the earlier two set of model clause.

4.4 Alternative to Contractual Solutions: The Binding Corporate Rules (BCR)

An alternative to contractual solutions is the implementation of corporate privacy policies also known as Binding Corporate Rules (BCR). These are internal codes of conduct which are designed to enable data transfers between various offices of the multinational corporation which are located outside the EEA applicable only to intra-group transfers precluding transfers outside the corporate group. Such transfers are made on the basis which ensures adequate safeguards of the rights and freedoms of data subjects (which do not violate the Eight Principle of the DPA and article 25 of the Data Protective Directive). Corporate group applying for BCR, after receiving the authorization from the Information Commissioner, needs to comply with a model checklist[139] and demonstrate that the required safeguards are in place within the organization such as details for an audit plan, description of processing and flow of information etc.[140] In case a multinational company wishes to get the BCR approved in order to export data outside the EEA, a mechanism is available in which one data protection authority co-ordinate the authorization process from the data protection authority falling under European jurisdictions in which the company does business.

The BCR recognized that data subjects are third party beneficiaries of the legal effects of these unilateral undertakings. It allows data subject to enforce compliance with the rules by lodging a complaint before the competent data protection authority. Where unilateral declarations cannot be considered as granting enforceable third party beneficiary rights, the corporate group have to put in place the necessary contractual

---

[139] Devise by Article 29 Working Party (WP 108) "Establishing a Model Checklist Application for Approval of Binding Corporate Rules' 05/EN WP 108-adopted 14 April 2005.

[140] (See detail in Vishwanathan, *Outsourcing to India, Cross Border Legal Issues*, LexisNexis Butterworths,2008, pp., 361)

arrangements which would give rise to third party beneficiary rights under local contract law. The implication of the above contractual clauses on an Indian service provider is clearly demarcated.

If the Indian service provider fulfills the requirements of a data processor, it can have the option of choosing the clauses intended for data transfers from data controller to data processor as per the Commission Decision dated 27 December 2001. If on the other hand, it qualifies as a controller (if it determines the purpose and manner of the processing), then the parties have the choice of including either the standard contractual clauses provided in the Commission Decision dated 15 June 2001 and/or the so called Business Clauses as per Commission Decision dated 27 December 2004. The company can replace contractual clauses by adopting the Binding Corporate Rules authorized by the concerned data protection authority. Though India does not possess a data protection legislation act, these contractual safeguards ensure data transfers from Europe do not violate the EC law which explains why outsourcing in India perseveres.

4.5 Data Protection in India

India is considered a business hub for outsourcing in the world and this has been corroborated by different studies capturing the trend of "outsourced work" to India which has diversified from Billing, Human Resources and different forms of customer services which, in one way or the other, are engaged in data processing on behalf of the client. Despite projecting itself as a favored destination for Outsourcing business, the callousness of the Indian law makers to enact a data protection statutory act is allowing other countries such as Korea, New Zealand, Hong Kong, Philippines, Malaysia.etc to edge past India on data protection and privacy legislations.[141]

(A) The Information Technology Act 2000

Unlike the EU or UK, which possess a specific legislation to data protection and privacy, none of it exists in India. Data protection and privacy rights have been interpreted time and again from four component sources in India. They are the

[141] Keong, Lee Min, 'Data Protection Laws vital for Outsourcing hubs', http://www.zdnetasia.com/news/security/0,39044215,62055879,00.htm

Constitution of India,[142] Judgements of Supreme Courts,[143] Indian Contract Act 1872 and the Information Technology (IT) Act 2000. The discussion in the following is devoted in examining the only piece of legislation in India, the IT Act, the content of which is relevant for data protection and processing. While Privacy rights are enforced under the Indian Constitution and the IT Act 2000, the Indian Contract Act 1872, the Copyright Act, 1957 and the IPC 1860 protects property rights. The IT Act was enacted by the Indian Parliament and received the assent of the President on the 9th June, 2000 and is effective from 17th October, 2000. This Act is based on the Resolution A/RES/51/162 adopted by the General Assembly of the United Nations on 30th January, 1997 regarding the Model Law on Electronic Commerce earlier adopted by the United Nations Commission on International Trade Law (UNCITRAL) in its twenty-ninth session.

(B) The IT Act is meant for E-Commerce and not Data Protection

The primary objective of the Information Technology Act (IT Act) 2000 was to introduce electronic/digital signatures into Indian law through asymmetric cryptography technology and ensure that electronic documents were given the same legal weights as traditional paper documents. Personal Data has not been defined in the IT Act. The IT Act however defines certain term under various sections[144] The IT Act provides no procedural law vis-à-vis data processing.[145] The Act does not contain any provisions which protect the handling and storage of data by anyone except the authorities created under the Act.[146] Known as Certifying Authorities they issue digital signature certificates and maintain all the database of public keys available to

---

[142] "Privacy" is not a subject in any of the three lists in Schedule VII of the Constitution. But Entry 97 of List I (Union List) states: "any other matter not enumerated in List II (State List) and List III (Concurrent List)..." Thus only the Parliament is competent to legislate on privacy since it can be interpreted as any other matter not enumerated in List II and List III. The Constitution of India has also embodied Rights in Part III called Fundamental Rights and enumerated in Article 14-30.

[143] Judgement of the Supreme Court of India has articulated that 'protection of privacy' as one of the features of the Fundamental Rights (Article 21- Life and Liberty). Judicial Activism has also brought the Right to Privacy within the realm of Fundamental Rights. As per Article 141 of the Constitution the decisions of the Supreme Court becomes the Law of the Land.

[144] The IT Act defines Information under section 2(1) (r), Data under section 2(1) (o), Computer Database under section 43, explanation (ii), Electronic Record under section 2(1) (t), Computer Resource under section 2(1) (k).

[145] The Act has limited practices relating to accessibility, retention and retrieval of electronic record under Section 7.

[146] The Act empowers the Central Government to appoint a Controller of Certifying Authorities who supervises the activities of the certifying authorities. These authorities have been accorded the status of Data Controllers under section 7 and the onus is on them to fulfill statutory conditions to retain electronic records.

the public, after they are satisfied that the applicant holds the private key corresponding to the public key listed in the digital signature certificate.

This preoccupation with electronic signatures has led to criticism that the IT Act did not possess sufficient teeth to prevent the increasing menace of cyber crime, identity theft and data breach. This shortcoming of the IT Act is also manifested through the failure of IT/ITES to curb the menace of identity theft, fraud and breach of personal data. In this section we contemplate on why the proposed draft is hostile towards liability claims such as compensation when privacy is breached or violated. The underlying principles of the draft seem to be criminal oriented rather than civil. This may forebode ill for legal remedy as far as privacy on data is concerned.

The government had set up an Expert Committee in January 2005 headed by the IT Department secretary Brijesh Kumar. The committee has been asked to re-examine the IT Act to ensure that it remained an enabler for development of information and communication technology. Adequate measures for promoting growth of electronic commerce and governance and for regulating cyber crimes and cyber forensics are to be the other focal points. The committee will also scan whether the Act addresses all aspects of cyber security in a manner that there is no scope for different interpretations and follows the international guidelines for uniformity. The committee will also consider the recommendations made by the inter-ministerial working group on cyber laws and cyber forensics and finalized the amendments to the Act. Legislation for data protection (privacy) and consideration of the feasibility of making the Act technology-neutral are among the terms of reference. Other considerations include regulation of cyber cafes and blocking of websites and India signing the European Cyber Crimes Treaty would be part of the agenda. The need for setting up of the committee was felt due to deficiencies in the Act and suggestions received for further improvement from professional bodies, institutions and other stakeholders such as the FICCI.[147]

4.6- Proposed Amendment in the IT Act

The proposed amendment of the Act will address concerns relating to electronic signatures, data protection, obscenity in electronic form and identity fraud and privacy which are important legal issues confronting the outsourcing industry

[147]Shubhendru Parth. The MMS Conundrum, http//dqindia.ciol.commakesections.asp/05011301.asp

today. The proposal, which if made into law, signifies a landmark achievement for India in the field of technology. For instance, the proposed amendment will accord electronic records legal recognition and the same recognition is given to digital signatures that is, digital signatures are given the same legal status as handwritten ones. The purpose of the Act is to comply with the UNCITRAL Model Law on Electronic Commerce (the Model Law) which does not exclude any specific types of transactions from its purview, unlike the IT Act 2000 which prohibits attaching electronic or digital signatures to legal documents such as power of attorney, trust, will and any contract for the sale or conveyance of immovable property.[148]

The IT Act confers technological regulatory mechanism such as the encryption system also known as the 'public key/private key' system to be used for digital signatures. Critics see this as undermining other technological authentication record which evolves over time by relying on one particular technology i.e. asymmetric cryptography. The bill therefore proposes replacing the concept of digital signatures with electronic signatures in an attempt to make the Act technologically neutral which will allow development of new technology for authentication records. This will also avoid amending the Act each time a new technology emerges. The IT Amendment deleted the expressed reference to the public/private key system which automatically removes reliance on asymmetric cryptography for validation of digital signatures.

(A) No Recognition for Privacy Rights in the IT Act

The IT Act does not create any privacy rights in data.[149] Neither is there provision for a cause of action for disclosure or other misuse of data.[150] India has not adopted the OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data 1980 and therefore none of its content principles or procedures requirements is enshrined under any Indian law. Constitutional interpretation of

---

[148] The Act also proposes that any information contained in an electronic record which is printed on paper, stored, recorded or copied in optical or magnetic media produced by a computer is admissible in any proceedings as evidence of the original documents. Therefore under the Act provided that it is no longer necessary to produce the original of a paper document in the transactions to which a digital signature may be affixed. This will require amending the Indian Evidence Act 1872 (Vishwanathan, *Outsourcing to India, Cross Border Legal Issues*, LexisNexis Butterworths, 2008, pp., 289-290)

[149] The Supreme Court has construed the 'right to privacy' as part of the Fundamental Rights under Article 21 of the Constitution and reiterated the Right to Privacy in many cases such as the *R. Rajagopal v State of Tamil Nadu (AIR 1995 SC 264), Kharak Singh v State of UP (AIR 1963 SC 1295).*

[150] Section 43 (a) and (f) of the IT Act allows compensation for infringements on unauthorized access, downloading, damages etc against the wrong doer. The Act only provides protection under section 66 & 72 against 'hacking' and 'breach of privacy & confidentiality' respectively.

privacy rights by the Supreme Court have not been restricted to disclosure of personal information of which the *Kharak Singh v State of UP*[151] and *Rajagopal v State of Tamil Nadu*[152] are seminal example.

In the *Kharak Singh,* the Supreme Court strike down on the domiciliary visits by the police as unconstitutional for abridging the fundamental right to life under article 21 of the Constitution. In the *Rajagopal,* the right to privacy of article 21 is reaffirmed but where information is a matter of public record, the right to privacy cannot be claimed. Interpretation of article 21 has extended to medical and financial records where the courts have recognized that the right to privacy may apart from contract also arise out of a particular specific relationship for instance the doctor-patient relationship.[153] However, constitutional rights to privacy can normally be claimed only against the State or State-owned enterprises and not against private individuals or establishments.[154] The absence of privacy rights in Indian law has its bearing on data protection and processing. Privacy rights is a fundamental principle in data protection, however, the IT Act does not recognize privacy protection as intrinsic to data protection. A civil law would protect privacy rights more effectively than criminal law. Since property law is part of civil law, it permits liability claims under tort laws such as compensation and would encourage an injured party to seek amends in court such as damages or an injunction.

(B) Violation of Contract and Personal Information

Since there is absence of data protection legislation in the country and s 72 of the IT act protects confidentiality only to acts by the certifying authorities of digital signatures it is therefore proposed that a new s 72A will make it a crime to disclose information in violation of a contract making it a punishable offence. The propose s 72A will make disclosure of personal information a criminal offence giving rise to imprisonment and penalty[155]. Hacking is a criminal offence tried under s 66 of the IT

[151] *AIR 1963 SC 1295*
[152] *AIR 1995 SC 264*
[153] (For detail see Vishwanathan, *Outsourcing to India, Cross Border Legal Issues*, LexisNexis Butterworths, 2008, pp., 318-326)
[154] Under Criminal law, the offense is against the state and the state is the plaintiff, and incarcerate an offender if found guilty.
[155] The penalty for such is imprisonment up to two years and/or fine up to INR 1, 00,000 under section 72 of the IT Act. The proposed Act makes anyone in breach of a lawful contract, including an intermediary, who has secured information with the intent to cause wrongful loss or wrongful gain is

Act.[156] Under s 66, whoever with the intent to cause or knowing that he is likely to cause wrongful loss or damage to the public or person destroys or deletes or alters any information residing in a computer resource or diminishes its value or utility or affects it injuriously by any means, commits hacking. In the *Abhinav Gupta v State of Haryana*[157], the petitioner seeking anticipatory bail, was found transferring unauthorized data from his previous employer, by hacking, through email which include confidential drawings.[158] The court dismisses his plea on ground that it will hamper the investigation of the case.

Under the new s 72A, the prevalent practice of selling databases would become a statutory offence as in the case of *Nivedita Sharma v Bharti Televentures and ors.*[159] Indian courts have only addressed the issue of rights to privacy in personal data only in the context of the consumer protection laws. The most significant of these judgements is the *Nivedita Sharma v Bharti Televentures, ICICI Bank Ltd, American Express Bank Ltd and Ors.*[160] The complainant who is a customer with Bharti Televentures initiated litigation before the Consumer Commission under the Consumer Protection Act, 1986 against Bharti Televentures, ICICI Bank Ltd, American Express Bank Ltd for harassment due to constant calls from various banks and financial institutions telemarketing their products and services through sale of her personal data. The commission observes that such call "interferes with the right to privacy of the complainant"[161] as well as causing financial loss. The Commission concluded that cellular service providers are jointly and severally liable for exchange/sale of data and is in complete violation of the terms and condition of the contract. However, the Consumer Forum still permits trading of information by a service provider with a business relationship.

Thus data trade is permissible as long as the relationship is business related which is not a foolproof measure to insulate breach of information. Though, the Consumer Forum has taken a bold decision, it has not resonated into legal discourse in favor of a statutory policy on data processing and protection partly because it

---

subject to punishment with imprisonment for a term of two years or/and with a fine up to INR 5,00,000 under section 72A.

[156] Hacking under s 66, tampering with Computer source code under s 65 and breach of confidentiality and privacy under s 72 are serious offences and invites criminal prosecution.

[157] *MANU/PH/0790/2008.*

[158] *Ibid.*, para 2

[159] 2006 Indlaw SC Del 69.

[160] *Ibid.*,

[161] *Ibid.*, para 30

remain a precedent only within the ambit of consumer forum. Privacy infringement is a matter that needs to be treated with paramount importance and is certainly more than what a consumer forum could deliberate considering that privacy infringement is rampant particularly in market transactions of different kinds.

Until now, a client providing data base to its Indian service provider could only rely on contractual provisions to prevent the service provider from transferring the data to a third party. The new bill therefore proposed that companies pursuing such malpractice of selling database would be prohibited as a violation of contractual requirements under s 72A. The weakness of the proposed amendment is that the act implicitly applied that a person who has been wronged has no recourse whatsoever by making the disclosure of personal information a criminal offence rather than a civil offence. Criminal conviction for breach of data is more difficult in India as it is subject to delay and this would make it harder for judges to send an accused to prison term for data violation which is not a serious offence under the IPC. Criminal law requires a higher burden of proof than a tort law before dispensing penalties which also cause unnecessary delays.

Disclosure of information should be made a civil offence which gives a right to compensation to the person whose information is disclosed. The use of terminology wrongful loss or wrongful gain effectively limits privacy rights of individuals under the proposed s 72A. The violation of privacy rights does not necessarily lead to monetary loss so therefore it is unclear what constitutes 'wrongful losses'. Also the propose s 72A imposes a mens rea requirement of criminal statutes in that it requires an intent to cause wrongful loss or gain. This is remarkably different from tort laws where privacy protection does not require intent to cause loss. Tort under negligence does not require the intent to commit a wrongful action; instead the wrongful action is sufficient to constitute negligence.[162] This may prove useful while disputing cases on data protection and privacy infringement. Moreover, the Act provided that Officers are not liable to compensate the person damaged by the disclosure though the onus is on them to maintain confidential obligations. This liability is shifted to an Indian service provider, acting as an intermediary which receives and transmit data/information, is liable for any known misuse of information or data or for not exercising due diligence to prevent the offence.

[162] (Rieksts Mark, 'Landmark Cases in Tort Law', www://acjnet.org/Downloads/documentloader.ashx?id=3506)

(C) Absence of Rights to Access data

Contrary to the EU Directive or the DPA 1998, the IT act does not consider the individual's right of access to data equally important to be made in to law such as the right to access and rectification of incorrect Personal Data.[163] This right is implicit to rights of privacy of the data subject. This is significant because without this right the individual is disable to seek information from a data controller or access to his database regarding the manner of processing, the purpose(s) for which data is held, the duration of storing data and maintenance of data.[164] Such statutory provision will enable the data subject to complain or file a cause of action against the data controller or importer resulting from a contractual breach. Right to access will also enable the subject to take corrective measures for incorrect information on his database particularly data that are sensitive.

Since the IT Act did not contain definition of sensitive personal data, it propose protection of sensitive personal data with a new s 43A empowering the central government to provide for a reasonable security practices and procedures for sensitive personal data or information. The act confers on the government the right to prescribe reasonable security practices and procedures. Sensitive personal information has been defined as 'such information as may be prescribed by the central government in consultation with such professional bodies or associations as it may deem fit'. The central government also reserves the right to prescribe reasonable security practices and procedures. According to Vishwanathan the bill unfortunately does not provide meaning to the phrase 'reasonable security practices and procedures' but rather defer this to a contractual agreement between the parties or any future law. The act through s 43A also specify that if a corporate body who is processing, dealing or handling any sensitive personal data or information in a computer resource which it owns, controls or operates, is negligent in implementing and maintaining reasonable security practices and procedures and thereby cause wrongful loss or gain to any person will be liable to pay compensatory damages not exceeding INR 50 million to the person affected.

---

[163] The UK Data Protection Act 1998, s 7, provides a basic right of access to individuals seeking information form a "data controller" upon a written request for information on whether personal data of which the individual is the data subject are being processed on behalf of the data controller.

[164] The EU Working Party requires local law to provide data subjects rights to access data and to rectify data that are inaccurate. It also allows data subject the right to object to the processing of their data except in certain cases provided in article 13 of the EU Directive.

(D) Provision against Obscenity and transmission of such data

The act revised sections 66 and 67 to create new criminal penalties for obscenity in electronic form intended to conform to the provisions on obscenity in the Indian Penal code 1960 following the *Avnish Bajaj v State.*[165] The petitioner, Mr. Bajaj, asked the court to annul his criminal prosecution for offences of making available sale of obscene product under s 292 of the IPC and s 67 of the IT Act. The court grants bail to Mr. Bajaj and held that the charges held under the s 292 of the IPC is not applicable to the petitioner as "a Director of a company or an employee cannot be held to be vicariously liable for any offence committed by the company itself'.[166] However, a prima facie case is made out against the petitioner under s 67 r/w s 85 of the IT Act which enables the prosecution to continue.[167]

With the prosecution now being limited to the Information technology Act, the safe harbor provisions of the act can be impleaded as the Information Technology Act of 2000 relieving Mr. Bajaj of all liability by the good faith and due diligence defenses.[168] However, the extent of safe harbor provision allowed under the Act is limited due to ambiguity in the definition of 'intermediary'. The extent of safe harbor is also limited only to this act leaving intermediaries vulnerable to civil and criminal liability flowing from the provision of other enactments. The Expert Committee proposes amendments in the IT Act which would conform to the U.S Safe Harbor privacy principles. It proposed to remove ambiguity in the definition of intermediary and the substantive provisions of safe harbor as per s 79 to extent the exemption from liability. The proposal of the new draft is to formulate one liability regime applicable to any infringement, whether it is copyright, defamation or privacy rights is commendable.

Besides, a new s 66A will make it punishable with imprisonment to any person who sends either through a computer resource or a communication device a content that is offensive or any content which he knows is false, for the purpose of causing annoyance, inconvenience, danger, obstruction, insult, injury, criminal intimation, enmity, hatred or ill-will, by persistently making use of computer resource or communication device. Section 67A makes it punishable with imprisonment up to

---

[165] 2004 Indlaw Del 711.
[166] *Ibid.*, para 18
[167] *Ibid.*, para 22 (e) and (f)
[168] Chapter XII, Section 79 and Chapter XIII, section 85(1) of the IT Act 2000.

five years and a fine whoever publishes explicit act or conduct through electronic transmission.

The Indian Penal Code is to be amended to include a new s 417A for addressing identity theft by making it punishable with imprisonment to any person who cheats by using the electronic signatures, password or other unique identification feature of any person. A new s 419A makes it punishable for any person who impersonates (electronic impersonation) by means of any communication device or computer resources. This clearly indicates that transmission of obscene data is liable under criminal proceeding leaving little scope of availing amenities under civil or tort law. The draft proposal seems to favor criminal proceedings for breach or violation of data or faulty and unauthorized data processing rather than civil approach for legal remedy (Vishwanathan, 2008).

(E) - Provision against Copyright Infringement

Processing of data in outsourcing contracts involves handling, creating and development of databases which constitute intellectual property rights such as copyrights. The advent of the internet not only provides new trademark and branding opportunities for conducting business globally but created different kinds of intellectual property rights (IPR) infringement and disputes. A statutory policy with statutory legal remedy will not only act as a deterrent but also ensure that user's data and rights are protected from privacy encroachment on the internet. On both count, the IT Act 2000 is abysmally weak in providing effective protection and assurance against intellectual property rights infringement. The IT Act does not provide for liabilities against online copyright infringement nor is it a part of the proposed amendment to it. Ironically, it was for this purpose that the proposed draft seeks to make changes to issues relating to electronic contracts, e-commerce frauds like phishing, protection of intellectual property rights on the internet etc.

Copyright law in India is embodied in the Copyright Act 1957 (Copyright Act) and amended by the Copyright (Amendment) Act, 1994. India is a member of the Berne Convention and the Universal Copyright Convention Registration of copyright may act as a prima facie proof of the copyright; therefore it is advisable to register a copyright. Copyright not only protects the original work of an author, it also provides protection to the original expression of ideas and not the idea itself. Section 2 (0) of the copyright Act defines 'literary work' to include tables and compilations, including

computer databases, expressed in words, codes, schemes or in other form, are entitled to copyright protection. The IT Act under section 43(a) provides for liability to pay damages for any "downloads, copies or extracts any data, computer data base or information from such computer, computer system or computer network".[169] Therefore the databases created by outsourcing service providers for telemarketing, BPO or otherwise, are entitled to protection as literary works. Copyright does not only protect the original work and expression of ideas but also protect infringement of similar work by the accused and the work copyrighted, and that similarity must have been caused by the infringer 'copying' the copyright owner's work.

In the Burlington Home Shopping Pvt. Ltd vs. Rajnish Chibber,[170] the plaintiff seeks interim injunction to restrain the defendant from using its data base which is a compilation of the addresses of clients/customers. The defendant has infringed on the petitioners database which is a list of clientele/customers database.[171] The plaintiff, plea that it owns the database, is an original "literary work" and therefore owns the copyright under the Copyright Act 1957, s 2(6). The court is of the view that any compilation amounting to literary work implies that the author has a copyright including the "compilation of addresses developed by anyone by devoting time, money labour and skill".[172] The court found 'circumstantial evidence' of the defendant having indulged into slavish imitation of plaintiff's original compilation, making out a clear case of copyright infringement. The Copyright Act is considered as one of the best in the world but so far copyright infringement in outsourcing is limited and it remains to be seen how far the Copyright Act can facilitate solution if the need arise particularly with rising online copyright infringement.

4.7 Conclusion

To sum up, Contractual obligation is not necessarily the best effective remedy for clients to rely on for ensuring that data transferred is protected and preserved as committed. In the event of a breach, legal remedy under contractual obligation is problematic and time-consuming. Legal remedy as suggested by the IT Act is biased towards criminal proceedings to restrain harms caused to others, implicitly implying

---

[169] Chapter IX, Section 43(a) of the IT Act 2000.
[170] *MANU/DE/0718/1995.*
[171] The petition seeks an interim injunction under the CPC 1908; Order 39 Rule 1 & 2 as permission to use the data base may cause irreparable injury.
[172] *MANU/DE/0718/1995, para 12.*

that criminal law is justified. The Act restricts the operation of tort laws which maybe more appropriate for the data subject to access with the assurance that he would be compensated for the harm caused. However, this research proposes that an appropriate statutory protection with stipulated statutory penalty, damages and other remedies would act as a good deterrent against data breach. A statutory data protection act would address problems relating to third party rights and legal remedy including compensation for infringement on data. A data protection statute needs to complement the contract law not subjugate it through reforms that are more criminal in nature.

The IT Act did succeed in creating dramatic changes by recognizing electronic records as legal and prohibits the disclosure of personal information making it a statutory offence with imprisonment and penalty. However the bill fails to provide prescription relating to the handling and storage of data. Breach of personal data is not regarded as grave (and is not an actionable claim) an offence as much as the requirements to show wrongful loss or gain or breach of contract without consent. Here, the act discriminates a breach of personal data from a contractual breach.

The provisions on the handling of sensitive personal data lack substance since neither the term 'sensitive personal data' nor 'reasonable security practices and procedures' are defined leaving this at the discretion of the central government. Other provisions of the act such as prevention for obscene and explicit material as well as electronic impersonation are all cast as crimes under the Indian Penal Code 1860 which leaves their implementation in the hands of the criminal justice system. There are other grey areas which in the Act which is of concern and needs special attention such privacy and data protection on the internet, clarity regarding the liability of network service providers etc. It seems that the IT Act is moving to a direction of compartmentalizing all forms of data breach or unauthorized data access under criminal jurisdiction.

A legal regime such as the IT Act should be abreast with the latest development taking place in the field of technology. Technological acceleration requires constant updates on statutory provision. The existing Act is fraud with loopholes since many issues do not find express solution in it such as online copyright infringement due to proliferation of ISPs. Internet is freely accessible today than ever before, and presents a challenge for lawmakers to identify who is communicating with

whom.[173] The proposed amendment to the existing Act will not succeed in creating privacy rights and regulating data processing, handling and disclosure of data on the lines of the EU Data Protective Directive or the UK DPA 1998.

[173] The use of publicly accessible terminals such as internet cafes, public libraries, terminals at airports, hotel lobbies and Wi-Fi "hot spots" makes data online infringement easier and difficult for law enforcers to contain.

CHAPTER 5

CONCLUSION

The central framework of this research focuses on outsourcing as an important strategy in modern business arrangements. Outsourcing has proliferated in different areas of technology and services sector buoyed by market forces such as liberalization, technological revolution as well as government support such as tax free benefits (as in the United States) and domestic infrastructural investment such as special economic zones (SEZs) in India. Outsourcing is an aberration from the traditional business strategy of vertical integration and market structure for exchange transaction. This unconventional business alignment has altered the firm's objective in meeting profit maximization through cost saving strategies which outsourcing offer immensely. Outsourcing is mostly cross-border investment which is facilitated with the advent of technological revolution in telecommunication and now the internet enabling the firm to conjecture new methods of exploiting more effective cost savings strategy.

Implicit to this arrangement is the enormous transaction of data whose volume has only increased in the recent past as more firms and corporations outsourced more business units to India and other countries. Contemporary problem on contract formulation occur basically from technological dynamism coupled with a changing business paradigm which has made contractual formulation more challenging. The boundary of the firm has been frequently tested by these changing paradigms one of which is outsourcing. Firms are abdicating internal management of cost through integration and choosing instead contractual arrangement for investment and incentives.

At the crux of this research is the formation of contract to ensure compliance and regulation on security measures to safeguard sensitive data. Contracts are not perfect and in most cases incomplete due to various contingency factors which are impossible to contractually specify ex ante. In the spectrum of governance structure of the firm, contract is one part of it, the other being the market and vertical integration. Contracts possess an advantage as it affords protection against opportunism by initiating market-based incentives. Thus the focus of this research is on contracts as a device to

protect data by specifying ownership to one of the contracting parties. The law through legal enforcement provides convenient mechanism for property rights to operate through the contract. The decomposition of property rights through contracts is a convenient expository device to assist us in understanding property rights in Outsourcing contracts.

Another theme of this research is to approach contractual rights from the perspective of property law. Property rights of an asset are clearly demarcated when ownership is delineated and verified. A contract enables this demarcation to be structured through contractual clauses. Law facilitates the enforcement of contracts but it also provides legal remedy for breach of contractual clauses. However, Indian law has been compartmentalized to include breach of contracts as criminal offences which does not provide scope for the development of civil and tort laws in an emerging area such as the IT and ITES. There is a need to demarcate the line in the application of criminal laws as opposed to civil and tort laws in data privacy.

This research endorsed the generally accepted view about incomplete contract, that theories on complete are not complete. Traditional contract theories focus on unforeseen contingencies which are not describable and hence difficult to specify during contract formulation. Problems of bargaining ex post are costly as one party may not have equal share in the surplus due to opportunistic behavior of the other party. In such case, contracts needs an enforcing agency such as a court which can legally enforce contracts either by mandating the parties to abide by the agreements or by mandating terms for the contracts. The role of the court is important for contract enforcement but is costly to litigate for disputing parties.

Contractual formulation is facilitated through a governance structure which can minimize transactions costs and preclude opportunism and other contractual hazards from occurring. The law takes various forms and its objective should be to reflect as closely as possible liability where transaction costs are minimized (Coase, 1960). The governance structure has change dramatically from reliance on markets to create strong incentives, to integration for internalizing value of transaction-specific investments to contractual arrangement to protect investments and create market-like incentives. The firm is in constant search for an appropriate governance structure which minimizes costs such as those we have discussed in chapter 1 and 2 of this research. As long as bounded rationality and opportunism perseveres, governance structure will evolve and so would the firm's ability to cope with these challenges.

The challenge for the law is in verifying claims on rights. The law can only recognize certain rights once it is satisfied that such rights, once enforced, are socially beneficial. According to Haansman, verification hinders creation of rights particularly when ownership is transferred to third parties since the underlying principle of property law is that property rights of an asset is held by a single owner. A partitioning of rights is possible only if adequate notice is given to the person affected by such partitioning which is costly as it entails regulation for establishing different types of property rights. Contracts possess an inherent advantage on claims of assets since it acts as the principal means of verification.

Contract law allows deviation from standard forms through the use of a contract which is binding between two contracting parties. By deploying the contract, property law allows the establishment of rights since the contract becomes the principal means for verification. Since the law enforces the contract, ownership rights are protected through the contract. Contracts could contain clauses describing property rights and those clauses would not only be binding but ensure that rights are protected. This research emphasized how important contracts are for protecting rights during data processing in outsourcing contracts.

The law makers need to adapt and amend existing laws to assure that data protection is in conformity with international regulations particularly on the rights of the data subject as we have discussed in Chapter 4. In India, rights of the data subject are vulnerable to different violation if privacy is not recognized as being a property right of the data subject. Existing provision on data protection is scattered and do not address privacy issue as forming an intrinsic part of property law.

Outsourcing being a risky activity, a contract does not suffice to ensure contractual performance, it needs to be sustaining through the requirement of proper laws. Private international law is the crux on which the proper law of contract formulation between two parties in two different countries is made possible. This enable parties to not only choose the proper choice of law but also allowing parties to resolve conflicts underlying these international contracts. The Indian depiction on legal jurisdiction is not clearly delineated because unlike other countries private international law is not codified in this country. Rather, any deliberation on private international law warrants an understanding of all laws prevailing in the country to grapple with the operation of such laws. The ramification on legal contractual conflicts such as those involving conflict between two different parties in two

different countries is facilitated if there are codified laws and statutory regulation in the country.

This research explicate the need for a statutory policy on data protection as existing laws fails to tackle some of the menace arising from disputes of different kinds. These laws are either outdated or irrelevant to the emerging problems on conflict resolution with growing cross border flow of investment and contractual treaties of different forms. The IT Act is not a data protection statute and its provision on data privacy is extremely limited. It does not clearly delineate liability either thereby impeding the option for other legal remedy other than criminal laws, for example remedy under tort laws.

The Indian liability regime is a cumbersome one permeating different laws and statues such that there is incoherence regarding liability between different laws for instance liability for data breach is different from a liability for defamation. The need of the hour is a single legal regime which addresses major issues of privacy, copyright, data infringement, identity theft and liability and others, all under a unified central regime. The Expert Committee (2006) set out the objective which was to align the IT Act with powers so profound that it may act as a catalyst for legal reform as far as privacy and data protection is concerned. Unfortunately, as we have examined, it has fallen short of its endeavor to effect the necessary changes. This research contemplates the need for a resilient single liability regime instead of a regime where liability is scattered over a plethora of statutes. This would minimize legal altercation between different laws regarding the remedy available particularly in contracts between two parties.

The advent of the internet has change the rule of the game and presents a huge challenge for data protection on related issues such as copyright infringement on the internet. The internet offer challenging proposition for law to cope up as infringement of any form may arise no matter how strict the law is. Online data infringement and unauthorized data sales cross boundaries within seconds and the law can seldom effect necessary actions without a proper and well defined data protection act. The Expert Committee did not stipulate any provision regarding online copyright infringement.

Cooperation between different countries is needed for the law to take its course. This implies that reciprocating countries where legal action may occur also needs to possess equally effective data protection laws of the type we have mentioned

above. This may ease the need to arbitrate or approach an arbitral tribunal for resolving disputes such as those involving contractual disputes. Enforcement of a foreign award is made easier if reciprocating countries enact laws on data protection and privacy rights. Legislation on data protection would remove barriers in the enforcement of foreign awards as well since the law would not be encumbered by trivial matters such as those usually accompanying the enforcement of a foreign award, raising question if law should be procedural, or if enforcement of such an award would mean subjugating the country's domestic substantive policies. Arbitration award is not given by law but it can be assimilated as a legal provision since arbitration clause is an important contractual clauses. The proper law of contract is incomplete without elaborating on arbitration clauses. It is with this recognition that the Indian Arbitration and Conciliation was passed in 1996 to enable Indian courts to enforce arbitration agreements in contracts.

In Outsourcing context, the lack of statutory data act does create an obstacle for contractual disputes and other contractual breach particularly breach of personal data and privacy. Statutory data protection enables the parties to expropriate and avail legal remedies on contractual disputes or breach of contract. Though the remedies available with the Indian system are theoretically sound and well aligned to meet any unforeseen contingencies, legal remedy is ambiguous since it is scattered through various laws and regulation. As is currently practice, criminal proceedings are the only remedy for data and violation of authorized data. Legal remedy should be unambiguous in order for law to take its course without undue delay. A statutory data protection would remove ambiguousness of availing legal remedies and liability which has hindered legal proceedings in the country.

Moreover, there are inherent problems with the Indian legal system which hampers efficient dispute resolution. These barriers occur from the trial stage and hinder delivery of justice. Most of the time, cases which should have been reported or adjudicated in a court of law disappears in oblivion as parties are not interested to sought legal solution. Legal reform is also necessary to enable law to function effectively as a regulatory and constitutive mechanism. The proposed draft of the Expert committee, while trying to address some of the lacunae in the previous IT Act focuses immensely on the criminal applicability of law rather than approaching the law from a civil aspect. This has several implications for development of tort laws and compartmentalized contract law strictly through a criminal perspective. Such an

approach prohibits the development of civil and tort laws and hinders legal reform in the country.

Realizing the importance of personal data protection, a bill titled The Personal Data Protection Bill 2006 was introduced in the Rajya Sabha in December 8, 2006. The bill seems to proceed in the general framework of the European Union Data Privacy Directive, 1996. The bill proposed the need for regulating the collection, processing and distribution of personal data. But the apathy of the Indian law makers and the lack of interest created by the legislation clearly show that it may take a long time for a data working on the line of the EU Directive or the UK DPA. The exposition of this research is that legal intervention is necessary for avoiding certain contractual costs and hazards but it should not encumbered contractual formulation by institutionalizing criminal law as a legal remedy.

BIBLIOGRAPHY

Secondary Sources

Abiru, Masahiro, "**Vertical Integration, Variable Proportions and Successive Oligopolies**," *The Journal of Industrial Economics*, Vol. 36, No. 3, (Mar., 1988), pp 315- 325.

Aghion, Philippe and Benjamin Hermalin, "**Legal Restrictions on Private Contracts Can Enhance Efficiency**," *Journal of Law, Economics and Organization*, Vol.6, No.2, (Autumn, 1990), pp. 381-409.

Argyres, Nicholas. S and Julia Porter Liebeskind, "**Contractual Commitments, Bargaining Power, and Governance Inseperability: Incorporating History into Transaction Cost Theory**," *The Academy of Management Review*, Vol.24, No.1, (Jan., 1999), pp. 49-63.

Argyres, Nicolas, "**Evidence on the Role of Firm Capabilities in Vertical Integration Decisions**," *Strategic Management Journal*, Vol.17, No.2, (Feb., 1996), pp. 129-150.

Barthelemy, Jerome and Dennis Adsit, "**The Seven Deadly Sins of Outsourcing (and Executive Summary)**," *The Academy of Management Executive (1993)*, Vol.17, No.2, (May, 2003), pp. 87-100.

Becker, Joseph D, "**Choice-of-Law and Choice-of-Forum Clauses in New York**," *The International and Comparative Law Quarterly*, Vol. 38, No.1, (Jan., 1989), pp. 167-175.

Bennedsen, Morten and Christian Schultz, "**Adaptive Contracting: The Trial-and-Error Approach to Outsourcing**," *Economic Theory*, Vol.25, No.1, Symposium in Honor of Birgit Grodal (1943-2004) (Jan., 2005), pp. 35-50.

Bhagwati, Jagdish, Panagariya, Arvind and T.N Srinivasan, "**The Muddles of Outsourcing**" *The Journal of Economic Perspectives*, Vol. 18, No. 4. (Autumn, 2004), pp. 93-114.

Bolton, Patrick and Michael D. Whinston, "**Incomplete Contracts, Vertical Integration, and Supply Assurance**," *The Review of Economic Studies*, Vol. 60, No.1, (Jan., 1993), pp 121- 148.

Bonanno Giacomo and John Vickers, "**Vertical Separation**," *The Journal of Industrial Economics*, Vol. 36, No.3, (Mar., 1988), pp. 257-265.

Cachon, Gerard P and Martin A. Lariviere, **"Contracting to Assure Supply: How to Share Demand Forecasts in Supply Chain,"** *Management Science*, Vol. 47, No. 5, (May, 2001), pp. 629-646.

Carlton, Dennis. W, **"Vertical Integration in Competitive Markets Under Uncertainty,"** *The Journal of Industrial Economics*, Vol. 27, No.3, (Mar., 1979), pp. 189-209.

Chakraborty, Chandana and C. Jayachandran, **"Software Sector: Trends and Constraints,"** *Economic and Political Weekly*, Vol.36, No. 34 (Aug. 25-31, 2001), pp. 3255-3261.

Chatterjee, Sayan, Lubatkin, Michael and Timothy Schoenecker, **"Vertical Integration and Market Structure: A Systematic Risk Analysis,"** *Organization Science*, Vol. 3, No.1 (Feb., 1992), pp. 138- 156.

Chung, Tai-Yeong, **"Incomplete Contracts, Specific Investments, and Risk Sharing,"** *The Review of Economic Statistics*, Vol.58, No.5, (Oct., 1991), pp. 1031-1042.

Coase, R.H, **"The Nature of the Firm: Influence,"** *Journal of Law, Economics and Organization*, Vol. 4, No.1, (Spring, 1988), pp. 33-47.

Colangelo Giuseppe, **"Vertical vs. Horizontal Integration: Pre-Emptive Merging,"** *The Journal of Industrial Economics*, Vol. 43, No.3 (Sep., 1995), pp. 323-337.

Cooter, & Robert Thomas Ulen, *"Law and Economics,"* Third Edition, Addison-Wesley Publishing House, 2000.

Corbett, Charles J, DeCroix, Gregory A and Albert Y. Ha, **"Optimal shared-saving contracts in Supply Chains: Linear Contracts and double moral hazard,"** *European Journal of Operational Research 163 (2005)*, pp. 653-667.

Demsetz, Harold, **"The Structure of Ownership and the Theory of the Firm,"** *Journal of Law and Economics*, vol 26, no 2, Corporation and Private Property: A Conference sponsored by the Hoover Institution (Jun., 1983), pp. 375-390.

Dewatripont, Mathias (Ed), *"The Economics of Contracting: Foundations, Applications and Empirical Investigations."* Proceedings of the Eight Franqui Colloquium Brussels, 19-21 Nov 1999.

Fama, Eugene. F and Michael C. Jensen, **"Agency Problem and Residual Claims,"** *Journal of Law and Economics*, Vol.26, No.2, Corporations and Private Property: A Conference Sponsored by the Hoover Institution (Jun., 1983), pp. 327-349.

Ghoshal, Sumantra and Peter Moran, **"Bad for Practice: A Critique of the Transaction Cost Theory,"** *The Academy of Management Review*, Vol.21, No.1, (Jan., 1996), pp. 13-47.

Gold, Bela, **"Technological Change and Vertical Integration,"** *Managerial and Decision Economics*, Vol. 7, No.3 (Sep., 1986), pp. 169-176.

Gonzalez Reyes, Gasco Jose and Juan Llopis, **"Information systems outsourcing risks: a study of large firms,"** *Industrial Management & Data Systems*, Vol. 105, No.1, 2005, pp. 45- 62.

Greenhut, M.L and H. Ohta, **"Related Market Conditions and Interindustrial Mergers,"** *The American Economic Review*, vol. 66, No.3, (Jun., 1976), pp 267- 277.

Gross, Harry, **"Make or Buy Decisions in Growing Firms,"** *The Accounting Review*, Vol. 41, No.4, (Oct., 1966), pp 745-753.

Hamilton, L James and Soo Bock Lee, **"The Paradox of Vertical Integration,"** *Southern Economic Journal*, vol. 53, No.1, (Jul, 1986), pp 110-126.

Hansmaan, Henry and Reinier Kraakman, **"Property, Contract and Verification: The "Numerus Clauses" Problem and the Divisibility of Rights,"** *The Journal of Legal Studies*, 31, no.2, Part 2: The Evolution of Property Rights, (Jun., 2002), pp. S373-420.

Hansmann, Henry, Kraakman. Reinier and Richard Squire, **"Law and the Rise of the Firm,"** *Harvard Law Review*, vol. 119: 1335-1403.

Harrigan, Kathryn Rudie, **"Formulating Vertical Integration Strategies,"** *The Academy of Management Review*, Vol. 9, No.4, (Oct., 1984), pp 638-652.

_____do_____ **"Vertical Integration and Corporate Strategy,"** *The Academy of Management Journal*, Vol. 28, No.2 (Jun., 1985), pp. 397- 425.

Heilman, Raymond J. **"Arbitration Agreements and the Conflict of Laws,"** *The Yale Law Review*, Vol.38, No.5, (Mar., 1929), pp. 617-649.

Hermalin, Benjamin E and Michael L. Katz, **"Judicial Modification of Contracts between Sophisticated Parties: A More Complete View of Incomplete Contracts and Their Breach,"** *Journal of Law, Economics and Organization*, Vol.9, No.2, (Oct., 1993), pp. 230-255.

Joskow, Paul. L, **"Vertical Integration and Long-Term Contracts: The Case of Coal-Burning Electric Generating Plants,"** *Journal of Law, Economics & Organization*, Vol.1, No.1, (Spring 1985), pp 33-80.

Kapur, Devesh, Ramamurti Ravi and Deependra Moitra, **"India's Emerging Competitive Advantage in Services (and Executive Commentary),"** *The Academy of Management Executive (1993),* Vol.15, No.2, Theme: Positioning Organizations and People for Competitive Advantage (May, 2001). pp. 20-33.

Klein, Benjamin, **"Contracting Costs and Residual Claims: The Separation of Ownership and Control,"** *Journal of Law and Economics*, Vol. 26, No.2,

Corporations and Private Property: A Conference Sponsored by the Hoover Institution (Jun., 1983), pp. 367-374.

Klein, Benjamin, Crawford Robert G and Armen A. Alchian, **"Vertical Integration, Appropriate Rents, and the Competitive Contracting Process,"** *Journal of Law and Economics*, Vol.21, No.2, (Oct.,1978), pp. 297-326.

Kochhar, Rahul, **"Explaining Firm Capital Structure: The Role of Agency Theory vs. Transaction Cost Economics,"** *Strategic Management Journal*, Vol.17, No.9, (Nov., 1996), pp. 713-728.

Koh, Harold Hongju, **"Transnational Public Law Litigation,"** *The Yale Law Journal*, Vol.100, No.8, Symposium: International Law (Jun., 1991), pp. 2347-2402.

Kramer, Larry, **"Rethinking Choice of Law,"** *Columbia Law Review*, Vol.90, No.2 (Mar., 1990), pp. 277- 345.

Laffont, Jean-Jacques and Jean Tirole, **"The Dynamics of Incentive Contracts,"** *Econometrica*, Vol. 56, No.5, (Sep., 1988), pp. 1153-1175.

Leiblein, Michael J, Reuer Jeffrey J and Frederic Dalsace, **"Do Make or Buy Decisions Matter? The Influence of Organizational Governance on Technological Performance,"** *Strategic Management Journal*, Vol.23, No.9, (Sep., 2002), pp. 817-833.

Levy, David. T, **"The Transaction Cost Approach to Vertical Integration: An Empirical Examination,"** *The Review of Economics and Statistics*, Vol. 67, No.3, (Aug., 1985), pp 438- 445.

Lieberman, Marvin. B, **"Determinants of Vertical Integration: An Empirical Test,"** *The Journal of Industrial Economics*, Vol. 39, No.5 (Sep., 1991), pp. 451-466.

Liebeskind, Julia Porter, Knowledge, **"Strategy and the Theory of the Firm,"** *Strategic Management Journal*, Vol. 17, Special Issue, Knowledge and the Firm, Winter, 1996, pp. 93-107.

Lyons, Bruce R, **"Strategic Bargaining and Vertical Separation,"** *The Journal of Industrial Economics*, Vol. 39, No.5 (Sep., 1991), pp. 577-593.

Madhok, Anoop, **"The Organization of Economic Activity: Transaction Costs, Firm Capabilities, and the Nature of Governance,"** *Organization Science*, Vol.7, No.5, (Sep. - Oct., 1996), pp. 577-590.

Mahoney, Paul. G, **"Contract Remedies and Options Pricing,"** *The Journal of Legal Studies*, Vol.24, No.1, (Jan., 1995), pp. 139-163.

Masten Scott. E, **"Institutional Choice and the Organization of Production: The Make-or-Buy Decision,"** *Journal of Institutional and Theoretical Economies: JITE*, vol. 142, (1986), pp. 493-509.

Masten Scott. E, Meehan, James. W, Jr.; and Edward A. Snyder, **"The Cost of Organization"** *Journal of Law, Economics and Organization*, vol.7, No.1, (Spring, 1991), pp. 1-25.

Morgan, Edmund M, **"Choice of Law Governing Proof,"** *Harvard Law Review*, Vol.58, No.2 (Dec., 1944), pp. 153-195.

Pablo, Spiller. T, **"On Vertical Mergers,"** *Journal of Law, Economics and Organization*, Vol. 1, No.2 (Autumn, 1985), pp. 285-312.

Park, William W, **"Duty and Discretion in International Arbitration,"** *The American Journal of International Law*, Vol.93, No.4, (Oct., 1999), pp. 805-823.

Pollock & Mulla, ***"Indian Contract and Specific Relief Acts (Vol 1 & 2),"*** Thirteenth Edition, LexisNexis, Butterworths Wadhwa, Nagpur, 2006.

Poppo, Laura and Todd Zenger, **"Do Formal Contracts and Relational Governance Function as Substitutes or Complements?"** *Strategic Management Journal*, Vol.23, No.8, (Aug., 2002), pp. 707-725.

Ramani, S, **"IT Enabled Services: Growing Form of Telework,"** *Economic and Political Weekly*, Vol.35, No. 26 (Jun. 24-30, 2000), pp. 2305-2307.

Rothaermel, Frank T, Hitt, Michael A and Lloyd A. Jobe, **"Balancing Vertical Integration and Strategic Outsourcing: Effects on Product Portfolio, Product Success and Firm Performance,"** *Strategic Management Journal*, Vol.27, pp 1033-1056(2006).

Schwartz, Allan and Robert E Scott, **"Contract Theory and the Limits of Contract Law,"** *The Yale Law Review*, Vol.113, No.3, (Dec., 2003), pp. 541-619.

Schwartz, Paul M, **"Property, Privacy and Personal Data,"** *Harvard Law Review*, Vol. 117, No.7, (May, 2004), pp. 2056-2128.

Shavell, Steven, **"Contractual Holdup and Legal Intervention,"** *Journal of Legal Studies*, Vol.36, (June 2007), pp. 325-351.

Shavell, Steven, **"Damage Measure for Breach of Contract,"** *The Bell Journal of Economics*, Vol.11, No. 2, (Autumn, 1980), pp. 466-490.

Smith, Henry. E, **"Exclusion versus Governance: Two Strategies for Delineating Property Rights,"** *The Journal of Legal Studies*, Vol.31, No.2, Part 2: The Evolution of Property Rights (Jun., 2002), pp. S453-S487.

Spencer, Barbara. J, **"Presidential Address: International Outsourcing and Incomplete Contracts,"** *The Canadian Journal of Economics*, Vol.38, No.4, (Nov., 2005), pp 1107-1135.

Srinivasan T.N and Anne Krueger, **"Information- Technology –Enabled Services and India's Growth Prospects (with Comments and Discussion),"** *Brookings Trade Forum*, Offshoring White-Collar Work (2005) , pp. 203-240.

Stern, David S, **"The Conflicts of Laws in Commercial Arbitration,"** *Law and Contemporary Problems*, Vol.17, No.3, Commercial Arbitration: Part 1 (Summer, 1952), pp. 567-579.

Sutcliffe, Kathleen M and Akbar Zaheer, **"Uncertainty in the Transaction Environment: An Empirical Test,"** *Strategic Management Studies*, Vol.19, No.1, (Jan., 1998). pp. 1-23.

Tadelis, Steven, **"Complexity, Flexibility and the Make-or-Buy Decision,"** *The American Economic Review*, Vol. 92, No.2, Papers and Proceedings of the One Hundred Fourteenth Annual Meeting of the American Economic Association (May, 2002), pp. 433-437.

Tirole, Jean, Incomplete Contract: **"Where Do We Stand?"** *Econometrica*, Vol.67, No.4, (Jul., 1999), pp. 741-781.

Vickers, John and Michael Waterson, **"Vertical Relationships: An Introduction,"** *The Journal of Industrial Economics*, Vol.39, No.5, (Sep., 1991), pp. 445-450.

Vishwanathan, Aparna, ***"Outsourcing to India: Cross-Border Legal Issues,"*** LexisNexis, Butterworths Wadhwa, Nagpur, 2008.

Walker Gordon and David Weber, **"Supplier Competition, Uncertainty, and Make-or-Buy,"** *The Academy of Management Journal*, Vol.30, No.3 (Sep., 1987), pp. 589-596.

Walker, Gordon and David Weber, **"A Transaction Cost Approach to Make-or-Buy Decisions,"** *Administrative Science Quarterly*, Vol. 29, No.3, (Sep., 1984), pp. 375- 391.

Williamson, **"Oliver E, Strategy Research, Governance and Competence Perspectives,"** *Strategic Management Journal*, vol.21, No.12, (Dec., 1999), pp. 1087-1108.

_____do_____, **"Organization Form, Residual Claimants, and Corporate Control,"** *Journal of Law and Economics*, vol.26, No.2, Corporations and Private Property: A Conference Sponsored by the Hoover Institution (Jun., 1983), pp. 351-366.

_____do_____, **"The Economics of Antitrust: Transaction Cost Considerations,"** *University of Pennsylvania Law Review*, Vol.122, No.6, (Jun., 1974), pp. 1439-1496.

_____do_____, **"The Economics of Governance,"** *The American Economic Review*, Vol.95, No.2, Papers and Proceedings of the One Hundred Seventeenth Annual Meeting of the American Economic Association, Philadelphia, PA, January 7-9,2005.(May 2005) pp.1-18.

_____do_____, **"The Economics of Organization: The Transaction Cost Approach,"** *The American Journal of Sociology*, Vol.87. No.3, (Nov.,1981), pp. 548-577.

_____do_____, **"Transaction- Cost Economics: The Governance of Contractual Relations,"** *Journal of Law and Economics*, Vol. 22, No.2, (Oct., 1979), pp. 233- 261.

Internet Sources

Agarwal, Anurag K, *Need for Data Protection Law*, http://www.hinduonnet.com/thehindu/op/2005/05/24/stories/2005052400481700.htm, (last visited on 7/8/2009)

Dalal, Praveen, *Data Protection Law in India: The TRIPS Perspective*, http://en.wikipedia.org/wiki/Data_Protection_Act (last visited on 7/11/2009)

Data Protection Act 1998- Wikipedia, the free encyclopedia, http://en.wikipedia.org/wiki/Data_Protection_Act

Data Protection India-do they have any protection? https://nicca.nic.in/pdf/itact2000.pdf

Data Protection Law in India, Galexia-Intelligence Report, Articles, Papers, Conferences and Seminars, *Article- Asia Pacific Privacy Developments 2007(January 2008)*, http://164.100.24.208/ls/bills-ls-rs/2006/96_2006.pdf. (last visited on 7/18/2009)

IT Act 2000-NIC Certifying Authority, https://nicca.nic.in/pdf/itact2000.pdf

Kaushik, Arpit, *Offshore Outsourcing: What role will recession play?* www.inforworld.com/.../Offshore - Outsourcing-what-role-will-recession-play-108 (last visited 06/11/2009)

Keong, Lee Min, "Data Protection Laws vital for Outsourcing hubs" http://www.zdnetasia.com/news/security/0,39044215,62055879,00.htm

Mark, Rieksts, *Landmark Cases in Tort Law*, http//:www.acjnet.org/Downloads/documentloader.ashx?id=3506

Part, Shubhendru, *The MMS Conundrum*, http://dqindia.ciol.commakesections.asp/05011301.asp, (last visited on 7/10/2009)

Pokhariyal, Poorvi, *Criminal justice system in India: Little done, vast undone,* http://www.indlaw.com/display.aspx?4289

Robinson, Mark H and Stan Lepeak, "Renegotiating Your Outsourcing Contract", http://www.bpoindia.org/columns/equaterra/renegotiating-your-outsourcing-contract.shtml (last visited on 7/8/2009)

Simmonds, Rick, *Benchmarking Clauses in Outsourcing Contracts –Worth the Effort?* http://www.outsourcingleadership.com/benchmarking-clauses-in-outsourcing-contracts.shtml

Singhania, Ravi and Dipak Rao, *Internet, IT and Software, Copyright and Domain Name Issues- India*, http://www.hg.org/article.asp?id=5260, (last visited on 7/8/2009)

The Economist print edition, Dec 11th 2008, *The World is Rocky*,http://www.nasscom.org/Nasscom/templates/NormalPage.aspx?id=55392 (last visited on 07/01 2009)