PRIVATIZATION AND THE INDIAN JUDICIARY

PRIVATIZATION OF government-owned companies in India has often been contested before appellate courts. Their rulings demonstrate that although the Indian judiciary supports the state's policy to divest, it is still to evolve broad-based policies for reviewing privatization. In fact, there are no considerations peculiar to 'privatization disputes' and the judicial process can be grouped into two familiar steps.[1] First, if the challenge is concerned primarily with the *decision* to privatize, the courts are reluctant to intervene if that decision follows a well-defined 'policy'.[2] As a second step, the courts scrutinize the *procedure* followed by the administration to ensure that the extant rules are respected.

Both steps, however, hardly contribute to developing a jurisprudence of privatization in a country where there is a surfeit of government-owned enterprise despite the transition to free market fifteen years ago.[3] This note attempts to identify the jurisprudential basis of divestment by preparing a catalogue of issues that judges may consider before ruling on the legality of the administration's decision to sell. It also analyzes a few judgments on privatization delivered recently by the Supreme Court of India and the High Courts at New Delhi and Calcutta. The choice of the decisions for discussion are based on two considerations: (i) they represent much of the case law on privatization in India; and, (ii) the cases provide a sampling of the various legal tools employed by the superior courts to resolve privatization disputes. The note then deliberates on the future of the judiciary's response to privatization. Proceeding from the legal doctrines and tools used in the cases under review, this part proposes that every decision concerning privatization must necessarily also examine the interests of the investors and labour groups,

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1. See, for instance, the Supreme Court judgments in *BALCO Employees Union* v. *Union of India*, (2002) 2 SCC 333 and *Centre for Public Interest Litigation* v. *Union of India*, (2003) 7 SCC 532.

2. Courts in India do not review administrative policy unless shown to be capricious, arbitrary, mala fide, or violating fundamental rights. For a recapitulation of the settled law see, *BALCO Employees Union* v. *Union of India ibid*.

3. The Government of India has conducted 120 equity sale transactions between 1991-92 and 2004-05, realizing Rs. 49214.03 crores. The government also made strategic sales of 37 public enterprises between 1999-00 and 2004-05, raising Rs. 10257.19 crores. Details of the transactions are *available at*: http://www.idvest.nic.in/performance.htm.

besides neutralizing the dealings of insiders and ensuring transparency in process. These issues are the focal point of discussion and should form a judge's repertoire of questions each time she entertains a disputed privatization. As a related theme, this note also evaluates the potential gains and losses from enacting a law to regulate privatization.

Recent judgments on privatization

The judgments that provide a broad perspective of the considerations that attract the attention of Indian courts are: *BALCO Employees' Union (Regd.)* v. *Union of India*[4] (*BALCO*) and *Centre for Public Interest Litigation* v. *Union of India*[5] (*CPIL*) decided by the Supreme Court; the ruling of the Calcutta High Court in *Bharat Bhari Udyog Nigam Ltd., Calcutta* v. *Jessop & Co. Ltd. Staff Association and others*[6] (*Jessop*); and that of the Delhi High Court in *M/s Modi Corp. Ltd.* v. *Union of India*[7] (*Modi Corp)*.

In *BALCO*, the Supreme Court considered the validity of the decision to sell a majority stake in the public sector Bharat Aluminium Company Limited. The principal objection to the sale came from the workers who claimed that they would lose their constitutionally guaranteed rights against a state entity once it was transferred to a private company.[8] They were joined by the State of Chhattisgarh (where the company was situated), which argued that the sale was procedurally flawed since the workers were never consulted before the decision, and the conversion would violate local land laws. Kirpal J writing for a unanimous court began his opinion by reiterating the settled principle that an executive policy (to divest) could not ordinarily be judicially reviewed:[9]

> Process of disinvestment is a policy decision involving complex economic factors. The Courts have consistently refrained from interfering with economic decisions as it has been recognised that economic expediencies lack adjudicative disposition and unless the economic decision, based on economic expediencies, is demonstrated to be so violative of constitutional or legal limits on power or so abhorrent to reason, that the courts would decline to interfere. In matters relating to economic issues, the

4. *BALCO Employees Union* v. *Union of India* , *supra* note 1.

5. *Centre for Public Interest Litigation* v. *Union of India*, *supra* note 1.

6. FMA No. 433 of 2003.

7. CW No. 189 of 2002 (judgment dated Jan 31, 2002).

8. Referring to their rights under Art. 14 [equality clause] and Art. 16 [equality of opportunity in matters of employment clause] of the Indian Constitution that is exercisable only against "the State".

9. BALCO, *supra* note 1 at 362.

> Government has, while taking a decision, right to "trial and error" as long as both trial and error are bona fide and within limits of authority.

The court held that the procedure adopted for the sale was valid. The ruling on procedure was based on the findings that: (i) labour had no fundamental right to be heard by the management even though the decision concerned the future of the company; (ii) the protective clauses in the shareholder's agreement were sufficient proof that the interests of labour had been adequately addressed; (iii) the sale was made under the aegis of an investment commission, and this was enough to accept the valuation of the company as well as the propriety of the procedure adopted by the executive; and, (iv) the sale did not violate any land laws, because the enterprise functioned from premises that had been validly leased.

In contrast, the *CPIL* court was petitioned to rule on only one issue: whether the executive had sold the government's stake in two public-enterprises – Bharat Petroleum Corporation Limited and Hindustan Petroleum Corporation Limited – according to the procedure stipulated in their governing statutes. These two companies were formed following the nationalization of foreign oil companies in the 1970s, and were regulated by the ESSO (Acquisition of Undertaking in India) Act, 1974, the Burma Shell (Acquisition of Undertaking in India) Act, 1976, and the Caltex (Acquisition of Shares of Caltex Oil Refining India Limited and all the Undertakings in India for Caltex India Limited) Act, 1977. The petitioner argued that since the foreign oil companies were nationalized avowedly in public interest, the companies born out of those acquisitions could not be privatized without seeking parliamentary approval. In its opinion, the court agreed with the petitioner that the statutes regulating the two companies implicitly prohibited the sale of government shares without the approval of Parliament. The court reasoned that a public-entity of national importance is established after a parliamentary decision and supported by the Consolidated Fund of India. Commensurately, the government company is subject to numerous statutory controls to ensure accord with national objectives. Divestment would entail decontrolling the entity that served a "common good" and allowing private ownership. It is a far-reaching step that must need the endorsement of the institution that established it in the first place. By deciding to sell the public-sector enterprises following an administrative decision alone, the government had run foul of the statutes and the sale was, therefore, procedurally flawed.

The Calcutta High Court in *Jessop* was also required to determine the legality of the executive's decision to sell a majority stake in Jessop & Company Ltd. The petitioner employee association had challenged

the privatization on the ground that the company was involved with railway transport – a strategic sector in which government holding was imperative. A two-judge bench overruled the decision of a single judge and held that the company manufactured railway wagons and coaches, which was not a strategic activity. The company could consequently be privatized. Interestingly, the bench observed that the judge below had exceeded his jurisdiction by investigating a multitude of issues that had not been raised in the pleadings, including, transparency in the privatization process, violations of the principles of natural justice, and the rationale for selling 72% of the government's stake in the company. The appellate bench, accordingly, decided that the rules of pleadings were sacrosanct and that the judge sitting alone had clearly erred by traversing beyond the written arguments.

Finally, in *Modi Corp.* the Delhi High Court was requested to examine whether an interested investor (Modi Corp. Ltd.) could join the auction of a public-sector company (Videsh Sanchar Nigam Ltd.) after the divestment process had commenced. The published bid requirements limited eligibility to only those private enterprises that could show a stipulated minimum net worth. The petitioner/investor admited that it did not initially meet the minimum net worth requirement and hence did not express any interest in the bid process. The investor, however, argued that a subsequent, unprecedented declaration of dividends devalued the latter's net worth considerably, making it affordable for the petitioner/ investor to join the fray later. The petitioner's grievance was that despite the change in circumstances, the government continued to ignore its request for permission to participate in the bid process. As a result, the petitioner argued, it had no alternative but to seek the intervention of the court. The court denied the plea and ruled that the investor was hopelessly late in expressing an interest in the divested company. The government advertisement inviting private enterprises to buy stakes in the public-sector company required candidates to apply on or before April 10, 2001. The petitioner, on the other hand, showed a semblance of interest only on October 8, 2001 when it first wrote to the Government of India for a chance to participate. "The petitioner has simply missed the bus", said the court, "and cannot now claim to join in at the fag end of the journey." The petitioner's contention that the subsequent devaluation of the public-sector enterprise was an accepted and pivotal fact was also disallowed. The court opined that even if the public-sector company had been devalued following an unprecedented dividend issue, the requirements for bidding had not been modified. For the court to now allow the petitioner to participate would tantamount to rewriting the rules of the game and intervening with government policy in deciding who should participate, irrespective of whether it would be favourable to the privatization itself.

These cases manifest the general legal principles and interpretative tools selected by the superior courts in India to adjudicate privatization disputes.

Issues implicated in a privatization dispute

The rulings examined earlier provide the foundation for developing a jurisprudence of privatization. Although they are susceptible to individual criticism, the cases help one to prognosticate improvements by informing of the existing boundaries of judicial review. As McBarnet notes:[10]

> Law must be recognized as an ongoing, renegotiable phenomenon open to being worked on constantly from the ground up by those formally subject to it and by the mediating force of the legal profession.

How, then, could one possibly improve upon the existing judicial technique? A starting point is to break from traditional rules of pleadings so that judges do not confine themselves to the written words of the parties and risk ignoring the bigger picture.[11] The advice in *Hoddeson* v. *Koos Bros.*[12] is pertinent in this context:

> We do not in exercise of our modern processes of appellate review permit the formalities of a pleading of themselves to defeat the substantial opportunities of the parties.

Underplaying the need for adhering to traditional rules of pleadings would allow the courts considerable latitude in approaching a privatization dispute differently, and to examine issues that the parties may have inadvertently overlooked, or perhaps even deliberately concealed. The next step is to examine the legality of a decision to privatize against codified law (including the statute establishing the enterprise), procedural regulations, and state policy[13] just as it is done today. If the decision to privatize passes that test, the final step is an independent verification that: (a) the investors are getting their due;

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10. Doreen McBarnet, 'It's Not What You Do but the Way You Do It: Tax Evasion, Tax Avoidance, and the Boundaries of Deviance', 12 *Int'l J Soc Law* 234.

11. *Supra* note 6.

12. 47 N.J.Super. 224, 135 A.2d 702 (App.Div.1957).

13. Including the valuation policy adopted by the administration. Valuation of companies depends principally on the company in question. See, Florencio Lopez de-Silanes, 'What Factors Determine Auction Prices in Privatization?' *Public Policy for the Private Sector* The World Bank Group (June 1997). However, a court charged with the responsibility of ruling on a privatization dispute must test the accuracy of the estimated auction price based on the Government of India's uniform valuation policy. A copy of the policy is *available at*: http://www.divest.nic.in/valuation.htm.

(b) the labour is not being short-changed; (c) insider interest does not surmount public interest; and, (d) there is transparency in the entire privatization process. The parameters of these considerations are discussed below:

(a) Protecting the investor's interests

Studies show that new owners of a privatized enterprise find it nearly impossible to raise external finance in countries that have no respect for property rights. Consequently, private owners are unwilling to reinvest earnings in such countries.[14] Poorly defined property rights are hence the chief cause for many of the problems faced by investors in developing and transition economies.[15]

Establishing efficacious property rights requires efficient control structures and expeditious enforcement of contracts. Shareholders (investors) should, therefore, have well protected rights over corporate assets after privatization. One way of doing this is to enforce the right to private property as embodied in article 300A of the Constitution.[16] Strong property rights also mean that privatized enterprises should not be surreptitiously controlled by vested political interests through a stream of government handouts that subsidizes the activities of that entity.[17]

In addition, court should examine if the managers of a privatized entity have absolute control rights over corporate assets. Regulation of managerial control prevents situations where managers with absolute control rights find little or no incentive to invest for the benefit of the shareholders.[18]

(b) Promoting labour welfare

Privatization often entails downsizing where the labour force is relieved voluntarily or through compulsory retirement schemes.[19] The

14. Alexander Dyck, 'Privatization and Corporate Governance: Principles, Evidence, and Future Challenges', 16(1) *The World Bank Research Observer* (Spring 2001) 59 at 68.

15. See further, Andrei Shleifer, 'Establishing Property Rights', in *Proceedings Of The World Bank Annual Conference On Development Economics* (1994) at 95-6. Shleifer defines establishment of property rights as the enforcement of "contracts through which economic agents try to arrive at more efficient control structures themselves or [of] finding ways to improve the efficiency of control rights directly."

16. The Art. reads: "No person shall be deprived of his property save by authority of law". The term "property" in Art. 300A has been interpreted to include the contractual rights of a company's shareholder. See, *Dwarkadas Shrinivas* v *Sholapur Spinning & Weaving Co. Ltd*., AIR 1954 SC 119 and *R.C. Cooper* v. *Union of India*, AIR 1970 SC 564.

17. Shleifer, *supra* note 15 at 93.

18. *Id.* at 97.

welfare loss suffered by separated public sector workers can be categorized into three components: (a) the present value of the resulting change in earnings, including bonuses and other cash benefits. Except for highly skilled workers, salaries in the public sector tend to be higher than earnings out of it; (b) the present value of the loss in non-wage benefits. Public sector jobs usually provide health coverage and old-age pension, among other benefits; (c) other, more intangible losses from separation. For instance, effort levels tend to be lower in the public sector than out of it, whereas job security is almost invariably higher.[20]

A court should thus be satisfied that the impugned privatization adequately safeguards the welfare of the existing labour. In addition, particular care must be taken for the welfare of female workers and those with bigger families as they are bound to suffer more from displacement.[21] Courts could thus require counsels to submit detailed economic and financial analysis of the effects of proposed welfare schemes on the workers.

(c) Uncovering the dealings of insiders

Courts must scrutinize the dealings of insiders in the soon-to-be-privatized government company. It may be necessary to examine the consolidated financial information of the insiders, including details of their prior transactions with the company.[22] This would bolster investor confidence since the ability of insiders to manipulate the privatization process for self-gain would be neutralized. On a broader plane, a judge must not limit herself to insiders *per se*, and should inquire into the dealings of all those concerned with the privatization.[23] Investigation of insider (and outsider) transactions is imperative to curtail corruption, and the larger public interest in doing so tilts the scales in favour of the court acting as a policing authority.

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19. Fears of lay-off are often the most common reasons that labour groups challenge privatization. For example, Airports Authority of India (AAI) employees struck work nation-wide to protest the decision to allow private companies a major stake in the modernization of international airports at New Delhi and Mumbai. They feared retrenchment despite a condition in the bid document that private companies would have to absorb 40% of the labour force if their bids were successful.

20. Martin Rama, "Public Sector Downsizing: An Introduction" 13(1) *The World Bank Economic Review* (January 1999) at 7.

21. *Id.* at 20.

22. Dyck, *supra* note 14 at 70.

23. For instance, the privatization of the state-run Centaur Hotel has drawn considerable criticism on the grounds that the administration gave undue "indulgence" to a particular bidder through "repeated extensions". "Discomforting aspects to Centaur Hotel disinvestments" *The Hindu*, New Delhi, Aug. 19, 2004.

(d) Ensuring transparency and public accountability

A public sector enterprise is established to serve people, and their subsequent sale is a matter of public interest where everyone would expect to be heard. Interested or affected citizens can be heard in open court, or by ensuring that the administration allows all concerned sections of society to express their views before reaching a decision to divest its stake. Such expressions of civil and political rights have an inherent and positive impact on government action and efficiency.[24] Government action is affected in two ways: (i) by compelling the administration to follow procedure; and, (ii) by securing the rights of private investors in divested companies from subversive government interference. Of course, another option is to let the legislature approve sales of government enterprises. However, this could be cumbersome, besides being limited to those companies that are regulated by Acts mandating the manner in which the government can sell its stake.[25]

Inviting public opinion on a proposed administrative decision is an established practice[26] and can even be replicated judicially. Courts can, therefore, require the state to explain the procedure it followed to reach the decision to privatize. Where the court believes that citizens have not been heard, or that the administration has not considered their views, it can stay the divestment for violation of procedural fairness.

The issues discussed above present a sampling of possible avenues and are by no means exhaustive. Each case undoubtedly presents unique problems, and courts must define their own priorities to seek open-ended solutions. In any event, the responses to the questions posited earlier help a judge to rationalize and work with the administration and the objectors in determining the exact contours of the sale.

A legislation for privatization?

A related theme is the prospect of framing a law to regulate all

24. Jonathan Isham, Daniel Kaufmann and Lant H. Pritchett, 'Civil Liberties, Democracy, and the Performance of Government Projects', 11(2) *The World Bank Economic Review* (May 1997) 219 at 237.

25. This is evident from the opinion of the Supreme Court in *Centre for Public Interest Litigation* v. *Union of India and another*, *supra* note 1. Writing for the court, Rajendra Babu J states that unlike *BALCO*, the present case required an enquiry into the Act establishing the public sector enterprise because the enactment regulated the manner in which the company could be privatized.

26. The Government of India's Ministry of Health and Family Welfare, for example, invites public comments on draft rules under the Prevention of Food Adulteration Act, 1954 and the Standard of Weights and Measures Act 1976. These (draft) rules are published extensively and those interested can intimate their concerns or suggestions before a specified date.

future privatisations.[27] Such a law would allow judges to test a particular case against explicit regulation. Deviations can then be easily identified and penalty would be uniform. Certainty of outcomes, continuation of policies, transparency in processes, and proper utilization of proceeds are some of the other advantages associated with a law regulating privatization.

The viability of a specific law for privatization is, however, debatable. Critics argue that such a law would require unnecessary expenses and efforts to draft what is best done by administrative decision, besides encouraging litigation, politicizing initiatives, restricting flexibility in programs, and causing administrative delays in implementing the enactment.[28] Succinctly put, they apprehend that "legislative mandate and empirical reality"[29] would rarely meet.

Whatever be the benefits or failings of an enactment, it is obvious that a debate on the legislation is fundamental to an improved understanding of privatization. Democratic deliberations on the need for a codified law would invariably interrogate the relative merits or demerits of privatization, including (but not limited to) the issues discussed above. The result would be a richer jurisprudence on privatization.

Conclusion

In rejecting the bromide that 'judges do not possess a fund of economic and social wisdom'[30] this note propagates the multidisciplinary approach of modern legal education.[31] Judges should, and must, draw on all forms of knowledge – legal, economic, social and political – to reach an informed decision.

This note also realizes that the responsibility for pushing the bounds of jurisprudence on privatization lies equally with the lawyers. They as opposing counsels must inform, and, if need be, educate. A 'Brandeis

27. Some countries such as Estonia, Turkey, and Bulgaria have already enacted legislation to regulate privatization programs.

28. See, Prajapati Trivedi, *How To Implement Privatisation Transactions: A Manual For Practitioners* 226-230 (2000).

29. I owe this phraseology to Dr. V.S. Rekhi in "Civil Procedure" *Annual Survey of Indian Law* 607 (2005).

30. A belief attributed to Justice Oliver Wendell Holmes Jr. See, J.S. Verma, *New Dimensions of Justice* 138 (2000). Also see, a similar opinion in *BALCO Employees Union* v. *Union of India*, *supra* note 1.

31. Although Lord Mansfield demonstrated the utility of multidisciplinary study more than a century ago when he weighed complex financial and economic data to decide commercial disputes. See, Robert D. Cooter, 'The Rule of State Law and Rule-of-Law State: Economic Analysis of the Legal Foundations of Development', in *Proceedings of The World Bank Annual Conference on Development Economics* 205 (1996).

Brief' style of submission would be particularly useful in achieving this objective.[32] Legal submissions can be substantiated by data that describe the financial, economic or sociological impact of privatization on investors, labour and the public. The courts must, in turn, welcome such analysis as a means to do "complete justice", as opposed to "convenient justice" where extra-legal issues are often avoided.

Cases involving challenges to privatization are complex, barely leaving courts with the opportunity to pick and choose issues that suit their wisdom. Judicial review of privatization would be illogical without a thorough examination of the legal, economic, social and political factors. While this may prolong litigation and delay outcomes, it would certainly be a better barometer to judge a sale.

*Apoorv Kurup**

32. Louis Brandeis undertook to defend the constitutionality of Oregon's maximum working hour law for women. The 'Brandeis Brief' (as his submissions later came to be known) contained a summary of the theory testing the law's constitutionality, followed by extensive data on the effect of the law on the health and safety of female workers. The resultant decision in *Muller* v. *Oregon* (1908) showed that judicial decision-making and sociology were in fact intertwined.

* BA, LL.B (Hon.), LL.M candidate (Harvard Law School).