Centre for Aerospace & Defence Laws (CADL)

Directorate of Distance Education

NALSAR University of Law, Hyderabad

Course Material

M.A. (AVIATION LAW AND AIR TRANSPORT MANAGEMENT)

Academic Year: 2019-2020; Batch 2018-20

II Year– III Semester

2.3.9. - Aviation Contracts & Tenders

Compiled by:

Prof. (Dr.) V. Balakista Reddy

Ms. Anita Singh

TABLE OF CONTENTS

II. MODULE II: INTERNATIONAL CONTRACT LAW: NORMS AND DRAFTING GUIDELINES

2.1. Tenders and Tendering Procedures

2.1.1. Tender Concept and Procedures
2.1.2. Tendering Procedures
2.1.3. Bidding Process

2.2. International Contractual Negotiations

2.2.1. Pre-Contractual Liability
2.2.2. Ascertaining Credit-Worthiness of the Foreign Party
2.2.3. Choices to be made by the Parties

2.3. Principles for Drafting of International Commercial Contracts

2.3.1. Important Norms And Conditions Of International Trade Contracts
2.3.2. Standard Form Contracts
2.3.3. Commercial Contracts
2.3.4. Engineering Contracts
2.3.5. International Transfer of Technology Agreements
2.3.6. International Commercial Agency / Franchise Contracts

2.4. Norms for Drafting International Commercial Contracts

2.4.1. Role of International Contracts in International Commerce
2.4.2. Parties to the transactions
2.4.3. Drafting of International Contracts for Sale of Goods
2.4.4. Sample draft of International Contract for Sale of Goods

III. MODULE III: AIRLINE CONTRACTS

3.1. Aviation Insurance Contracts
3.2. Airline Lease Agreement
3.3. Airline Purchase and Sales Agreement
3.4. Contract of Carriage by Air
3.5. Aircraft Maintenance, Repair and Overhaul Agreement
3.6. Ground Handling Agreement
3.7. Code-Sharing and Interline Agreement

IV. MODULE IV: AIRPORT CONTRACTS

4.1. Airport Lease Agreement
4.2. PPP in Airport Infrastructure
4.3. Airport In-Terminal Concession Agreement

MODULE I FUNDAMENTALS OF CONTRACT LAW

ESSENTIALS OF CONTRACT LAW

Law of Contracts constitutes the most important branch of mercantile law. It is the backbone of trade and commerce. It is not only the trading community, which is concerned with the law of contract, but it affects every person. It affects one and all. The law of contracts creates legal rights and obligations. The main purpose of law of contracts is to ensure the element of definiteness in mercantile transactions. The test of contractual intention is objective, not subjective. What matters is not what the parties had contemplated in their mind but what a reasonable person would think, in the circumstances, their intention to be. The Indian Contract Act, 1872 lays down the general rules regarding the contract. These general rules are applied in every special contract entered into between two parties. It may be noted that the Act is not exhaustive in itself. There are other important Acts relating the special types of contracts, The Negotiable Instruments Act 1881, The Indian Companies Act 1956, The Indian Partnership Act 1932, The Sale of Goods Act 1930 etc.

Law of contract is the most important branch of Business Law. It would have been very difficult, to carry on trade or commerce in the absence of this law. It is not only the business community which is concerned with the law of contracts, but it affects every person. Contract is considered as the foundation of the civilized world. Since every one of us enters into a number of contracts from sunrise to sunset. When a person drinks a cup of tea, or rides a bus, or goes to the cinema to see a movie or purchases the goods, or gives a loan to friend, etc. he enters into a contract though he may be unaware of it. Such contracts create legal rights and obligations. The law of contract is mainly concerned with the enforcement of these rights and obligations.

The law of contract determines the circumstances in which a promise or an agreement shall be legally binding on the person making it. It is concerned with rights in personam as distinguished from rights in rem. For example, if X is entitled to receive a sum of money from Y, this right can only be exercised by X and not by others. This is a right in personam. On the other hand, if X owns a plot of land and Y is the immediate neighbor, the right of X to have complete possession and enjoyment of land is available not only against Y but against the whole world. This right of X is known as the right in rem.

INTRODUCTION TO INDIAN CONTRACT ACT 1872

The laws of contract in India are contained in the Indian Contract Act, 1872. This Act is based mainly on English Common Law which is to a large extent made up of judicial precedents. It extends to the whole of India except the State of Jammu and Kashmir and came into force on the first day of September 1872. The Act is not exhaustive. It does not deal with all the branches of the law of contract. There are separate Acts which deal with contracts relating to negotiable instruments, transfer of property, sale of goods, partnership, insurance, etc. Further the Act does not affect any usage or custom of trade (Sec. 1).

The Structure of the Indian Contract Act is broadly classified as follows:

- General principles of the law of contract are expressed by sections 1 to 75
- The contracts of Indemnity and Guarantee are given under Section 124-147
- Principles of Contract regarding Bailment and Pledge – Section 124 – 147
- Principles of Contract regarding Contracts of Agency – Section 182 - 238

The provisions of Indian Contract Act are subjection to some assumptions. The various provisions of the Indian Contract Act, it will be proper to see some of the basic assumptions underlying the Act include: (i) Subject to certain limiting principles, there shall be freedom of contract to the contracting parties and the law shall enforce only what the parties have agreed to be bound. The law shall not lay down absolute rights and liabilities of the contracting parties. Instead it shall lay down only the essentials of a valid contract and the rights and obligations it would create between the parties in the absence of anything to the contrary agreed to by the parties ; and (ii) Expectations created by promises of the parties shall be fulfilled and their non-fulfillment shall give rise to legal consequences. If the plaintiff asserts that the defendant undertook to do a certain act and failed to fulfill his promise an action at law shall apply.

AGREEMENT & CONTRACT – MEANING

The Law of Contract constitutes the most important branch of Mercantile or Commercial Law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the civilized world.

A legally binding agreement is called a contract. In other words a contract is an agreement which will be enforced by the courts. Salmond defines contract as, "an agreement creating and defining obligation between the parties". Halsbury's defines a contract to be, "an agreement between two or more persons which is intended to be enforceable at law and is constituted by the acceptance by one party of an offer made to him by the other party to do or abstain from doing some act."

Section 2(h) of the Indian Contract Act defines a contract as, "An agreement which is enforceable at law." This definition has two important components which constitute the basis for a contract. They are: (1) An agreement, and (2) Legal obligation.

We shall now examine these elements in detail.

Agreement: Every promise and every set of promises, forming the consideration for each other, is an agreement [Sec. 2 (e)]. Thus it is clear from this definition that a promise is an agreement. What is a promise? The answer to this question is contained in Section 2(b) which defines the term:" When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise". An agreement, therefore, comes into existence only when one party makes a proposal or offer to the other party and that other party signifies his assent (i.e., gives his acceptance) thereto. In short, an agreement is the sum total of 'offer' and 'acceptance'.

On analyzing the above definition the following characteristics of an agreement become evident:

(a) Plurality of persons: There must be two or more persons to make an agreement because one person cannot enter into an agreement with himself.

(b) Consensus-ad-idem: Both the parties to an agreement must agree about the subject-matter of the agreement in the same sense and at the same time.

Legal Obligation: As stated above, an agreement to become a contract must give rise to a legal obligation. Obligation is an undertaking to do or to abstain from doing some definite act. The obligation must be such as is enforceable by law. In other words, it must be a legal obligation and not merely moral, social or religious. To take an example, "Please, come to my house", says Ram to Mohan, "and we shall go out for a walk together". Mohan came to the house of Ram but Ram could not leave the house because of some important engagement. Mohan cannot sue Ram in damages for his not fulfilling the promise, the reason being that there had been no intention between Mohan and Ram to create any legal obligation by the agreement as made between them. In the circumstances, there was, in eye of law no contract between Ram and Mohan.

Similarly, an another kind of obligation which does not constitute a contract is the arrangement made between husband and wife. Such agreements are purely domestic and are not intended to create legal relationship.

The Leading case on this point is ***Balfour v. Balfour (1919)***

Facts of the case are: Mr. Balfour was employed in Ceylon. Mrs. Balfour owing to ill health, had to stay in England and could not accompany him to Ceylon. On the accusation of leaving her in England for medical treatment Mr. Balfour promised to send her | | 30 per month while he was in abroad. But Mr. Balfour failed to pay that amount. So Mrs. Balfour filed a suit against her husband for recovering the said amount. The court held that it was a mere domestic agreement and that the promise made by the husband in this case was not intended to be a legal obligation. Hence the suit filed by Mrs. Balfour was dismissed since there was no contract enforceable in a court of law.

Decision of the Case

(a) Agreements which do not create legal relations are not contracts.

(b) Agreements between husband and wife in domestic affairs is not a contract.

It may be noted that the law of contract deals only with such obligations which spring from agreements. Obligations which are not contractual in nature are outside the scope of the law of contract. For example, obligation to maintain wife and children, obligation to comply with the orders of a court and obligation arising from a trust do not fall within the scope of The Contract Act. Sir John Salmond has rightly observed. "The law of contract is not the whole law of agreements, nor is it the whole law of obligations. It is the law of those agreements which create obligations and those obligations which arise from an agreement".

Agreements which are not Contracts

Agreements in which the idea of bargain is absent and there is no intention to create legal relations are not contracts. These are: agreements relating to social matters or domestic arrangements between husband and wife.

ESSENTIAL ELEMENTS OF A VALID CONTRACT: AN OVERVIEW

All agreements are not contracts. Only that agreement which is enforceable at law is a contract. In other words, the parties to the agreement must have intended that it shall have legal consequences and be legally enforceable. An agreement which is not enforceable at law cannot be a contract. Thus, the term agreement is wider in scope than contract. All contracts are agreements but all agreements are not contact.

An agreement, to be enforceable by law, must possess the essential elements of a valid contract as contained in section 10 of the Indian Contract Act. According to Section 10, "All agreements are contract if they are made by the free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void." As the details of these essentials form the subject-matter of our subsequent chapters, it is proposed to discuss them in brief here.

The essential elements of a valid contract are as follows:

Offer and acceptance: There must be a 'lawful offer' and a 'lawful acceptance' of the offer, thus resulting in an agreement. The adjective 'lawful' implies that the offer and acceptance must satisfy the requirements of the Contract Act in relation thereto.

Intention to create legal relations: There must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. Agreements of a social or domestic nature do not contemplate legal relations, and as such they do not give rise to a contract. An agreement to take dinner at a friend's house is not an agreement intended to create legal relations and therefore is not a contract. Agreements between husband and wife also lack the intention to create legal relationship and thus do not result in contracts.

Illustrations:

(a) H promises his wife W to get her a saree if she will sing a song. W sang the song but H did not bring the saree for her. W cannot bring an action in a court to enforce the agreement as it lacked the intention to create legal relations.

(b) The defendant was a civil servant stationed in Ceylon. He and his wife were enjoying leave in England. When the defendant was due to return to Ceylon, his wife could not accompany him because of her health. The defendant agreed to send her || 30 a month as maintenance expenses during the time they were thus forced to live apart. She sued for breach of this agreement. Her action was dismissed on the ground that no legal relations had been contemplated and therefore there was no contract.

In commercial agreements an intention to create legal relations is presumed. Thus, an agreement to buy and sell goods intends to create legal relationship, hence is a contract, provided other requisites of a valid contract are present. But if the parties have expressly declared their resolve that the agreement is not to create legal obligation, even a business agreement does not amount to a contract. The case of Rose & Frank Co. vs Crompton and Brothers Ltd., provides a good illustration on the point.

Illustration: In the above case R Company entered into an agreement with company, by means of which the former was appointed as the agent of the latter. One clause of the agreement was a follows: "This arrangement is not entered into as a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts. It was held that there was no intention to create legal relations on the part of parties to the agreement and hence there was no contract.

Consensus ad idem: The minds of both the parties must be ad idem. In other words, the two parties must have agreed about the subject matter of the contract at the same time and in the same sense. For instance, if A who owns two cars, one Ambassador and the other Fiat, offers to sell B one car, A intending it to be the Ambassador, B accepts the offer thinking that it is the Fiat, there is no consensus and hence no contract.

Competency of Parties: The parties to the agreement must be competent to contract. If either of the parties to the contract is not competent to contract, the contract is not valid. According to section 11 following are the persons who are competent to contract –

- who have attained the age of majority according to the law to which they are subject;
- who are of sound mind;
- who are not disqualified from contracting by any law to which they are subject.

Lawful consideration: The third essential element of a valid contract is the presence of 'consideration'. Consideration has been defined as the price paid by one party for the promise of the other. An agreement is legally enforceable only when each of the parties to it gives something and gets something. The something given or obtained is the price for the promise and is called 'consideration'. Subject to certain exception, gratuitous promises are not enforceable at law.

The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. It may be past, present or future. But only those considerations are valid which are lawful. The consideration is lawful, unless - it is forbidden by law; or is of such a nature that, if permitted it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or is immoral; or is opposed to public policy (Sec. 23).

Free Consent: An agreement must have been made by free consent of the parties. A consent may not be free either on account of mistake in the minds of the parties or on account of the consent being obtained by some unfair means like coercion, fraud, misrepresentation or undue influence. In case of mutual mistakes, the contract would be void, while in case the consent is obtained by unfair means, the contract would be voidable.

Lawful object: For the formation of a valid contract it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered into must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful for one or the other reasons mentioned above the agreement is void. Thus, when a landlord knowingly lets a house to a prostitute to carry on protection, he cannot recover the rent through a court of law.

Written and Registered: According to the Indian Contract Act, a contract may be oral or in writing. But in certain special cases it lays down that the agreement, to be valid, must be in writing or/and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make a gift for natural love and affection must be in writing and registered (Sec. 25). Similarly, certain other Acts also require writing or/and registration to make the agreement enforceable by law which must be observed. Thus, (i) an arbitration agreement must be in writing as per the Arbitration and Conciliation Act, 1996; (ii) an agreement for a sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882 before they can be legally enforced.

Not declared to be void: The agreement must not have been declared to be expressly void. Agreements mentioned in sections 24 to 30 have been expressly declared to be void.

Certainty: Section 29 of the Contract Act provides that "Agreements, the meaning of which is not certain for capable of being made certain, are void". In order to give rise to a valid contract the terms of the agreement must not be vague or uncertain. It must be possible to ascertain the meaning of the agreement, for otherwise, it cannot be enforced.

Illustration: A agrees to sell B a hundred tons of oil. There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

Possibility of Performance: Yet another essential feature of a valid contract is that it must be capable of performance. Section 56 lays down that "An agreement to do an act impossible in itself is void". If the act is impossible in itself, physically or legally, the agreement cannot be enforced at law.

Illustration: A agrees with B to discover treasure by magic. The agreement is not enforceable.

KINDS OF CONTRACTS

<u>From the point of view of Enforceability</u>

From the point of view of enforceability a contract may be valid or voidable or void or unenforceable or illegal.

Valid contract: An agreement enforceable at law is a valid contract. An agreement becomes a contract when all the essentials of a valid contract as laid down in section 10 are fulfilled. A offers to sell his house for Rs. 10,000 to B. B agrees to buy it for this price. It is a valid contract. A contract to enter into a contract is, however, not a valid contract.

Void contract: A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. It is a contract without any legal effects. A contract may be valid at the time when it is made but it may become void subsequent to its formation Thus, a contract with one who had been an alien friend but later on becomes an alien enemy would be a case of a void contract.

However, a void contract is not necessarily unlawful; it is destitute of legal effects. The law will not enforce such a contract, nor can it be made valid by the parties.

A void contract should be distinguished from void agreement. An agreement not enforceable at law is a void agreement. In the case of a void agreement no contract comes into existence. An agreement with a minor is void. But in the case of void contract, a contract does come into existence but subsequently ceases to be enforceable by law. An agreement which is void never matures into a contract. An agreement which becomes illegal in the course of performance is a case of avoid contract, while an agreement which is null and void ab initio is a case of a void agreement. Void contracts may better be called void agreements to avoid contradiction in terms.

Voidable contract: According to Section 2(i), "an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract". Thus, a voidable contract is one which is enforceable by law at the option of one of the parties. Until it is avoided or rescinded by the party entitled to do so by exercising his option in that behalf, it is a valid contract.

Usually a contract becomes voidable when the consent of one of the parties to the contract is obtained by coercion, undue influence, misrepresentation or fraud. Such a contract is voidable at the option of the aggrieved party i.e., the party whose consent was so caused (Secs. 19 and 19A). But the aggrieved party must exercise his option of rejecting the contract (i) within a reasonable time, and (ii) before the rights of third parties intervene, otherwise the contract cannot be repudiated.

Illustrations: (a) A. threatens to shoot B if he does not sell his new Bajaj Scooter to A for Rs. 2,000. B agrees. The contract has been brought about by coercion and is voidable at the option of B.

Unenforceable contract: It is a contract which is otherwise valid, but cannot be enforced because of some technical defect like absence of a written form or absence of a proper stamp. Such contracts must be sued upon by one or both of the parties. Such contracts cannot be proved in the court. Such contracts will not be enforced by the courts until and unless the defect is rectified.

Illustrations: (a) Amar intending to deceive Akbar falsely represents that five hundred quintals of indigo are made annually at Amar's factory and thereby induces Akabar to buy the factory. The contract has been caused by fraud and is voidable at the option of Akabar.

Other circumstances under which a contract becomes voidable: The Indian Contract Act has laid down certain other situations also under which a contract becomes voidable. For example,

(i) When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, then the contract becomes voidable at the option of the party so prevented (Sec. 53).
Illustration: A. contracts with B that A shall whitewash B's house for Rs. 100. A is ready and willing to execute the work accordingly, but B prevents him from doing so. The contract becomes voidable at the option of A.

(ii) When a party to the contract promises to do a certain thing within a specified time, but fails to do it, then the contract becomes voidable at the option of the promise, if the intention of the parties was that time should be of the essence of the contract (Sec. 55).
Illustration: X agrees to sell and deliver 10 bags of wheat to Y for Rs. 2,500 within one week. But X does not supply the wheat within the specified time. The contract becomes voidable at the option of Y.

<u>Consequences of rescission of voidable contract</u>: Section 64 lays down the rights and obligations of the parties to a voidable contract after it is rescinded. The Section states that when a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is a promisor. If the party rescinding a voidable contract has received any benefit from another party to such contract, he must restore such benefit, so far as may be, to the person from whom it was received. For example, when a contract for the sale of a house is avoided on the ground of undue influence, any money received on account of the price must be refunded. Notice that the Section aims at placing both the parties to a voidable contract, after its rescission, on the same footing as for there had been no contract at all. But it must be remembered that the benefit which is to be restored must have been received under the contract.

<u>Void agreement</u>: "An agreement not enforceable by law is said to be void" (Sec.2 (g)). Thus a void agreement does not give rise to any legal consequences and is void ab-initio. In the eye of law such an agreement is no agreement at all from its very inception. There is absence of one or more essential elements of a valid contract, except that to 'free consent', in the case of a void agreement. Thus, an agreement with a minor is void ab-initio as against him, because a minor lacks the capacity

to contract. Similarly, an agreement without consideration is void ab-initio, of course with certain exceptions as laid down in Section 25. Certain agreements have been expressly declared void in the Contract Act e.g., agreements which are in restraint of trade or of marriage or of legal proceedings or which are by way of wager.

Obligation of person who has received advantage under void agreement or contract that becomes void: In this connection Section 65 lays down that when an agreement is discovered to be void or when a contract becomes void any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it. Thus, this Section provides for restitution of the benefit received; so that both parties may stand unaffected by the transaction; in the following two cases:

(a) When an agreement is discovered to be void: In other words, when an agreement is void ab-initio but the fact of its being void being discovered at a later stage. For example, A pays B Rs. 1,000 for B's agreeing to sell his horse to him. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. In this case the agreement is discovered to be void and B must repay to A Rs. 1,000. It should, however, be noted that agreements which are known to be void or illegal, when they are entered into, are excluded from the purview of this Section.

(b) When a contract becomes void: Restitution is also allowed in the case of a void contract. For example, A agrees to sell B after one month 10 quintals of wheat at Rs. 700 per quantal and receives Rs. 600 as advance. Soon after the contract, private sales of wheat are prohibited by an Act of the legislature. The contract becomes void but A must return the sum of Rs. 600 to B. Similarly, where after accepting Rs. 1,000 as advance for singing at a concert for B, A is too ill to sing. A is not bound to make compensation to B for the loss of the profits which B would have made if A would have been able to sing, but A must refund to B the 1,000 rupees paid in advance.

Illegal Contract: A contract which is either prohibited by law or otherwise against the policy of law is an illegal contract. It is void ab-initio. Thus, a contract to commit dacoity is an illegal contract and cannot be enforced at law. An illegal contract should be distinguished from a void contract. Both are unenforceable at law but there is something more in an illegal contract. Every illegal contract is a void contract but every void contract may not be illegal contract e.g. a wagering agreement is void but not illegal or an agreement with a minor is void but not illegal. Every void contract is not illegal unless its object or consideration is (a) immoral or (b) opposed to public policy etc. A void contract does not affect a collateral contract. But when a contract is illegal collateral contracts depending thereon are also void. An illegal contract is like an infectious disease and is fatal not only to the main contract but to collateral contract as well.

Example: X borrows Rs. 10,000 from Y for the purpose of smuggling goods. Y knows the purpose of the loan. The agreement between X and Y is collateral to the main agreement which is illegal. The collateral agreement is also illegal.

Difference between voidable contract and void agreement

- A void agreement has from the very beginning no legal effects. It is unenforceable at law. A voidable contract is one which one of the parties may affirm or reject at his option. It is valid and enforceable till it is repudiated or rescinded.
- The defect in the case of voidable contract is curable and may be condoned. But a void agreement is void ab initio and its defects are incurable.
- In the case of a void agreement even a third party cannot acquire any right from person claiming under such contract while in the case of voidable contract, a third party can acquire a valid title from a person claiming under such a contract.
- Since a void agreement is unenforceable at law there does not arise any question of compensation on account of the non-performance of the agreement. But in case of a voidable contract, a person is entitled to compensation for loss or damages suffered by him on account of the non-performance of the contract.
- A voidable contract does not affect the collateral transaction. But where the agreement is void on account of illegality of the object, the collateral transaction will also become void.

Contracts Classified on the Basis of Performance

Unilateral contract: A unilateral contract is one in which a promise on one side is exchanged for an act on the other wide. In such contracts one party to the contract has performed his part and an obligation is outstanding against the other party. Thus, where a doctor in a private clinic, examines a patient and gives the medicine, the patient alone remains liable to pay the fees. It is a case of unilateral contract.

Bilateral contract: In such a contract a promise on one side is exchanged for a promise on the other. It is a contract in which there is an obligation on the part of both the parties to do or to refrain from doing a particular act. A promises to paint a picture in return for which B promises to pay Rs. 500. Here a promises to paint the picture and B promises to pay. Each party is thus both a promisor and a promisee.

Executed contract: A contract is said to be executed when one party to the contract has performed his share of the obligation and the other party is still to perform his share of the promise. In executed contracts, the contract does not come into existence until one party to it has done all that he can be required to do. Thus, where A advertises a reward of Rs. 500 to anyone who finds his missing dog, and when B knowing the offer brings the missing dog, A becomes liable to pay Rs. 500.

Executory contract: It is a contract where some future act is to be done. It is one which is either wholly unperformed, or there remains something to be one of both the sides. Thus, where an agreement is made to build a house in six months, it is an executory contract.

Kinds of Contracts from the Point of View of Mode of Creation

From the point of view of mode of creation a contract may be anyone of the following types:

Express contract: Where both the offer and acceptance constituting an agreement enforceable at law are made in words spoken or written, it is an express contract. For example A tells B on telephone that he offers to sell his car for Rs. 1,00,000 and B in reply informs A that he accepts the offer, there is an express contract.

Implied contract: Where both the offer and acceptance constituting an agreement enforceable at law are made otherwise than in words i.e., by acts and conduct of the parties, it is an implied contract. Thus, where A, coolie in uniform takes up the luggage of B to be carried out of the Railway station without being asked by B, and B allows him to do so, then the law implies that B agrees to pay for the services of A, and there is an implied contract. Similarly, where M, a professional shoe shiner starts polishing the shoes of N without being requested to do so, and N allows M to polish his shoes knowing that M expects to be paid for the service, there comes into existence an implied contract and N is under obligation to pay to M.

Constructive or quasi-contract: It is a contract in which there is no intention on either side to make a contract, but the law imposes a contract. In such a contract rights and obligations arise not by any agreement between the parties but by operations of law. Thus, a finder of lost goods is under an obligation to find out the true owner and return the goods. Similarly, where certain books are delivered to a wrong addressee, the addressee is under an obligation either to pay for them or return them.

GOVERNMENT CONTRACTS

The subject of government contracts has assumed great importance in the modern times. Today the state is a source of wealth. In the modern era of a welfare state, government's economic activities are expanding and the government is increasingly assuming the role of the dispenser of a large number of benefits. Today a large number of individuals and business organizations enjoy largess in the form of government contracts, licenses, quotas, mineral rights, jobs, etc. This raises the possibility of exercise of power by a government to dispense largess in an arbitrary manner. It is axiomatic that the government or any of its agencies ought not to be allowed to act arbitrarily and confer benefits on whomsoever they want. Therefore there is a necessity to develop some norms to regulate and protect individual interest in such wealth and thus structure and discipline the government discretion to confer such benefits.

Contract-Meaning of the term

A contract is an agreement enforceable by law which offers personal rights, and imposes personal obligations, which the law protects and enforces against the parties to the agreement. The general law of contract is based on the conception, which the parties have, by an agreement, created legal rights and obligations, which are purely personal in their nature and are only enforceable by action against the party in default.

Section 2(h) of the Indian Contract Act, 1872 defines a contract as "An agreement enforceable by law". The word 'agreement' has been defined in Section 2(e) of the Act as ‘every promise and every set of promises, forming consideration for each other’

Government Contract

A contract to which The Central Government or a State Government is a party is called a 'Government Contract'.

Position in Britain

According to Common Law, before 1947, the Crown could not be sued in a court on a contract. This privilege was traceable to the days of feudalism when a lord could not be sued in his own courts. Another maxim which was pressed into service was that the 'King can do no wrong'. A subject could, however, seek redress against the Crown through a petition of right in which he set out his claim, and if the royal fiat was granted, the action could then be tried in the court. The royal fiat was granted as a matter of course and not as a matter of right, and there was no remedy if the fiat was refused. The Crown Proceedings Act,1947, abolished this procedure and permitted suits being brought against the Crown in the ordinary courts to enforce contractual liability, a few types of contracts being, however, excepted.

Position in India

The Indian Contract Act, 1872 does not prescribe any form for entering into contracts. A contract may be oral or in writing. It may be expressed or be implied from the circumstances of the case and the conduct of the parties. But the position is different in respect of Government Contracts. A contract entered into by or with the Central or State Government has to fulfill certain formalities as prescribed by Article 299 of the Indian Constitution.

'Contracts' and 'Government contracts'

It is true that in respect of Government Contracts the provisions of Article 299(1) must be complied with, but that does not mean that the provisions of the Indian Contract Act have been superseded. In the case of State of Bihar v Majeed, the Hon'ble Supreme court held that; "It may be noted that like other contracts, a Government Contract is also governed by the Indian Contract Act, yet it is distinct a thing apart. In addition to the requirements of the Indian Contract Act such as offer, acceptance and consideration, a Government Contract has to comply with the provisions of Article 299. Thus subject to the formalities prescribed by Article 299 the contractual liability of the Central or State Government is same as that of any individual under the ordinary law of contract.". As regards the interpretation of contract, there is no distinction between the contracts to which one of the parties is the Government and between the two private parties.

Though there is hardly any distinction between a contract between private parties and Government contract so far as enforceability and interpretation are concerned yet some special privileges are accorded to the Government in the shape of special treatment under statutes of limitation. Some privileges are also accorded to Government in respect of its ability to impose liabilities with preliminary recourse to the courts. This probably is because of doctrines of executive necessity and public interest.

Formation of Government Contracts

The executive power of the Union of India and the States to carry on any trade or business, acquire, hold and dispose property and make contracts is affirmed by Article 298 of the Constitution of India. If the formal requirements required by article 299 are complied with, the contract can be enforced against the Union or the States.

Article 299 provides:

"(1) All contracts made in the exercise of executive power of the union or a state shall be expressed to be made by the President or by the Governor of the State as the case may be, and all such contracts and all assurances of property made in the exercise of that power shall be executed on behalf of the President or the Governor by such person and in such manner as he may direct or authorize.

(2) Neither the President nor the Governor shall be personally liable in respect of any contract or assurance made or executed for the purpose of any enactment relating to Government of India hereto before in force , nor shall any such contract or assurance on behalf of any of them be personally liable in respect thereof".

Thus Article 299 lays down three conditions which the contracts made in the exercise of the executive power of the Centre or a State must fulfil to be valid –
The contract must be expressed to be made by the president or the Governor as the case may be;
These contracts made in the exercise of the executive power are to be executed on behalf of the President/Governor as the case may be; and
the execution must be by such person and in such manner as the President or the Governor of the case as the case may be, may direct or authorize. The expression "executed" does not by itself contemplate execution of a formal contract by the executing parties. A tender for the purchase of goods in pursuance of a tender notice, notification or statement inviting tenders issued by or on behalf of the President or the Governor, as the case may be, and acceptance in writing which is expressed to be made in the name of the President or Governor and is executed on his behalf by a person authorized in that behalf would fulfil the requirements of Article 299(1). If these requirements are fulfilled, a valid contract may result from the correspondence.

It has been held by the Hon'ble Supreme Court in the case of Bhikaraj Jaipuria v Union of India.

"it is clear from the words "expressed to be made" and "*executed*" that there must be a formal written contract…The provisions of Article 299(1) are mandatory in character and any contravention thereof nullifies the contract and makes it void. The provisions of Article 299(1) have not been enacted for the sake of mere form but they have been enacted for safeguarding the Government against the unauthorized contracts. The provisions are embodied in the constitution on the ground of public policy on the ground of protection of general public and these formalities cannot be waived or dispensed with."

Where a contract is made by tender and acceptance, the acceptance must be made by a duly authorized person and on behalf of the President, and a valid contract may result from correspondence.

A contract complying with the Article can be enforced by or against the government. It is subject to the general provisions of the contract law ,and its terms cannot be changed by resorting to Article 14 of the constitution . A contract not complying with any of the conditions of Article 299(1) of the Constitution is not binding on or enforceable by the Government , and is absolutely void , though not so for collateral purposes , and cannot be ratified. No damages can be claimed for breach unless the contract is complete under this article.

The provisions have been embodied to protect the general public as represented by the government. The terms of the Article have therefore been held to be mandatory and not merely directory. This means that a contract not couched in the particular form stipulated by Article 299(1) cannot be enforced at the instance of any of the contracting parties. Neither the government can be sued and held liable for the breach of such a contract nor can the government enforce such a contract against the other contracting party.

Implied Contract with the Government

In view of Article 299(1) there can be no implied contract between the government and another person, the reason being that if such implied contracts between the government and another person were allowed, they would in effect make Article 299(1) useless, for then a person who had a contract with the government which was not executed at all in the manner provided under Article 299(1) could get away by saying that an implied contract may be inferred on the facts and the circumstances of the particular case. It was held by the Hon'ble Supreme Court in the case of K. P. Chowdhary v State of Madhya Pradesh that,

"In view of the provisions of Article 299(1) there is no scope for any implied contract. Thus no contract can be implied under this Article.if the contract between the Government and a person is not incompliance with Article 299(1), it would be no contract at all and would not be enforceable as a contract either by the Government or by the person."

The Court justified this strict view by saying that if implied contracts between the government and other persons were allowed, they would in effect, make Article 299(1) a dead letter, for then a person who had a contract with the government which was not executed at all in the manner provided under Article 299(1) could get away by pleading that an implied contract be inferred from the facts and circumstances of the case.

However, the Courts have also realized that insistence on too rigid observance of all the conditions stipulated in Article 299 may not always be practicable. Hundreds of government officers daily enter into a variety of contracts, often of a petty nature, with private parties. At times, contracts are entered through correspondence or even orally. It would be extremely inconvenient from an administrative point of view if it were insisted that each and every contract must be effected by a ponderous legal document couched in a particular form.

The judicial attitude to Article 299 has sought to balance two motivations:
On the one hand, to protect the Government from unauthorized contracts; and
On the other hand, to safeguard the interests of unsuspecting and unwary parties who enter into contracts with government officials without fulfilling all the formalities laid down in the Constitution.

A strict compliance with these conditions may be inequitable to private parties, and at the same time, make government operations extremely difficult and inconvenient in practice. Consequently, in the context of the facts of some cases, the courts have somewhat mitigated the rigours of the formalities contained in Article 299(1), and have enforced contracts even when there have not been full, but substantial, compliance with the requirements of Article 299(1). In effect, it may be true to say that the judicial view has oscillated between the liberal and rigid interpretation of Article 299.

A contract to be valid under Article 299(1) has to be in writing. It does not, however, mean that there should always be a formal legal document between the Government and the other contracting party for the purpose. A valid contract could emerge through correspondence, or through offer and acceptance, if all conditions of Article 299(1) are fulfilled.

Under Article 299(1), a contract can be entered into on behalf of the Government by a person authorized for the purpose by the President, or the Governor, as the case may be. The authority to execute the contract on behalf of the government may be granted by rules, formal notifications, or special orders; such authority may also be given in respect of a particular contract or contracts by the President/Governor to an officer other than the one notified under the rules. Article 299(1) does not prescribe any particular mode in which authority must be conferred; authorization may be conferred ad hoc on any person.

Principles Underlying Government Contracts Reasonableness, Fairness

The principle of reasonableness and rationality which is legally as well as philosophically an essential element of equality or non-arbitrariness is projected by Article 14 and it must characterize every State Action, whether it be under the authority of law or in exercise of executive power without making of law. The state cannot , therefore , act arbitrarily in entering into relationship, contractual or otherwise with a third party, but its action must conform to some standard or norm which is rational an non- discriminatory. The action of the Executive Government should be informed with reason and should be free from arbitrariness.

It is indeed unthinkable that in a democracy governed by the rule of law the executive Government or any of its officers should possess arbitrary power over the interests of the individual. Every action of the executive Government must be informed with reason and should be free from arbitrariness. That is the very essence of the rule of law and its bare minimal requirement. And to the application of this principle it makes no difference whether the exercise of the power involves affection of some right or denial of some privilege.

ll actions of the State and its instrumentality are bound to be fair and reasonable. The actions are liable to be tested on the touchstone of Article 14 of the Constitution of India. The State and its instrumentality cannot be allowed to function in an arbitrary manner even in the matter of entering into contracts. The decision of the State either in entering into the contract or refusing to enter into the contract must be fair and reasonable. It cannot be allowed to pick and choose the persons and entrust the contract according to its whims and fancies. Like all its actions, the action even in the contractual field is bound to be fair. It is settled law that the rights and obligations arising out of the contract after entering into the same is regulated by terms and conditions of the contract itself.

The requirement of 'fairness' implies that even administrative authority must act in good faith; and without bias; apply its mind to all relevant considerations and must not be swayed by irrelevant considerations; must not act arbitrarily or capriciously and must not come to a conclusion which is perverse or is such that no reasonable body of persons properly informed could arrive at. The principle of reasonableness would be applicable even in the matter of exercise of executive power without making law. It is settled principle of law that the court would strike down an administrative action which violates any foregoing conditions.

The duty to act fairly is sought to be imported into the contract to modify and alter its terms and to create an obligation upon the State which is not there in the contract. The Doctrine of fairness or the duty to act fairly and reasonably is a doctrine developed in the administrative law field to ensure the Rule of Law and to prevent failure of justice where the action is administrative in nature. Just as principles of natural justice ensure fair decision where the function is quasi-judicial, the doctrine of fairness is evolved to amend, alter or vary the express terms of the contract between the parties. This is so, even if the contract is governed by statutory provisions.

In a democratic society governed by the rule of law, it is the duty of the State to do what is fair and just to the citizen and the State should not seek to defeat the legitimate claim of the citizen by adopting a legalistic attitude but should do what fairness and justice demand.

Public Interest

Tate owned or public owned property is not to be dealt with at the absolute discretion of the executive. Certain precepts and principles have to be observed. Public interest is the paramount consideration. There may be situations where there are compelling reasons necessitating the departure from the rule, but there the reasons for the departure must be rational and should not be suggestive of discrimination. Appearance of public justice is as important as doing justice. Nothing should be done which gives an appearance of bias, jobbery or nepotism.

The consideration to weigh in allotting a public contract are and have to be different than in case of a private contract as it involves expenditure from the public exchequer. The action of the public authorities thus has to be in conformity with the standards and norms which are not arbitrary, irrational or unreasonable. And whenever the authority departs from such standard or norms, the Courts intervene to uphold and safeguard the equality clause as enshrined in Article 14 of the Constitution and strike down actions which are found arbitrary, unreasonable and unfair and prone to cause a loss to the public exchequer and injury to public interest. Therefore, even when an award of contract may not be causing any loss to the public exchequer manifestly, it may still be liable to quashing for being unfair, unreasonable, discriminatory and violate of the guarantee contained in Article 14.

Equality, non-arbitrariness

From a positivistic point of view, equality is antithetic to arbitrariness. In fact, equality and arbitrariness are sworn enemies; one belonging to the rule of law in a republic, while the other, to the whim and caprice of an absolute monarch. Where an act is arbitrary, it is implicit in it that it is unequal both according to political logic and constitutional law and is violative of Article 14. the principle of reasonableness, which legally as well as philosophically, is an essential element of equality or non-arbitrariness pervades Article 14 like a brooding omni-presence and the procedure contemplated by Article 21 must answer the test of reasonableness in order to be in conformity with Article 14.

Contractual Liability

Article 299(2) immunizes the President, or the Governor, or the person executing any contract on his behalf, from any personal liability in respect of any contract executed for the purposes of the Constitution, or for the purposes of any enactment relating to Government of India in force. This immunity is purely personal and does not immunize the government, as such, from a contractual liability arising under a contract which fulfills the requirements under Article 299(1). The governmental liability is practically the same as that of a private person, subject, of course, to any contract to the contrary.

In order to protect the innocent parties, the courts have held that if government derives any benefit under an agreement not fulfilling the requisites of Article 299(1), the Government may be held liable to compensate the other contracting party under S.70 of the Act, on the basis of quasi-contractual liabilities, to the extent of the benefit received. The reason is that it is not just and equitable for the government to retain any benefit it has received under an agreement which does not bind it. Article 299(1) is not nullified if compensation is allowed to the plaintiffs for work actually done or services rendered on a reasonable basis and not on the basis of the terms of the contract.

Section 70 lays down three conditions namely:

1. a person should lawfully do something for another person or deliver something to him;
2. in doing so, he must not intend to act gratuitously; and
3. the other person for whom something is done or to whom something is delivered must enjoy the benefit thereof.

The Courts have adopted this view on practicable considerations. Modern government is a vast organization. Officers have to enter into a variety of petty contracts, many a time orally or through correspondence without strictly complying to the provisions under Article 299. In such a case, if what has been done is for the benefit of the government for its use and enjoyment, and is otherwise legitimate and proper, Section 70 of the Act should step in and support a claim for compensation made by the contracting parties notwithstanding the fact that the contract in question has not been made as per the requirements of Article 299. If Section 70 was to be held in applicable, it would lead to extremely unreasonable circumstances and may even hamper the working of government. Like ordinary citizens even the government should be subject to the provisions of Section 70.

Similarly, if under a contract with a government, a person has obtained any benefit, he can be sued for the dues under Section 70 of the Act though the contract did not confirm to Article 299. If the Government has made any void contracts it can recover the same under Section 65 of the Act.

It needs to be emphasized that Section 70, Contract Act, does not deal with the rights and liabilities of parties accruing from that from relations which resemble those created by contracts. Thus, in cases falling under Section 70, the person doing something for another cannot sue for specific performance of the contract nor can he ask for damages for breach of the contract for a simple reason that no valid contract exists between the parties. All that Section 70 provides is that if the goods delivered are accepted, or the work done is voluntarily enjoyed, then the liability to enjoy compensation for the said work or goods arises. Section 70 deals with cases where a person does a thing not intending to act gratuitously and the other enjoys it.

Section 70, in no way detracts from the binding character of Article 299(1). The cause of action for the respondent's claim under Section 70 is not any breach of contract by the government. In fact, the claim under Section 70 is based on the assumption that the contract in pursuance of which the respondent has supplied the goods, or made the construction in question, is ineffective and, as such, amounts to no contract at all. Thus, Section 70 does not nullify Article 299(1). In fact, Section 70 may be treated as supplementing the provisions under Article 299(1).What Section 70 prevents is unjust enrichment and it as much to individuals as to corporations and governments.

Judicial Review in Contractual Matters

Judicial quest in administrative matters has to find the right balance between the administrative discretion to decide matters contractual or political in nature, or issues of social policy and the need to remedy any unfairness. A State need not enter into contract with anyone, but when if does so it must do so fairly without discrimination and without unfair procedure; and its action is subject to judicial review under Article 14 of the Constitution of India.

Where the Government is dealing with the public, whether by way of giving jobs or by entering into contracts or issuing quotas or licenses or granting other forms of largess, it cannot arbitrarily use its power of discretion and in such matters must conform to certain standards or norms which are not arbitrary, irrational or irrelevant.

The principles of judicial review would apply to the exercise of the contractual powers by the Government bodies in order to prevent arbitrariness or favouritism. However, there are inherent limitations in the exercise of that power of judicial review.

The judicial power of review is exercised to rein any unbridled executive functioning. The restraint has two contemporary significances. One is the ambit of judicial intervention; the other covers the scope of the Court's ability to quash an administrative decision on its merits. These restraints bear the hallmark of judicial control over administrative action. Judicial review is concerned with not reviewing the merits of the decision in support of which the application for judicial review is made, but the decision making process itself.

It is not for the Court to determine whether a particular policy or particular decision taken in the fulfilment of that policy is fair. It is only concerned with the manner in which the decisions have been taken. The extent of the duty to act fairly will vary from case to case. Shortly put, the grounds upon which an administrative action is subject to control by judicial review can be classified under:

1. Illegality: This means the decision-maker must understand correctly the law that regulates his decision-making power and must give effect to it.
2. Irrationality
3. Procedural impropriety

The above are only the broad grounds but it does not rule out the addition of further grounds in course of time. With respect to the judicial review of administrative decisions and exercise of contractual powers by Government bodies, the Hon'ble Supreme Court has held,

"The Government must have freedom of contract. In other words, a fair play in the joints is a necessary concomitant for an administrative body functioning in the administrative sphere or quasi-administrative sphere. However, the decision must not only be tested by the application of the Wednesbury principle of reasonableness (including its other facts) but must be free from arbitrariness not affected by bias or actuated by malafides."

While exercising the power of judicial review, in respect of contracts entered into on behalf of the State, the Court is concerned primarily as to whether there has been any infirmity in the 'decision making process'. By way of judicial review the Courts cannot examine the details of the terms of the contract which have been entered into by the public bodies or the State. Courts have inherent limitations on the scope of any such enquiries. But at the same time the Courts can certainly examine whether "decision making process" was reasonably rational, not arbitrary and violative of Article 14 of the Constitution. If the contract has been entered into without ignoring the procedure which can be said to be basic in nature and after an objective consideration of different options available, taking into account the interest of the State and the public, then Court cannot act as an appellate authority by substituting its opinion in respect of the selection made for entering into such contract. But once the procedure adopted by the authority for the purpose of entering into the contract is held to be against the mandate of Article 14 of the Constitution, the Court cannot ignore such action saying that the authorities concerned should have some latitude or liberty in contractual matters and any interference by the Court amounts to encroachment on the exclusive right of the executive to take such decision. The doctrine that the powers must be exercised reasonably has to be reconciled with the no less important doctrine that the Court must not usurp the discretion of the public authority which the Parliament has appointed to take the decision. Within the bounds of legal discretion is the area in which the deciding authority has genuinely free discretion. If it passes these bounds, it acts ultra vires. The decisions which are extravagant or capricious cannot be legitimate. But if the decision is within the confines of reasonableness, it is no part of the Court's function to look further into its merits.

OFFER AND ACCEPTANCE

OFFER

Definition

A statement by a person, called the offeror, indicating his willingness to contract which statement is made in the awareness that it shall become binding an acceptance by the other person called the offeree.

Case law

Green Acres Farm (Pvt) Ltd v Haddon Motors (Pvt) 1983(1) ZLR 17 (SC)

In this case the defendant sent a truck to the plaintiff with a note requesting the plaintiff to check over the truck. The plaintiff did the checks over the truck and proceeded to effect repairs. Upon presentation of the invoice the Defendant refused to pay arguing that they had not requested the plaintiff to effect any repairs. The plaintiff took the matter to the courts. The Court held that there is no offer made by the plaintiff to repair the truck.

An offer must meet/have the following requirements

1. It must be consistent with all the essentials of the contract, otherwise it is void.
2. It must clearly define all the terms in which an agreement is sought. Therefore it must not be vague, *Levenstein v Levenstein 1955 (3) SA 615 (SR)*
3. It must be communicated to the offeree. The offeree must have knowledge of the offer if his acceptance is to constitute a valid contract.

Case law

Bloom v American Swiss Watch Company 1914 AD 100. It was held that there was no offer made to the plaintiff when he volunteered the information and did not know that there was an offer of reward money. See also *Lee v American Swiss Watch Company 1914 AD 121.*

4. It must be made with intention of being accepted. This means serious intention to create legal relations. This embraces the following:
    - it must not be mere social arrangement or offers made in gest which lacks the animus contrahendi. See *Balfour v Balfour [1919] KB(2) 571.*
    - It must not be binding in honour or gentlemen's agreements i.e. excluding the jurisdiction of the courts. (where the offer) it cannot constitute a legally binding contract. *(Rose and Frank Company v Crompton and Brothers Ltd (1922) (2) KB 261.*
    - It must not be an offer to negotiate or treat i.e. it must be an offer to enter into a binding contract and not merely an invitation to do business or receives offers (i.e. tenders). See *Crawley v Rex 1909 TS 1105.*
    - It may be to one definite person, or to the world. If the offer is made to a definite person or to a number of definite persons, acceptance should be by that person or

those persons only. If it is made to the public anyone else may accept. See *Carlill v Carbolic Smoke Ball Company 1893 (1) QB 256.*

5 The offer must not have been revoked or lapsed. An offer is revoked if it is withdrawn by the offeror. The following should be noted:

- Revokation is not effective until the offeree is aware of it.
- An offer can be revoked to any stage before it is accepted
- The offeror must take reasonable steps to find and inform the offeree of the revocation *Bryne and Co v Lean van Tienhoven and Co 1880 KB*.

6 Where an offer was accompanied by an option, the latter must not have expired. An option is a separate contract to keep the contract open for a specific period. The offer must be accepted within the stipulated period *Boyd v Nel 1922 AD 414.*

7 The offer may be verbal written or implied. Thus if a person boards a bus, the owner of a bus impliedly makes an offer to the person to ride in the bus and the passenger accepts the offer by taking bus seat and tending his fare.

<u>Case law</u>

Ferguson v Merensky 1903 TS 657 Transvaal Supreme Court) where F was anxious to buy M's first two farms. F wrote a letter to M in the following terms:

"If you still desire to dispose of your two farms, I shall be pleased to have your price 2nd terms".

M replied and said:

"I have no objection to sell the two farms in question and as there are coals on the farm and a railway line I will be passing near them, I ask 30 shilling per acre".

In that letter on the referred F to his lawyer with reference to the terms of the contract. When F sued M saying that the latter had sold the farms to him, the Court held that M's reply to F's letter did not constitute a firm offer from which he could not withdraw and which F was entitled to accept M's lawyer had written to F declining the offer made by the plaintiff and at the same time making new proposals. On behalf of the defendant M which the plaintiff had refused to accept

What Constitute An Offer?

There is a distinction between a firm offer and invitation to treat or negotiation. A firm offer is the one which is unconditional and unqualified, it states all the terms and the material facts on which the offer is based. It must become a contract upon an acceptance of the offer as it stands. Thus a "come lets negotiate" is not a firm offer – if a shop displays an item for sale at X dollars can we say that is a firm offer? In the case of <u>*Crawley v Rex 1909 TS 1105*</u> state that the complainant, a shop keeper had advertised a sale of a particular brand of tobacco at a very cheap price in order that he might attract the custom of a large number of the public. He put a placard outside his shop on which the price was shown, the Appellant entered the shop, bought the tobacco and went away. After some minutes he came back again asked for another pound of the same tobacco, unfortunately the complainant declined to serve the Appellant with the tobacco and told him to leave his shop, the Appellant refused to leave the shop whereupon he was arrested for trespass. The Appellant had argued that he had a contract of sale with the complainant but the court thought otherwise and held that there was no contract between the parties. It emphasized that the mere fact that a tradesman advertises the price of the goods he sells does not mean offer to any member of the public. It does not mean the right to enter the shop and purchase at the displayed price. The court also held in the case that: A contract is not constituted when any member of the public comes in and tenders the price mentioned in the advertisement. In summary therefore display of goods at a certain price is not a firm offer but only an invitation to treat. On the contrary, it is the customer who makes the firm offer by presenting goods at the till and when the shop owner accepts the offer to buy, a contract then comes into being.

Case
Carlill v Carbolic Smoke Ball Company
Where the company inserted an advertisement in the newspaper offering to pay 100 pounds to anyone who contracts the increasing epidemic of influenza or any disease caused by taking cold after having used their smoke balls 3 times daily for two weeks according to the printed directions supplied on each ball the advertisement went on to say that 1000 pounds had been deposited with the certain bank showing its commitment in the matter. During the last epidemic of influenza many thousands carbolic smoke balls were sold as preventives against the disease but in no ascertained case was the disease contracted by those using the smoke balls. The plaintiff alleged, on the faith/strength of an advertisement bought one of the balls at chemist and used it as directed three times a day for 2 weeks but she was attacked by the influenza and she claimed the 100 pounds reward price the court of first instance held and she was entitled to the 100 pounds but the defendants appealed but their appeal was dismissed. In point of law the advertisement in this case was an offer to pay 100 pounds to any member of the public who would have performed at those conditions set out in the newspaper. Performance of those conditions was held to constitute acceptance of the offer. The court held further and the offer was a continuing offer which was not important.

Case
See further *Lee v American Swiss Watch Company 1914 AD 12* *Dietrichsen v Dietrichsen 1911 TPD 486.*

Q. To whom may an offer be made/addressed?

- An offer maybe addressed to a particular person, to a group of persons or to the world at large depending on its terms.

Termination of An Offer

Firstly an offer can be terminated by rejection by the offeree. It can lapse on the expiration of fixed period within which it was meant to be accepted. If there is no such fixed period within which an offer should be accepted an offer lapse after the expiry of some (reasonable time).

<u>What constitutes a reasonable time depends on the facts and circumstances of each case</u>

An offer can also be terminated by revocation but this presupposes/presumes that the offer is an ordinary revocable offer as opposed to an option.

- An OPTIO is an offer coupled with a stipulated period of time during which the offeror is not free to revoke it.
- When an option A make an offer to B and gives a stipulated time within which he must accept to it A also is not allowed to make the same offer to C within the same.
- Thus in an option there will be two contracts/conditions to be observed i.e. that of time and that of not having made the same offer to another third party.
- An ordinary revocable offer can simply be terminated by the offer by revocation but before it has been accepted the revocation must be communicated with the offeree.

Lastly an offer is also terminated by death of the offeror.

Who can accept an offer?

As far as ordinary revocable offers are concerned the general rule is that, "an offer made by A may be accepted by C or D".

<u>Case</u>

Blew v Snoxell 1931 TPD 226

Blew wrote to Richard Curle Ltd offering to buy a certain piece of land of a certain piece. The land was owned by Richard Curle Ltd but by Snoxell who indicated to Richard Curle in writing that he accepted the offer. Richard Curle Ltd thereupon notified Blew that the owner of the land had accepted his offer. When Snowxell later sued Blew for damages for alleged breach of contract Blew excepted to the summons on the ground that there was no valid agreement between him and Snoxell. The court held that, "Now it is trite law (i.e. simple legal principle), and an offer made by one person to another can not be accepted by a third party for the simple reason that there was no intention on the part of the one person to contract with the other.

Whatever the subject matter of the contract maybe:

-The Court held further that it was perfectly clear and the offer was made to Richard Curle Ltd and that the plaintiff purported to have accepted that offer but there was nothing to show any acceptance by Richard Curle Ltd. That being the case, there was no contract on which the plaintiff was entitled to come to court as the offer was never made to him.

Case

In the case of *Bird v Sumerville and Anor*, Bird signed an offer to sell land addressed to Sumerville, Sumerville and the second respondent both of whom, the estate agent appointed by Bird had been conducting negotiations with, added the second respondent's name as the purchaser and both signed the agreement of sale. The court upheld Bird's contention/argument that no contract had come into existence because although he initially had no intention of calling to a specific person, his signature of the claimant addressed to Sumerville manifested an intention to sell to him and nobody else. The offer was accordingly not to open for acceptance by Sumerville and another but could be accepted by Sumerville alone.

- The intention of the parties runs through the whole acceptance of contract, parties are bound to what they agreed and they are bound because they agreed intentionally and voluntarily.
- When an option is to sell for cash the offeree may cede that option to the third party because the optional holder has a contractual right which is regarded as property. In this regard i.e. when the option is to sell for cash as long as cash is paid. It does not make a difference to the offeror whether A is B, C or D who pays the cash.
- If the offeror gives credit to the offeree then that option may not be ceded. The giving of credit involves an element of direct personal dealing.

Case

Hersh v Nel 1948(3) SA 686(A) where Nel owned two farms and he gave Mr West an option to purchase the two farms and the together with another person ceded the option to Hersh who then accepted Nel's offer before its expiry. When Hersh accepted the offer Nel refused to sell the farms. When sued, the rule made in the case of Blue v Snoxell was applied i.e. an offer made by A to B may not be accepted by C.

- The court however distinguished an option made in a case sale. The sale of the two farms was on a cash transaction thus in accordance with the principles outlined above the court ruled and the cession to Hersh was valid and his accepted gave him a contract with Nel.

Case

Madan v Macedo Heirs and Anor 1991(1) ZLR 295(SC)

Acceptance:

- The acceptance of an offer must result in a binding contract and not further negotiations. An acceptance must be unconditional/unequivocal and clear.
- A counter offer is not a valid acceptance
- A counter offer is where the offeree instead of unconditionally accepting the offer makes his or her own offer to the offferor.
- This happens in a case where A offers to sale a thing to B at a price of $5 000 then B in response to that offer from A tells A that he is prepared to buy that thing for $4 000. B's conduct in such a situation constitutes/is what is called counter-offering.
- A counter offer may also be in the form of extraneous conditions attached to the acceptance.

- The effect of a counter offer is to terminate the original offer. If the offeree's acceptance is also shrouded in ambiguity/vague it does not constitute an acception.

Case:

Boerne v Harris 1949(1) SA 793(A)

In which the Appellant was the lessee at premises owned and leased by the respondent. The contract lease agreement contained an option under which the appellant could renew the lease agreement for a longer period of 5 years, the period was to be recognised from 15 April 1947 and the option was to be exercised by October 15 1946. On October 5 1946 the lessee's attorneys/lawyers addressed a letter to the lessor in the following terms, "We refer to the lease in respect of the Hotel … and have to advise you that our client intends to renew the lease for a further period of 5 years from 15 October 1946 in terms therefore acceptance of the court held that the purported option was ambiguous in that it was not in accordance with the terms of the option and because of that the exercising of the option was held to be invalid.

Case:

Orlon Investments P/c v Ujama Investment and Ors

If an acceptance has a condition attached to it when A is not an acceptance at all it becomes a counter offer. If the offer is not prepared to accept the counter offer from the offeree the later can not go back and accept the original offer originally made to him and thus there would be nothing left to accept.

Case

Water Mayer v Murry 1911 (AD) 61

Water Mayer owned the farm which Murry wished to buy. Murry wrote a letter to Water Mayer offering to buy his farm for 1 700 pounds. Water Mayer wrote back and said, I accept the offer to sell the farm at 1 700 provided you pay all the expenses and 1 000 pounds is paid at the time of signing the agreement. Murry wrote back and said, "Fine, but the price is not payable at the time of signing … Water Mayer wrote back and said he was no longer interested in selling the farm. When Murry sued Water Mayer the court ruled that Murry had no case because he had made counter offer therefore no contract had been concluded between the parties.

- It must be underscored however that a request for modification of terms is not a counter offer and it does not destroy/terminate the original offer.
- As a general rule a contract is concluded when and where communication of acceptance reaches the mind of the offeror (however, there are exceptions to this general rule). Thus if the offer is communicated to the offeree by telephone in a situation where the offeree is in Harare and the offeree is in Cape Town the contract would be deemed to have been conducted in Cape Town.
- This general rule is subject to change by the parties to the contract i.e. they may agree otherwise the offeror may decide to do away with the need to communicate acceptance. The offeror may also prescribe a particular mode of acceptance e.g. the offerer may say if you wish to accept the offer send it by registered post/ through email or at such and such an office.

Case

R v Nel 1921 AD 339

In this case the Respondent Nel had licence to sell liquor in Transvaal. He received an order form Armstrong who was resident in Cape Town the order was delivered to Nel in the Transvaal (is the written order) and the bottles of liquor were then allocated to the purchaser in Cape Town. Nel was prosecuted for selling liquor in Cape Town without licence as it was necessary for court to make a finding as to when and where the contract of sale had been concluded. The offeror was in the Cape and the offeree in the Transvaal.

The nature of the transaction was that the offeror had dispensed with the need for communication of acceptance and the court concluded that the sale agreement/contract had been sealed in the Transvaal, the moment Nel decided to sell the liquor and he was not guilty.

Case

McKenzie v Farmers Coop Meat Industries Ltd 1922 AD 16

McKenzie applied for shares in the cooperative company the application form read in part, "I agree to accept the above number of shares or any lesser number and may be allotted to me". McKenzie was making the offer to buy the shares and concurrently dispensed with the need for communication of acceptance in that he had expressed the intention that the cooperative should on receiving his application forthwith proceed to allot shares to him. A contract would come into existence as soon as the share transfer secretaries sing a share certificate giving McKenzie any number of shares.

Case

In the *Ujamaa Investment case* the Appellant company was buying shares from the respondents company. The parties engaged in negotiations and there were a number of drafts exchange by the parties and the forth draft was signed by the respondent on October 9 1984. They then sent two copies of that draft to the Appellant under cover of a letter which read in part as follows, "If it is not acceptable, your earlier return of the agreement had a particularly interesting clause which read as follows. This agreement shall only become of force and effect when executed by the seller and by the purchaser. The appellant/purchaser signed both copies of the agreement and kept them in his drawers. After some time the purchaser sued for the transfer of the share but the Respondent alleged that they had not agreed on anything.

- It should be noted that the memorandum said the respondent was to return the agreement only if there was no acceptance and by necessary application keep the if there was acceptance.
- Clause 20 provide that the moment the purchaser signed the agreement, it become a binding contract. In other words and second clause dispensed the need for communication of acceptance. The Appellant argued that they had sent two copies so that the respondent would return one and keep one for his records and return the other one.
- However the memorandum said if the terms were not accepted the respondent was suppose to return the papers quickly and so it was argued that it did not say "If accepted do not return them"

- The court held that the respondent had not dispensed with the need for communication of acceptance and because acceptance had not been communicated it held there was no contract.
- Where the offeror chooses to use the post as the means of communication the expedition theory applies. According to this theory a contract is concluded as soon as the letter of acceptance is posted. The contract is concluded before the offeror receives the letter, let alone reads the letter. Thus there will be a binding contract even though the letter never get into the hands of the offeror.
- The rationale behind this theory is that the offeror must suffer the risk consequences of choosing a specific method of acceptance (is communicated acceptance).

The leading case on the Expectation theory is that of:

Cape Explosive Works v SA Oil & Fat Industry 1921(4) CPD 244 where the first defendant wrote a letter on the 10th of July 1916 and sent it by post from Delmore in Transvaal to the plaintiff in Sommerset in Cape Town. The letter contained an offer to sell certain quantities of glycerine oil. On the 14th of July 1916 the plaintiff replied accepting the offer. Then on 11 September 1916 the second defendant of Durban sent a letter by post to the plaintiff in Cape Town containing another offer to sell a certain quantity of glycerine oil. The letter of acceptance was the posted on 16 September by the plaintiff's in Cape Town. In an action of the …… the defendants took exception to the jurisdiction of the court on the ground that they were not entered into in the Cape but in the Transvaal and Natal respectively where the defendants had received the letters of acceptance. This argument did not find favour with the court which held that the contracts had been concluded in Cape Town where the letters of acceptance had been posted.

- When the offeror makes the offer by post the immediate inference is that acceptance can also be by post so it is open to the offeror to indicate that he will not consider himself bound unless and until he receives the letter of acceptance.
- If the offeror does not make this special provision the expedition theory will be applied without any exception. The basis of the rule is that by using the post first the offeror by implication authorises the offeree to use the same method of communication.

<u>Case</u>

Smeiman v Volkersz 1954(4) SA 170

The Applicant and the respondent made an option to sell some shares to the applicant. The option was verbal and it was to remain open till 15 February 1954. On the 15th of February a lawyer acting for the applicant phoned the respondent's office in the Cape only to be told that the respondent was not in the Cape but somewhere in OFS.

- Applicant's lawyer then quickly wrote a letter exercising the option on behalf of the applicant. A copy of the letter was sent to respondent's Cape Town office and another to where the respondent was thought to be.
- Both copies were posted on the 15th of February but neither reached the respondent on the date. If the expedition theory is applied then the option had been exercised timeously but if it did not apply, then it was not exercised on time because it had lapsed. The question was,

"Had the respondent impliedly authorized the use of the post?" Looking at the facts and what was the appropriate method of replying? The court held that the mere fact that parties reside at a distance does not *per se* warrant the use of post, the expedition theory therefore did not apply.

- By using the post one of the risks the offeror assumes is precisely that the offeree had an option of using a more expeditious means of communication in respecting the offer.
- Similarly, a faster means of communication would neutralize a posted acceptance.

<u>Case</u>

A to Z Bazaars (Pvt) Ltd v Ministry of Agriculture1975(3) SA 468

- The offer contained in a notice of expropriation in terms of Section 2 of the Expropriation Act (SA) requires the offeree to signify his acceptance or rejection of the offer of compensation. In accordance with the provision of Section 6(1)of the Act.
- This Section provided that the owner of the property in question should deliver or cause to be delivered a statement indicating whether or not he was accepting. Court interpreted this Section to mean that the owner was required to physically deliver to the Ministry concerned a written acceptance for a contract to come into existence.

- There was accordingly no room for the applicant of the expedition theory.

  Jansen JA said, But even under the law the question whether the alleged agreement has been conducted by posting must depend upon particular circumstance of each case. The Expedition Theory does not hold without exceptions.

- It is important therefore to establish the precise limits of the application of the Expedition Theory.
- Thus the judge emphasized that it is not clear that all whether the Expedition Theory, mainly condemned for the protection of the offeree, should necessarily produce the possibility of a neutralization of the posted acceptance before it is received by the offeror.

Mistake And Quasi-Mutual Assent

N/B First there must be offer and acceptance (i.e. in the formulation of a contract).

The second requirement that ought to be present is that of agreement of which can either be actual apparent. As regards actual agreement there has to be a meeting of minds of the parties involved in a coincidence of wills. This is referred to as a *consensus ad idem* on the subjective theory. What it means is that if the terms of the contract are different as known by A and B then there is no contract.

<u>Case</u>

Jordan v Trollip (1960) (1) PH 825

-In a Robert AJ reiterated Wessels train/trial of thought that in order to determine the existence/otherwise of a contract. It is the manifestation of the parties wills and not the unexpressed will which is of importance.

-This point was further emphasized in the case of *Jones v Anglo African Shipping Company 1936 (1972) SA 827 of 834*, where the court held that, "In the interpretation of a contract the general rule is that the court should determine what the true intention of the parties was.

-As regards apparent agreement it has come to be accepted that a contract can also come into existence in the absence of actual agreement. If one of the parties conducts himself in a manner that make the other party believe that he is agreeing to a proposed term of contract. This is referred to as Quasi Mutual Assent or the objective theory of contract.

-The doctrine of Quasi Mutual Assent was clearly articulated in the case of *Smith v Hughes (1871) 6QB 597 of 607* where Blackburn J had this to say, "If whatever a man's real intention maybe he so conducts himself and reasonable men would believe that he was assenting to the terms proposed by the other parties terms".

-This is sometimes referred to as Agreement by conduct.

-The following relevant factors must be taken into consideration when dealing with matters relating to Quasi Mutual Assent:

(a) has A instead of B into believing that he is prepared to contract on terms a, b, c if the answer is no then the court should consider the following question
(b) Was B's belief reasonable? If the answer is Yes then there is a contract as understood by B on the basis of Quasi Mutual Assent.

-Courts have often asked this question, "Is there any difference between <u>Quasi Mutual Assent</u> and <u>Estoppel?</u>

-Before addressing the question it is imperative to define what estoppel is.

-<u>Estoppel</u> is a general principle of law whereby, if a person either negligently or fraudulently misrepresents facts and another relies on the misrepresentation to his detriment the person making the misrepresentation is prevented from ascertaining and providing that the true state of affairs is different.

-For a person to establish estoppel he has to prove the following four factors:

(i) That there was a misrepresentation (i.e. either negligent/fraudulently).
(ii) That there was fault on the party of the represent or either in the form of negligence.
(iii) That the other party relied on the misrepresentation.
(iv) That there was detriment which was caused by a reliance upon such misrepresentation.\

ACCEPTANCE

Requirements of Acceptance

Acceptance of an offer is the expression, by words or conduct, of assent to the terms of the offer in the manner prescribed or indicated by the offer. Thus acceptance may be expressed or implied

HBF Dalgety v Morton: There are two requirements to satisfy for valid acceptance to occur:

1. The offeree must agree to accept the terms of the offer
2. This information must be communicated to the offeror.

Acceptance must correspond to Offer: Offeree must have knowledge of and act in reliance to an offer

The offeree must have knowledge of the terms of the offer at the time of purported acceptance. Acceptance is not valid if two identical offers are made or if a party performs the act of acceptance without knowledge of the offer.

- *Tinn v Hoffman: A Counter Offer is not Acceptance:* If a counter offer is made, the original offer is rejected and the counter offer can then itself be accepted or rejected. Once a counter offer is made and the original offer rejected, the offeree can no longer accept the original offer
- *Hyde v. Wrench*: A purported acceptance that departs from the terms of the offer but only in a minor non-material way may be effective and not amount to a counter offer
- *Turner Kempson v Camm:* Acceptance must be Unqualified
  If there is an agreement on all terms of the offer, and the parties intend to be bound immediately, this would be considered unqualified acceptance of the offer.
- *Masters v Cameron: Mere Inquiry does not Constitute Acceptance*
  After receiving an offer, an offeree may want further clarification of one or more terms. This inquiry can at most, only communicate interest but not acceptance nor rejection of an offer.
- *Stevenson Jaques v McLean: Notification to the Offeror of the Fact of Acceptance*
  The offeree must communicate acceptance of the offer to the offeror and agreement is not complete until such communication is affected.
- *Soares v Simpson: Method of Acceptance*: What is an appropriate method of acceptance in any given situation will depend on each situation, whether the offeror has outlined a specified method of acceptance with in the offer, or if it is not stipulated, the appropriate method of acceptance will depend on the intention of the parties as derived from the particular facts. Whether acceptance has occurred depends on whether the offeree has complied with the requirements for the method of acceptance for the particular situation.

a) <u>Method of Acceptance Stipulated by Offeror</u>

The offeror may stipulate how acceptance should take place (eg. the performance of an act, return post etc.). If acceptance does not occur in this way, generally there is no agreement. Although, if the offeree accepts in a manner that is more advantageous for the offeror, then the acceptance will be valid.

Tinn v Hoffman

Also, if the method of acceptance was inserted for the convenience of the offeree, the offeree may wave the benefit of the clause and accept in a different way. Or even if a manner of acceptance is prescribed in the offer, on the true construction of the terms in the offer, this may not be the only method of acceptance that will be effective

b) <u>Acceptance by Silence</u>

The offeror cannot stipulate silence to constitute consent under any circumstances. The technique of delivering a product with a notice stating that unless the goods are returned within a stated period (or rejection communicated in a different way), the buyer will be taken to have agreed to buy the product on the stated terms is now prohibited by statute.

c) <u>Acceptance by Conduct</u>

An offeror may stipulate the manner of acceptance by advising the offeree that if he/she wishes to accept the offer, the offeree should perform stipulated acts waiving the need to communicate acceptance. Acceptance can be express or implied.

<u>Instantaneous Communication: Acceptance must be communicated</u>

a) <u>General Rule</u>

When the mode of acceptance is instantaneous communication, the general rule of law is that the contract will be formed when acceptance of the offer is communicated to the offeror and that communication is received.

b) <u>Meaning of instantaneous Communication</u>

Face to face communication, telephone conversations and telex messages are all considered forms of instantaneous communication.

<u>Postal Acceptance Rule</u>

The postal acceptance rule is the exception to the general rule that acceptance occurs when it is communicated to the offeror.

a) Statement of the rule

Where the circumstances are such that it must have been within the contemplation of the parties that, according to the ordinary usages of mankind, the post might be used as a means of communicating the acceptance of an offer, the acceptance is completed as soon as it is posted. The rule operates only where the post is an acceptable method of communication between the two parties (eg. the offer was made by post or it is stipulated in the offer that the post is an acceptable method of communication)

b) Policy behind the rule: The postal rule promotes contractual certainty.
c) To what communication does the rule extend: The postal acceptance rule applies to forms of communication that are akin to mail but does not extend to any form of instantaneous communication, even if that communication bears some similarities to communication by post.

d) Where is the rule displaced?
The rule is displaced if the court decides that it was not within the contemplation of the parties that the post was an accepted method of communication. Whether the postal rule is displaced turns the intention of the offeror. If the offeror says or implies that actual notification is required before an agreement if formed the postal acceptance rule will be displaced.

e) Revocation of the acceptance prior to receipt
The offer is formed when the letter of acceptance is posted. A subsequent purported withdrawal of that acceptance will be ineffective.

Acceptance in Unilateral Contracts

- Acceptance commonly by conduct: The requirement for acceptance to be communicated is often impliedly waived. Acceptance is affected by the offeree by performing the requirements that are specified by the offeror.
- Withdrawal of an offer after acceptance has commenced
  Generally, once an offeree has begun to accept the offer by performing the acts stipulated, it is likely to be too late for the offeror to withdraw the offer and claim there has been no contract formation.

Who may accept an offer?

- An offer can only be accepted by the person to whom it was made.
- Acceptance may be communicated only by the offeree or his or her agent

Powell v Lee

If an offer is made to the public at large it can sometimes be accepted by a number of people. In *Carlill's Case* the offer was capable of acceptance by anyone who qualified under the terms of their offer (eg. anyone who purchased a smoke ball, however, in the case of a reward, while many people may have the information which qualifies them for the reward, only the first person to come forth will be eligible).

Contract formation: time and place

- Instantaneous communication: A contract is formed when and where the offeror receives and accepts the acceptance communicated.
- Post: If the postal acceptance rule applies, the contract is formed when, and at the place that, the letter of acceptance is posted.

CONSIDERATION

CONCEPT OF CONSIDERATION

According to section 10 of Indian Contract Act, 'Consideration' is one of the essential elements of a valid contract. The fact of its existence serves to distinguish those promises by which the promisor intends to be legally bound from those which are not seriously meant. In the words of Blackstone : "A consideration of some sort or other is so necessary to the forming of a contract, that a *nudum pactum*, or agreement to do or pay something on one side, without any compensation on the other, will not at law support an action; and a man cannot be compelled to perform it... The law supplies no means nor affords any remedy to compel the performance of an agreement made without consideration. If I promise a man £100 for nothing, he neither doing nor promising anything in return or to compensate me for my money, my promise has no force in law". The breach of a gratuitous promise cannot be redressed by legal remedies. It is only when a promise is made in return of 'something' from the promisee, that such promise can be enforced by law against the promisor. This something in return is the consideration for the promise.

Definition of Consideration: It may be defined as the price for which the promise of the other is bought. It is something which is of some value in the eyes of law. It may be some benefit to the plaintiff or some detriment to the defendant. It is also used in the sense of quid pro quo i.e. something in return.

Section 2(d) of the Indian Contract Act defines consideration as :

a. when at the desire of the promisor,
b. the promisee or any other person,
c. has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing,
d. something, such act or abstinence or promise is called a consideration for the promise.

The definition of consideration as given in section 2(d) is a simple and practical definition. It is something of value which the promisee has given, gives or promises to give in return for the promise. It does not mean payment of money only. Forbearance to sue is good consideration. A promise can be a consideration for another promise. A single consideration may support more than one promise. It can also consist in performance. Settlement of dispute can be a good consideration for the promise. Similarly, if the promisee gives up any legal right, he gives sufficient consideration to support the other party's promise. Thus, refraining from smoking, gambling or drinking would supply the consideration needed to support another person's promise to pay a certain sum of money to the one who refrained. But the mere doing of a thing which a person is already legally bound to do is no consideration for a new promise in his favour.

Illustrations:

a. X agrees to sell his horse to Y for Rs. 10,000. Here X's promise to sell his horse is for Y's consideration to pay Rs. 10,000. Similarly, Y's promise to pay Rs. 10,000 is for X's consideration to sell his horse to Y.
b. A agrees to give Rs. 1,000 to B as a voluntary donation for a temple building. This promise is not binding on A because there is no reciprocal consideration for his promise. However, if B has undertaken any liability on the faith of A's promise, the contract is binding on A.
c. A promises his debtor B not to file a suit against him for one year on B's agreeing to pay him Rs. 100 more. The abstinence of A is the consideration for B's promise to pay.

ESSENTIALS OF VALID CONSIDERATION

The essentials of a valid consideration are discussed as follows:

It must move at the desire of the promisor: In order to constitute legal consideration, the act or abstinence forming the consideration for the promise must be done at the desire or request of the promisor. Thus acts done or services rendered voluntarily, or at the desire of third party, will not amount to valid consideration so as to support a contract. The logic for this may be found in the worry and expense to which every one might be subjected, if he were obliged to pay for services, which he does not need or require.

The leading case on this point is *Durga Parsad v. Baldeo (1880)*

Decision: Consideration should be at the desire of the promisor.

Facts of the case are: D promised to pay P a commission on articles sold by him in a bazar in which he occupied a shop in consideration of P having expended money in the construction of such bazar. The money had not been spent by P at the request of D but was spent by him at the desire of the Collector of the District. In a suit by P it was held that there was no consideration for the promise made by D and hence no contract.

Illustration: Mr. A advanced money to B on an undertaking given by his father and obtain promissory notes for the amount advanced. On a suit to recover the amount, it was held that these pro-notes were without consideration in as much as the advances were not made at the request of B. (*Raja of Venkatagiri v. Krishnaya* AIR 1948 P.C. 150).

A promise to **subscriber to a public or a charitable object is unenforceable** because there is not benefit to the promisor. But where the other party has undertaken a liability on the faith of the promise made by the promisor, it is enforceable.

The leading case on this point is *Kedar Nath v. Gori Mahomed (1886)*

Decision: An Act done at the request of the promisor is a good consideration to supply the promise.

Facts on the case are: X had agreed to subscribe Rs. 100 towards the construction of a Town Hall at Howrah. Y the secretary of the committee, on the faith of the promise called for plans and entrusted the work to contractors and undertook liability to pay them. X refused to pay the promised amount and Y brought a suit against him. It was held that though the promise was to subscribe to charitable institutions and there was no benefit to X, yet it was supported by consideration in that Y, the promisor suffered a detriment in having undertaken a liability to the contractors on the faith of the promise made by X.

But where nothing has been done in furtherance of the object of the fund raised a promised subscription is not legally recoverable.

Consideration may move from the promisee or any other person : The important feature of the definition of consideration in Section 2 (d) is that the act which is to constitute a consideration may be done by the promise or any other person. It means that as long as there is a consideration for a promise, it is immaterial who has given it. It may move from the promisee, or if the promisor has no objection, from any other person. This is wider than the concept of England, where consideration can move only from the promisee. Consideration moving from a third party who is minor is no consideration.

The leading case on this point is *Chinnaya v. Ramaya* (1882)

Decision : Consideration may move from the promisee or any other person.

Facts of the case are : An old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed a writing in favour of the maternal uncle agreeing to pay the annuity. The daughter did not, however, pay the annuity and the uncle sued to recover it. It was held that there was sufficient consideration for the uncle to recover the money from the daughter.

Illustration : X, Y and Z enter into an agreement under which X pays Rs. 1,000 to Y and Y agreed to build a house for Z. Here Z is a party to the contract but stranger to consideration and can enforce the contract. It will be observed in the above case that there was no contract between the daughter and the maternal uncle, but as a result of the agreement between the old lady and her daughter, the uncle was the beneficiary and was entitled to the consideration though he was a stranger to the contract. Therefore, consideration need not move from the promisee, but can move from any other person.

Doctrine of Privity: A Stranger to a Contract Cannot Sue

A person may be a stranger to the consideration but he should not be a stranger to the contract because privity of contract is essential for enforcing any of the rights arising out of the contract. It being a fundamental principle of the law of contracts that a stranger to a contract cannot use, only a person who is a party to a contract can sue on it. Thus where A mortgages his property to B in consideration of B's promise to A to pay A's debt to C, C cannot file a suit against B to enforce his promise, C being no party to the contract between A and B (*Iswaram Pillai vs Sonnivaveru*, 1915, 38 Mad. 753).

Exceptions: The above rule that a stranger to a contract cannot sue is subject to the following exceptions:

(i) Where an express or implied trust is created: In case of a trust, the beneficiary can sue in his own right to enforce his rights under the trust, though he was not a party to the contract between the settler and the trustees.

Illustration: (a) A transfers certain properties to B to be held by B in trust for the benefit of M.M. can enforce the agreement i.e., trust (M.K. Rapai vs John, (1965), A.I.R. Ker 203)

(ii) Family settlement: Where a provision is made in a partition or family arrangement for maintenance or marriage expenses of female members; such members, though not parties to the agreement, can sue on the footing of the arrangement.

Illustration: A daughter a long with her husband entered into a contract with her father whereby it was agreed that she will maintain her mother and the property of the father will be conveyed to them. The daughter subsequently refused to maintain the mother. On a suit it was held that the mother was entitled to require her daughter to maintain her, through she was a stranger to the contract (Veeramma vs Appayya, 1957, A.I.R. AP 965).

(iii) When the defendant constitutes himself, as the agent of the third party.

Thus if A receives some money from B to be paid over to C and he admits of this receipt to C, then C can recover this amount from A who shall be regarded as the agent of C (*Surajan vs Nanat*, 1940, A.I.R. Lah 471).

(iv) In case of agency: Where a contract is entered into by an agent, the principal can sue on it.

(v) In case of assignment of rights under a contract in favour of a third party either voluntarily or by operation of law, the assignee can enforce the benefits of the contract, e.g., the assignee of an insurance policy or the official assignee on the insolvency of a person can sue on the contract even though originally they were not parties to it.

Consideration may be past, present or future : The words, "has done or abstained from doing; or does or abstains from doing; or promises clearly indicate that the consideration may consist of either something done or not done in the past, or done or not done in the present, or promised to be done or not done in the future. To put it briefly, consideration may consist of a past, present or a future act or abstinence.

Consideration may consist of an act or abstinence. For example, an agreement between B and A, under which B; on failing to pay the debt amount on the due date to A; promises to raise the rate of interest from 9 per cent to 12 per cent in consideration of A promising not to file a suit against him for another one year is a valid contract; A's abstinence being the consideration for B's promise.

Past Consideration : When something is done or suffered before the date of the agreement, at the desire of the promisor, it is called 'past consideration'. It must be noted that past consideration is good consideration only if it is given by the promisee, 'at the desire of the promisor'. Illustrations:

(i) A teaches the son of B at B's request in the month of January, and in February B promises to pay A a sum of Rs. 500 for his services. The services of A will be past consideration.

(ii) A lawyer, gave up his practice and served as manger of a landlord at the latter's request in lieu of which the landlord subsequently promised a pension. It was held that there was good past consideration. (*Shiv Saran vs Kesho Prasad*)

Present Consideration: When the consideration for a promise is given simultaneously with the promise it is called present consideration. A present consideration consists in doing or abstaining from doing something. A promise to give time to a debtor is good consideration. Present consideration arises where there is a promise to pay for goods sold and delivered.

Future consideration: A future or executory consideration is a promise to do or give something in return in future for the promise then made. It is also called a promise for the promise. Mutual promises to marry, a promise to do working return of promise of payment are examples of future consideration.

Illustration: A promises to deliver goods to B when the ship arrives and B promises to pay A Rs. 1000 against the receipt of goods. This is a case of future consideration, which is to be performed by both the parties when the ship arrives.

It need not to be adequate: The law of contract nowhere laid down that consideration should be adequate to the promise. What is required is that there must be some consideration for the promise. Adequacy is for the parties to decide at the time of making the agreement. Inadequacy of consideration is no ground for refusing the performance of the promise, unless it is evidence of fraud. It should be of some value in the eyes of law. Even a smallest consideration is sufficient provided it has some value. If a man gets what he contracted for, the court will not inquire whether it was an equivalent to the promise which he gave in return. Where in an agreement the consent of the promisor has been freely given, an inadequacy of the consideration will not render it unenforceable. For example: A agrees to sell his house worth Rs. 90,000 to B for Rs. 9,000. A's consent to the agreement was freely given, the agreement is a contract not withstanding the inadequacy of the consideration.

Consideration must be real: Though consideration need not be adequate, it must be of some value in the eyes of law, i.e., it must be real and competent. Where consideration is physically impossible, illegal, uncertain or illusory, it is not real and therefore shall not be a valid consideration.

i. Physically impossible: A promise to do something which is physically impossible, e.g., to make a dead man alive or to run at a speed of 100 kilometres per hour, does not form valid consideration.
ii. Legally impossible: A promise to do something which is illegal, e.g., a promise for illegal cohabitation, does not amount to good consideration.
iii. Uncertain consideration: A promise to do something which is too vague and uncertain, e.g., a promise to pay such remuneration "as shall be deemed right", is no consideration in the eye of law.
iv. Illusory consideration: Again, an illusory or deceptive consideration does not amount to a valid consideration. Consideration is illusory if it consists in a promise to perform a public duty, or to perform a contract already made with the promisor.

Illustration: A (the plaintiff) received a subpoena (a kind of summon) to appear at a trail as a witness on behalf of B (the defendant). B promised him a sum of money for his trouble. On default by B, A filed the suit for the recovery of the promised sum. It was held that A being under a public duty to attend and give evidence, there was no consideration for the promise and hence the promise is unenforceable (*Callins vs Godefroy*).

EXCEPTIONS OF THE RULE, "NO CONSIDERATION, NO CONTRACT"

Consideration being one of the essential elements of a valid contract, the general rule is that "an agreement made without consideration is void". But there are a few exceptions to the rule where an agreement without consideration will be perfectly valid and binding. These exceptions are as follows

Agreement made on account of natural love and affection: An agreement made without consideration is enforceable if, it is (i) expressed in writing, and (ii) registered under the law for the time being in force for the registration of documents, and is (iii) made on account of natural love and affection, (iv) between parties standing in a near relation to each other. Thus there are four essential requirements which must be complied with to enforce an agreement made without consideration, as per Section 25(1). Illustration : (a) A for natural love and affection, promises to give his son B, Rs. 1,000. A puts his promise to B into writing and registers it. This is a valid contract. (b) A, by registered agreement on account of love and affection for his brother B undertook to discharge a debt due by B to C. Actually A did not fulfil the promise. So B paid the debt. It was held that B could recover the amount of debt from A. [*Venkataswamy v. Rangaswamy* (1903) 13 M.L.J. 428].

It should, however, be noted that mere existence of a near relation between the parties does not necessarily import natural love and affection. Thus where a Hindu husband, after referring to quarrels and disagreement between him and his wife, executed a registered document in favour of his wife, agreeing to pay for separate residence and maintenance, it was held that the agreement was void for want of consideration because it was not made out of natural love and affection. [RajlaKhi Devi vs Bhootnath) (1990), 4,C.W. N. 488].

Compensation for services rendered: According to Section 25(2), agreement made without consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something of the promisor or something which the promisor was legally compliable to do. To apply this rule, the following essentials must exist :

a) the act must have been done voluntarily;
b) for the promisor or it must be something which was the legal obligation of the promisor;
c) the promisor must be in existence at the time when the act was done';
d) the promisor must agree now to compensate the promisee.

A promise to pay for past services voluntarily rendered would be enforceable under this rule. If, however, something has not been done voluntarily, this clause will not apply. Thus, where the services were rendered by the advocate on request and were not voluntarily it was held that this clause had no application. The promisor should be in existence at the time when the service is rendered. Work done by the promoters of a company before its formation cannot be said to have been done for the company. Such a clause in the articles of association is not binding unless it is subsequently confirmed by the company.

Agreement to pay a time-barred debt Sec. 25 (3) expressed that where there is an agreement, made in writing and signed by the debtor or by his authorised agent, to pay wholly or impart a debt barred by the law of limitation, the agreement is valid even though it is not supported by any consideration. A time barred debt cannot be recovered and therefore a promise to repay such a debt is without consideration, hence the importance of the present exception.

But before the exception can apply, it is necessary that:

i. the debt must be such of which the creditor might have enforced payment but for the law for the limitation of suits [Sec. 25(3)];
ii. the promisor himself must be liable for the debt;
iii. there must be an 'express promise to pay' a time barred debt as distinguished from a mere 'acknowledgement of a liability' in respect of a debt; and
iv. the promise must be in writing and signed by the debtor or his agent.

Illustration : A owes B Rs. 1,000, but the debt is barred by the Limitation Act. A signs a written promise to pay B Rs. 500 on account of the debt. This is a contract (Appended to Sec.25).

Completed gifts: Explanation 1 to section 25 provides that the rule 'No consideration, of contract' shall not affect validity of any gifts actually made between the donor and the donee. Thus if a person gives certain properties to another according to the provisions of the Transfer of Property Act, he cannot subsequently demand the property back on the ground that there was no consideration.

CAPACITY TO CONTRACT

An essential element of a valid contract according to Section 10, is that the contracting parties must be 'competent to contract'. Section 11 lays down that "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject". Thus a person is competent to contract under:

a) if he is not a minor, according to the law to which he is subject,
b) if he is not of unsound mind, and
c) if he is not disqualified from contracting by any law to which he is subject.

MINOR

A minor is a person who is not a major. According to The Indian Majority Act, 1875, a minor is one who has not completed his or her 18th year of age. A person attains majority on completing his 18th year in India. In the following two cases, a person continues to be a minor until he completes the age of 21 years.

a) Where a guardian of a minor person or property has been appointed under the Guardians and Wards Act, 1890; or
b) Where the superintendence of a minor's property is assumed by a Court of Words.

Why should minors be protected?

A minor has an immature mind and cannot think what is good or bad for him. Minors are often exploited and their properties stolen. As such he must be protected by law from any exploitation or ill design. But at the same time, law should not cause unnecessary hardship to persons who deal with minors.

Effects of minor's agreements

A minor's agreement being void is wholly devoid of all effects. When there is no contract there should be no contractual obligation on either side. The various rules regarding minor's agreement are discussed below.

- An agreement with or by a minor is void
  Section 10 of the Contract Act requires that the parties to a contract must be competent and Section 11 says that a minor is not competent. But neither section makes it clear whether the contract entered into by a minor is void or voidable. Till 1903, courts in India were not unanimous on this point. The Privy Council made it perfectly clear that a minor is not competent to contract and that a contract by a minor is void ab initio. The leading case on this point is *Mohori Bibi v. dharmo Das Ghose* (1914; 37 Mad 38)
  Decision: An agreement with or by a minor is absolutely void.

Facts of the case are: A, a minor borrowed Rs. 20,000 from B and as a security for the same executed a mortgage in his favour. He became a major a few months later and filed a suit for the declaration that the mortgage executed by him during his minority was void and should be cancelled. It was held that a mortgage by a minor was void and B was not entitled to repayment of money.

- No ratification: An agreement with minor is completely void. A minor cannot ratify the agreement even on attaining majority, because a void agreement cannot be ratified. A person who is not competent to authorize an act cannot give it validity by ratifying it. Thus, where a minor borrowed a sum of money by executing a simple promote for it and after attaining majority executed a second promote in respect of the original loan plus interest thereon, a suit upon the second promote was not maintainable.
  If on coming of age, a minor makes a new promise and not merely an affirmation of the old promise, for a fresh consideration, the new promise will be binding.

- Beneficial agreements are valid contracts: Any agreement which is of some benefit to the minor and under which he is required to bear no obligation, is valid. In other words, a minor can be a beneficiary e.g., a payee, an endorsee of a promise under a contract (*Goekda Latcharao vs Vishwanadham Bhomayya*). Thus money advanced by a minor can be recovered by him by a suit because he can take benefit under a contract. The Hindu Minority and Guardianship Act, 1956, also provides to the same effect, namely a natural guardian is empowered to enter into a contract on behalf of the minor and the contract would be binding and enforceable if the contract is for the benefit of the minor.

  Example : (i) A duly executed transfer by way of sale or mortgage in favour of a minor, who has paid the whole of the consideration money, is enforceable by him or by any other person on his behalf [(Raghava Chariar vs Srinivasa, (1917), 40 Mad. 308 (F.B.)].

  Example : (ii) X, a minor, insured his goods with an insurance company. The goods were damaged. X filed a suit for claim. The insurance company took the plea that the person on whose behalf the goods were insured was a minor. The court rejected the plea and allowed the minor to recover the insurance money. [*The General American Insurance Company Ltd. v. Madan Lal Sonu Lal* (1935) 59 Bom 656]

  Contracts of apprenticeship and service by a minor : A contract of apprenticeship stands on a different footing than an agreement of service by a minor. A contract of apprenticeship is valid and binding upon a minor because such a contract is protected by the Apprentices Act, 1961, provided the case falls within the terms of that Act. The Act, inter alia, provides that the minor must not be less than fourteen years of age and the contract must be entered into on behalf of the minor by his guardian. The Act was passed with a view to enabling children to learn trades, crafts and employment, by which, when they come to full age, they may gain a livelihood. So far as an agreement of service by a minor is concerned, it is void because a minor's promise to serve would supply no consideration for the promise of the defendant to pay him/her a salary.

- Liability for necessaries

The case of necessaries supplied to a minor or to any person whom such minor is legally bound to support is governed by section 68 of the Indian contract Act. A claim for necessaries supplied to a minor is enforceable at law. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries. There is no personal liability of the minor, but only his property is liable. A minor is also liable for the value of necessaries supplied to his wife.

"What is a necessary article", is to be determined with reference to the status and circumstances of the particular minor. Objects of mere luxury are not necessaries, nor are objects, which though of real use are excessively costly. Food and clothing may be taken as simple examples of necessaries. The necessaries would also include the infant's lodging expense, medical attendance, cost of defending a minor in civil and criminal proceedings. Loans taken by a minor to obtain necessaries also bind him. But where a minor is engaged in trade, contracts entered into by him for trading purposes are not for necessaries and are not binding on him.

Not only must the goods supplied be such as are suitable to the minor's status, they must also be actually necessary. Ten suits of clothes are necessaries for a minor whereas even three suits may not be deemed necessary for another.

The whole question turns upon the minor's status in life. Utility rather than ornament is the criterion.

Example: Inman an infant undergraduate in Cambridge bought eleven fancy waistcoats from Nash. He was at the time adequately provided with clothing. Held the waistcoats were not necessary and the price could not be recovered. [*Nash v. Inman* (1908) 2. K.B.I.]

Certain services rendered to a minor have been held to be necessaries. These include education, medical advice, a house given to a minor on rent for the purpose of living and continuing his studies, etc.

Goods necessary when ordered might have ceased to be necessary by the time they are delivered e.g., where a minor orders a suit from a tailor but buys other suits before that order is actually delivered. Here the minor could not be made to pay the tailor.

The following have been held to be necessaries :

1.0 Livery for an officer's servant.
1.1 Horse, when doctor ordered riding exercise.
1.2 Goods supplied to a minor's wife for her support.
1.3 Rings purchased as gifts to the minor's fiancee.
1.4 A racing bicycle.

On the other hand, following have been held not to be necessaries :

1.0 Goods supplied for the purpose of trading.

1.1 A silver-gift goblet.
1.2 Cigars and tobacoo.
1.3 Refreshment to an undergraduate for entertaining.

- The rule of estoppel does not apply to a minor
  Where a minor by misrepresenting his age has induced the other party to enter into a contract with him, he cannot be made liable on the contract. There can be no estoppel against a minor. In other words, a minor is not estoppled from pleading his infancy in order to avoid a contract. It has been held by a Full Bench of the Bombay High Court in the case of Gadigeppa v. Balangowda (A.I.R. 193, BOM 561) that where an infant represents fraudulently that he is of majority age and thereby induces another to enter into a contract with him, then in an action founded on the contract, the infant is not estopped from setting up infancy. The court may, however, require the minor to compensate the other party on the ground of equity. This is based on the rule that a minor can have no privilege to cheat men.
  Fraudulent misrepresentation as to age by an infant will operate against him in certain cases. If a minor obtains property or goods by misrepresenting his age, he can be compelled to restore it but only so long as the same is traceable in his possession.
  If by misrepresenting himself to be of full age, has obtained money from a trustee and given release, the release is good and he cannot compel the trustee to make payment a second time.

- No Specific performance
  A minor's contract being absolutely void, there can be no question of the specific performance of such a contract. A guardian of minor cannot bind the minor by an agreement for the purchase of immovable property; so the minor cannot ask for the specific performance of the contract which the guardian had no power to enter into.
- Liability for torts
  A minor is liable in tort. Thus, where a minor borrowed a horse for riding only he was held liable when he let the horse to one of his friends who jumped and killed the horse. Similarly, a minor was held liable for his failure to return certain instruments which he had hired and passed on to a friend. But a minor cannot be made liable for a breach of contract by framing the action on tort. You cannot convert a contract into a tort to enable you to sue an infant.
- Partnership
  A minor being incompetent to contract cannot be a partner in a partnership firm, but under section 30 of the Indian Partnership Act, he can be admitted to the benefits of partnership.
- Minor agent. A minor can be an agent (Sec. 184). He shall bind the principal by his acts done in the course of such an agency, but he cannot be held personally liable for negligence or breach of duty. Thus in appointing a minor as an agent, the principal runs a great risk.

- Minor and insolvency. A minor cannot be adjudicated as an insolvent, for, he is incapable of contracting debts. Even for necessaries supplied to him, he is not personally liable, only his property is liable (Sec. 68).
- Contract by minor and adult jointly. Where a minor and an adult jointly enter into an agreement with another person, the minor has no liability but the contract as a whole can be enforced against the adult (*Jamna Bai vs Vasanta Rao*). In *Sain Das vs Ram Chand*, [(1923). 4 Lah. 334] where there was a joint purchase by two vendees, one of whom was a minor, it was held that the vendor could enforce the contract against the major vendee.
- Minor shareholder. A minor, being incompetent to contract, cannot be a shareholder of the company. A company can also refuse to register transfer or transmission of shares in favour of a minor unless the shares are fully paid. It follows from it that a minor, acting through his lawful guardian, may become a shareholder of the company, in case of transfer or transmission of fully paid shares to him. Logically also, if a minor could legally hold property in his name, it would be wrong to debar him from holding fully paid up shares in his own name.

PERSONS OF UNSOUND MIND

As stated earlier, the section 11 disqualifies a person who is not of sound mind from entering into a contract. Contracts made by persons of unsound mind like a minor's contract are void. The reason is that a contract requires assent of two minds but a person of unsound mind has nothing which the law recognizes as a mind.

Section 12 deals with the question as to what is sound mind for the purpose of entering into a contract. It lays down that, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it he is capable of understanding it and of forming a rational judgment as to its effect upon his interests".

The Section further states that:

(i) "A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind." Thus a patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals.

(ii) "A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind". Thus, a sane man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgment as to its effect on his interest, cannot contract while such delirium or drunkenness lasts.

In Halsbury's Laws of England, it is stated "The general theory of the law in regard to acts done, contracts made by parties affecting their rights and interests, is that in all cases there must be a free and full consent to bind the parties. Consent is an act of reason accompanied by deliberation, and it is upon the ground that there is a want of rational and deliberate consent that the conveyance and contracts of unsound mind are generally deemed to be invalid; or in other words, (subject to exceptions), there cannot be a contract by a person of unsound mind."

Unsoundness of mind may arise from:

a) Idiocy – It is God given and permanent, with no intervals of saneness. The mental powers of an idiot are completely absent because of lack of development of the brain;
b) Lunacy or Insanity – It is a disease of the brain. A lunatic loses the use of his reason due to some mental strain or disease. Of course he may have lucid intervals of sanity:
c) Drunkenness – It produces temporary incapacity, till the drunkard is under the effect of intoxication, provided it is so excessive as to suspend the reason for a time and create impotence of mind;
d) Hypnotism – It also produces temporary incapacity, till the person is under the impact of artificially induced sleep;
e) Mental decay on account of old age, etc.

Effects of agreements made by persons of unsound mind: An agreement entered into by a person of unsound mind is treated on the same footing as that of minor's and therefore an agreement by a person of unsound mind is absolutely void and inoperative as against him but he can derive benefit under it (*Jugal Kishore vs Cheddu*, 1903, ALL L.J.43). The property of a person of unsound mind is, however, always liable for necessaries supplied to him or to any one whom he is legally bound to support, under Section 68 of the Act.

DISQUALIFIED PERSONS

The third type of incompetent persons, as per Section 11, is those who are "disqualified from contracting by any law to which they are subject". These are:

Alien enemies: An alien living in India is competent to contract with citizens of India. He can maintain an action on a contract entered into by him during peace time. But if a war is declared, an alien enemy cannot enter into any contract with an Indian citizen. Contracts entered into before the declaration of war are either stayed or terminated but contracts entered into during the war are unenforceable.

Foreign sovereigns and ambassadors: These persons are immune from the jurisdiction of local courts, unless they voluntarily submit to its jurisdiction. These persons have right to contract but can claim the privilege of not being sued. The rules regarding suits by or against foreign sovereigns are laid down in sections 84 to 87 of Civil-Procedure Code.

Example: E, who was a diplomat and was on the staff of a foreign embassy rented a house belonging to M. M. sued him for arrears of rent. It was held that no action could be brought against him as he was protected by diplomatic privileges. [*Engelke v. Musman* (1928) A.C. 433]

Convict: A convict is one who is found guilty and is imprisoned. During the period of imprisonment, a convict is incompetent

(a) to enter into contracts, and

(b) to sue on contracts made before conviction. On the expiry of the sentence, he is at liberty to institute a suit and the Law of Limitation is held in abeyance during the period of his sentence.

Married women: Married women are competent to enter into contracts with respect to their separate properties (Stridhan) provided they are Major and are of sound mind. They cannot enter into contracts with respect to their husbands' properties. A married woman can, however, act as an agent of her husband and bind her husband's property for necessaries supplied to her, if he fails to provide her with these.

Insolvents: An insolvent cannot enter into a contract as his property vests in the official receiver or official assignee. This disqualification of an insolvent is removed after he is discharged.

Joint-stock company and corporation incorporated under a special Act (like L.I.C., U.T.I.). A company/Corporation is an artificial person created by law. It cannot enter into contracts outside the powers conferred upon it by its Memorandum of Association or by the provisions of its special Act as the case may be. Again, being an artificial person (and not a natural person) it cannot enter into contracts of a strictly personal nature e.g. marriage.

CONSENT

MEANING AND CONCEPT

According to Section 13, 'Two or more persons are said to have consented when they agree upon the same upon the same thing in the same sense'. A contract which is regular in all other respects may still fail because there is no real consent to it by one or both of the parties. There is no consensus ad idem or meeting of the minds. Consent may be rendered unreal by mistake, misrepresentation, fraud, coercion or undue influence. When there is no consent at all, as in mutual mistake, there is no contract.

This is defined by Salmond as error in consensus, so that there was not at the relevant tune any real agreement or common intention between the parties, or their minds had not met. Error in consensus-a misunderstanding-prevents the existence of any consensus ad idem and therefore of any contract.

When there is consent, but no free consent, there is generally a contract voidable at the option of the party whose consent was not free, as in the case of misrepresentation, fraud, undue influence or coercion. This is known as error in causa. In this case a true contract is constituted by consent of the parties, but the consent of one of the parties was induced or caused by the supposed existence of a fact which actually did not exist.

Definition

The term 'free consent' may be defined as the consent which is obtained by the free will of the parties, and neither party was forced or induced to give his consent. If the consent is there but it is not free or real, then the contract will be voidable at the option of the party whose consent is not free. The term 'free consent' is defined in Section 14 of the Indian Contract Act, which reads as under:

- Consent is said to be free when it is not caused by-
- Coercion, as defined in Section 15, or
- Undue influence, as defined in Section 16, or
- Fraud, as defined in Section 17, or
- Misrepresentation, as defined in Section 18, or
- Mistake, subject to the provisions of Sections 20, 21 and 22

Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake." The analysis of this section shows that when consent of either party is obtained by one of the above-mentioned elements, it will not be free. When the consent is there but it is not free Salmond describes it as *error in causa*.

ELEMENTS WHICH AFFECT THE CONSENT OF THE PARTIES

According to Section 14, the following elements affect the consent of the parties:

- Coercion
- Undue influence
- Fraud
- Misrepresentation
- Mistake

The consent obtained by any of the above elements is not free consent. It may be noted that in the first four elements mention above (i.e., coercion, undue influence, fraud and misrepresentation), the consent is there but it is not free. But in the last element (i.e., mistake), there is no consent at all because there is no identity of minds. The effect of 'no free consent' and 'no consent at all' on the contract may be stated as under:

a) When the consent is not free, then the contract is voidable at the option of the party whose consent is not free. A voidable contract is enforceable at the option of the party whose consent was not free.

b) When there is no consent, then the contract is void ab initio (i.e., from the very beginning). In fact, no contract will come into existence in such a case. A void contract being void ab initio, is not enforceable at the option of either party.

Thus, there is lot of difference between 'no free consent' and 'no consent at all.' In the following cases, there is complete absence of consent (a) when there is error as to the nature of the contract itself, (b) when there is error as to the identity of the parties, (c) when there is error as to the subject-matter of contract.

MISTAKE

The law believes that contracts are made to be kept; the whole structure of business depends on this, as the businessmen depend on the validity of contracts. Accordingly, the law says most clearly that it will not aid anyone to evade consequences on the plea that the was mistaken. On the other hand, the law also realises that mistakes do occur, and that these mistakes are so fundamental that there is no contract at all. So, if the law recognises mistake in contract, that mistake will render the contract void. This is the basic law of mistake in contract.

The general common law rule is that mistake made by one or both parties in making a contract has no effect on the validity of contract. For example, an error of judgement is not an operative mistake and does not affect the validity of the contract. If A buys an article thinking it is worth Rs. 10, when in fact it is worth only Rs. 5, the contract is good and A must bear the loss if there has been no misrepresentation by the seller.

Mistake of fact

Section 20 of the Contract Act provides: "When both the parties to an agreement are under a mistake as to a matter of fact essential to agreement, the agreement is void." Thus, to be operative (so as to render the contract void) the mistake must be (i) on the part of both the parties, (ii) of fact and not of law or opinion, and (iii) so fundamental as to negate mistake of fact, the contract would be void. Such a mistake prevents the formation of any contract at all, and the court will declare it void. But as Section 22 provides unilateral mistake of fact will not render the contract voidable.

Mistake of law

If there is mistake of law of land, the contract is binding because everyone is deemed to have knowledge of his own law, and ignorance of law is no excuse. But mistake of foreign law and mistake of private rights are treated as mistakes of fact, and are excusable. The laws of a foreign country require to be proved in Indian courts as ordinary fact, and so a mistake of foreign law makes the contract void. Similarly, if a contract is made in ignorance of private rights, it would be void, e.g. where A buys property which already belongs to him.

Operative Mistake of Fact

Operative mistakes may be classified into the following categories:

a) Mistake as to the nature of the contract itself.

b) Unilateral mistake, i.e. mistake made by one party only.

c) Bilateral mistake, where both parties make a mistake, which may be either (i) Common Mistake, or (ii) Mutual Mistake.

Common Mistake occurs where both parties have made the same mistake and may also be designed as identical bilateral mistake. Mutual Mistake occurs where both parties make a different mistake and may also be called non-identical bilateral mistake. These are clearly differentiated in following paragraphs between themselves and contrasted with unilateral mistake.

a) Mistake as to a nature of contract

The general rule is that a person who signs as instrument is bound by its terms even if he has not read it.

But if a person signs a contract in the mistaken belief that he is signing a document of a different nature, there will be a mistake which avoids the contract.

The mistake must be as to the nature of the contract and not merely as to the contents of the document, and also the mistake must be due to either (a) the blindness, illiteracy, or senility of the person signing, or (b) a trick or fraudulent misrepresentation by the other party as to the nature of the document.

b) Unilateral Mistake

Unilateral mistake occurs when one of the parties to a contract is mistaken as to some fundamental fact concerning the contract and the other party knows this. This latter requirement is important because if B does not know that A is mistaken, the contract is good. Unilateral mistakes may be of two types: (i) regarding identity of party and (ii) unilateral mistake of offeror.

i. Identity of party: The cases of unilateral mistake are mainly concerned with mistake by one party as to the identity of the other party. It is rule of law that if a person intends to contract with A, B cannot give himself if any rights under if. Here, when a contract is made in which personalities of the contracting parties are or may be of importance, no other person can interpose and adopt the contract. For example, where M intends to contract only with A but enters into contract with B, believing him to be A, the contract is vitiated by mistake, as there is no Consensus ad idem. Remember that mistake as to identity of the person with whom the contract is made will operate to nullify the contract only if:

- the identity is of material importance to the contract, and
- the mistake is known to the other party, i.e. he knows that it is not intended that he should become a party to the contract but some other person is intended.

In *Cundy V. Lindsay* (1878 3 A.C.459), one Blenkarn by imitating the signature of a reputable firm called Blenkarn and Son, induced Lindsay to supply him with goods on credit, which he afterwards sold to Cundy, an innocent purchaser. Lindsay claimed the recovery of the goods, or their value from Cundy. It was held that the contract between Blenkarn and Lindsay was void for mistake, and that no property passed to Cundy. Cundy was liable to Lindsay from the value of the goods.

In *Philips V. Brooks* (1919 2 K.B.243), the plaintiff was a jeweller. One North entered his shop and asked to see some jewellery. He chose one ring worth £450 and a pearl necklace, priced £2,250 and offered to buy them. The jeweller accepted the offer. North then offered to pay by cheque. The jeweller accepted the cheque, but said delivery would be delayed until the cheque was cleared. North then said that he was Sir George Bullough, a well-known person, and gave a London address, which the jeweller checked in the directory. Since North had signed the cheque as George Bullough, the jeweller was deceived as to his identity and allowed him to take away the ring. North promptly pledged the ring with Brooks, a pawnbroker, for £350. The cheque was dishonoured and the jeweller claimed to recover the ring from Brooks. It was held that the contract was made before the identity became important, therefore it was not void on the ground of mistake. The jeweller intended to contract, and did contract with the person present whoever he was. The misrepresentation took place at the time of signing the cheque after the man who had bought it, namely, North. The contract could be avoided on the ground of fraudulent misrepresentation before the ring was pawned, but since at the time the ring was pledged it had not been avoided, the pawn broker got good title.

In *Lake v. Simmons* (1927 A.C.487), A woman, by falsely representing to a firm of jewellers that she was the wife of a certain Baron, obtained two pearl neckless on the pretext of showing them to her husband with a view to buying at the agreed price. The woman then sold the neckless to an innocent buyer. It was held that there was no contract between the jewellers and the woman and therefore the buyer from her must return the necklaces to the jewellers. Though the woman got the physical possession of the necklace, there was no mental assent, as the jewellers intended to deal not with her but quite a different person, namely, the wife of the Baron.

In *Said v.Butt* (1920 3 K.B.497), B, the manager director of a Theatre, gave instructions that a ticket was not to be sold to S.S. knew this, and asked a friend to buy a ticket from him. With this ticket, S went to the theatre, but B refused to allow him to enter. It was held that there was no contract with S, as the theatre company never intended to contract with S. By mere device of an agent he could not constitute himself as the contractor with the theatre owners who had already refused him ticket.

In the words of Sir William Anson: "If a man accepts an offer which is plainly meant for another, or if he becomes party to a contract by falsely representing himself to be another, the contract in either case is void, or to put it more accurately, no contract ever comes into existence. In the first case one party takes advantage of the mistake, if the other creates it."

ii. Unilateral mistake of offeror where the offeror makes a material mistake in expressing his intention, and the Offeree knows, or is deemed to know of the error, the mistake is operative and the contract is void.

In Hartog v. Colin Shields (1939 3 E.R.566). H claimed damages for breach of contract, alleging that C had agreed to sell him 30,000 Argentinian hare skins and had failed to deliver them. C contended that there was a material mistake in the offer and that H was well aware of this mistake when he accepted the offer. The mistake alleged by C was the skins were offered at certain prices per pound made to prices per piece, and it was also the custom of the trade. Held, the contract was void expressed C's real intention; H must have known that is was made under a mistake.

But if there is a mistake on the part of one party alone, and the other does not, and cannot be deemed to know of the mistake, the contract is binding.

In Van Praagh v. Everidge (1902 2 Ch. 266), at a sale of landed properties by auction, E purchased one lot in mistake for another. The price was not extravagant and the mistake was solely due to his own carelessness. Held, the contract was binding on E.

c) Bilateral Mistake

A bilateral mistake, as observed earlier, arises when both parties to a contract are mistaken as regards a fact essential to the contract. They may have made a common or identical mistake; or a mutual or non-identical mistake.

Following may be cases of bilateral mistakes-

- Common mistake as to the existence of the subject.
- Common mistake as to the fact fundamental to the agreement.
- Mutual or non-identical mistake as to the identity of the subject matter.
- Mistake as to quality of subject-matter or promise.
- Mistake as to non-disclosure in contracts of utmost good faith.

Common mistake as to the existence of the subject-matter: Where both parties believe the subject-matter of the contract to be in existence at the time of the contract but in fact it is not in existence, there is operative mistake and the contract is void.

If A agrees to sell his car to B, and unknown to them both the car had at the time of the sale been destroyed by fire, then the contract will be voids because A has innocently undertaken an obligation which he cannot fulfil.

In Scott v. Coulson (1903 2 Ch. 249), G agreed to assign to H a policy of assurance upon the life of L.L. had died before the agreement was made. Held, no contract on account of common mistake.

Again in Couturier v. Hastie (1857 8 Exch. 40), there was a contract to buy cargo described as shipped from port A to port B and believed to be at sea which in fact had got lost earlier unknown to the parties and hence not in existence at the time of the contract. It was held that the contract was void due to the common mistake of parties.

But where the circumstances are such that the seller is deemed to have warranted the existence of the goods, the seller is probably liable to the buyer for breach of contract if the goods are non-existent.

Common mistake as to a fact fundamental to the agreement: Where the parties have made a contract based on a common misapprehension relating to the fundamental subject-matter of the contract there is 'operative mistake'. This means that the contract actually made is essentially different from the contract the parties intend to make.

Mutual or non-identical mistake as to the identity of the subject-matter: Where the parties are both mistaken as to a fundamental fact concerning the contract but each party has made a different mistake, there is a mutual or non-identical mistake.

Thus, if A offers to sell his Ambassador Car, and B agrees to buy thinking A means his Fiat Car, there is a bilateral mistake which is mutual or non-identical. The contract does not come into existence under such a mistake, because there is no consensus ad idem. The parties have negotiated completely at cross-purposes and they were never in agreement.

There would be no contract even if the mistake was caused by the negligence of a third party.

In Henkel v. page (1870 6 Ex.7), P wrote to H inquiring the price of rifles and suggested that he might buy as many as fifty. On receipt of a reply he wired "send three rifles". Due to the mistake of the telegraph clerk the message transmitted to H was "send the rifles." H dispatched 50 rifles. Held, there was no contract between the parties.

Mistake as to quality of subject-matter or promise: Mistake as to the quality raises difficult question. If the mistake is bilateral and because of the mistake the thing does not possess the quality bargained for the contract is obviously void. But if the mistake is only unilateral difficulty arises. Mere mistake as to quality of the subject-matter of a contract does not invalidate it, but mistake of one party to the promise of the other party as to quality of subject-matter, known to that other party, does invalidate the contract. Such a question generally arises in cases of sale of goods. The principle commonly applicable is caveat emptor-Let the buyer beware. There is generally no obligation on a contracting party to enlighten the other party even where he knows or suspects there is a misapprehension.

For example, A offers to sell a watch to B, and B thinking it is a gold watch, offers Rs. 5000 for it. A knowing the watch is not gold, accepts B's offer without enlightening him. The contract is binding, provided A made no representation in the matter.

But where a party knowing that the other was laboring under a mistake "snatches a bargain" by hurriedly closing the transaction, this unilateral mistake will enable the party to avoid the contract.

Mistake through non-disclosure in contracts of utmost good faith or *uberrimae fidei*: A contract *uberrimae fidei* is a contract of utmost good faith. In such a contract the law imposes a special duty to act with the utmost good faith, i.e. to disclose all material information. Failure so to disclose all facts truthfully renders the contract voidable at the option of the party. Here silencer can amount to misrepresentation.

Contracts *uberrimae fidei* (utmost good faith)

Contracts *unberrimae fidei* are-

a) Contracts of insurance of all kinds. The assured must disclose to the insurer all material facts; and non-disclosure or misstatement will render the contract of insurance void (Ratan Lal v. Metropolitan Co., 1959 Pat. 413).
b) Contracts to take shares in a company under a prospectus. When a company invites the public to subscribe for its shares by means of a prospectus, it is under statutory obligation to disclose truthfully the various matters set out in the Companies Act, 1956. Any person responsible for the non-disclosure of any of these matters is liable to damages. Also, the contract to take shares is voidable where there is a material non-disclosure in the prospectus.
c) Contracts for the sale of land. The vender is under a duty to purchaser to show good title to the land he has contracted to sell. He must, therefore, disclose all defects in title. This duty does not extend to physical defects in the property itself.
d) Contracts of family arrangements. When members of a family make agreements or arrangements for the settlement of the family property, each member of the family must make full disclosure of every material fact within his knowledge.
e) Suretyship and partnership contracts. Contracts of suretyship and contracts of partnership, though often described as contracts unberrimae fidei, are not properly so described: they do not require utmost good faith at their formation. In both cases, after the contract has been made there is a duty of utmost good faith on the parties to disclose to each other all material facts coming to light after the making of the contract.

MISREPRESENTATION

A representation is a statement of fact made by one party to the contract to the other which induces the other to enter into the contract. According to Section 18, misrepresentation is a representation that is untrue. But representation always means a statement of fact not a statement of intention or of opinion or of law.

An untrue statement or misrepresentation may be either (i) Innocent, or (ii) Willful or Deliberate with intention to deceive and is called Fraud.

Innocent Misrepresentation

Innocent misrepresentation is a misstatement made innocently and with an honest belief as to its truth. It is sometimes called "Invalidating Misrepresentation". The effect of innocent misrepresentation of fact is that the party misled by it may repudiated the contract and (i) raise the misrepresentation as defence to any action the other party may bring against him, or (ii) sue for rescission of the contract and restitution of anything he has transferred to the misrepresented.

Damages of misrepresentation

Generally, the injured party cannot get damages for innocent misrepresentation. But in the following exceptional cases he can get damages:

a) From promoters or directors who made such misrepresentation in a prospectus under Company Law;
b) Against an agent who commits a breach of warranty of authority;
c) From a person who (at the Court's discretion) is stopped from denying a statement he has made where (i) he made a positive statement intending that it should be relied on, and (ii) the innocent party did rely on it, and thereby suffered damage.

What to be proved?

It should be remembered that in order to avoid a contract on the ground of misrepresentation, it is necessary to prove that (i) there was a representation or assertion, (ii) such representation induced the party aggrieved to enter into contract, (iii) the assertion was of fact (and not of law, as ignorance of law is no excuse); (iv) the statement was not a mere opinion, or hearsay, or commendation (i.e. reasonable praise) or tradesman's "puff", (v) the statement, which has become or turned out to be untrue, was made with an honest belief in its truth.

Effect: In an innocent misrepresentation, the party aggrieved may avoid the agreement, even though the statement was true at the time it was made but became untrue later by reason of change of circumstances.

FRAUD OR WILFUL MISREPRESENTATION

Section 17 of the Contract Act defines Fraud as follows : Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance or by a party to a contract, or with his connivance or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract :

1. the suggestion as to a fact, of that which is not true, by one who does not believe it to be true;
2. the active concealment of a fact by one having knowledge or belief of the fact;
3. a promise made without any intention of performing it;
4. any other act fitted to deceive; and

5. any such act or omission as the law specially declares to be fraudulent.

But mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak or unless his silence is, in itself, equivalent to speech.

In the worlds of Lord Herschel Fraud is "an untrue statement made knowingly, or without belief in its truth, or recklessly, careless whether it be true or false" with intent to deceive.

In simple terms, fraud is false statement or wilful concealment of a material fact with intent to deceive another party. The party deceived or defrauded can avoid the contract and also claim damages.

Characteristics of Fraud:

The essential characteristics of fraud are following -

(a) There must be representation or assertion and it must be false, or there must be active or wilful concealment of a material fact. If there is an actual false statement, the case is simple, A, intending to deceive B, falsely represent that the Television set he is offering for sale is German made, when it is in fact a locally made set. If concealment is alleged mere non-disclosure of material facts, however morally censurable, does not render a contract voidable. Mere silence is not misrepresentation, unless silence is in itself equivalent to speech, or where it is the duty of person keeping silence to speak; as where a fiduciary relation exists between the contracting parties or the contract requires utmost good faith. Disclosure is also essential where part-truth amounts to falsehood. If part only of facts is disclosed, and the undisclosed part so modifies the part disclosed as to render it, by itself, substantially untrue, there is a duty to disclose the full facts. Non-disclosure will amount to fraud.

In *R.V. Kylsant* (1932 1 K.B. 442) A prospectus contained statements which were true; that the company had paid dividends every year between 1921 and 1927. In fact, in each of these years the company had incurred substantial losses, and was only able to pay the specified dividends out of secret reserves. No disclosure was made of these losses. Held, the prospectus was false, because it put before intending investors figures which apparently disclosed the existing position of the company, but in fact it hid it, and Lord Kylsant, a director, who knew that it was false was guilty of fraud.

(b) The representation must be of fact. The assertion must be of fact and not a mere expression of opinion, or hearsay, or puffery of flourishing description.

Thus, if A, who is about to sell a horse to B, says that the horse is a beauty and is worth Rs. 10,000 that is A's opinion and B is at liberty to reject it. But if in fact he paid only Rs. 5000 for it, then A has misstated a fact, and if B has been induced by that statement to buy the horse, he may rescind the contract on the ground of fraud.

(c) There must be knowledge of the falsehood of the representation or a reckless disregard as to its being true or false. In a reckless misstatement the person is not sure as to the fact in his own mind; he feels a doubt, yet he represents to the other party, as if he is certain about the truth of the fact represented by him. Such misrepresentation is fraud. Also a promise made without an intention of performing it is fraud. To buy goods with the preconceived idea of getting goods without paying for them is fraud.

(d) The representation must be made with the object of inducing the party deceived to act upon it. The assertion must be made with the intention of inducing one to act on the assertion who does so act. This means that there is an inducement in fact and the assertion is one which necessarily influenced and induced the party to act. The party misled must not have exercised his own skill of judgement.

(e) The representation must in fact deceive. The representation must be acted upon as it was intended to be acted upon so that the party misled is actually deceived. A deceit which does not deceive is not fraud.

(f) The plaintiff must be thereby damnified. It is a common saying that "there is no fraud without damage", for an action being one of deceit, and unless the plaintiff and sustained damage or injury, no action will lie. The damage may consist of actual and temporal injury, that is, some losses of money or money's worth, or some tangible detriment capable of assessment.

Difference between Misrepresentation and Fraud

The main difference between fraud and misrepresentation is that in fraud the person making misrepresentation does believe it to be true and in misrepresentation he does not believe it to be true. In both the cases it is a misstatement of facts which mislead the promisor. Misrepresentation (often called innocent misrepresentation) differs form fraud (often called fraud or wilful misrepresentation) in following respects.

(i) Intention of the Party. Fraud generally implies that there is an intention to deceive whereas misrepresentation may be innocent. Thus both in fraud and misrepresentation, there is statement which is false, but the distinction between them mainly turns round the intention of the party. A false statement without any intention to deceive would be misrepresentation but a false statement deliberately or recklessly made to deceive another is a case of fraud.

(ii) Additional action for damages. Fraud gives right to an action for deceit, in addition to its effects of avoidance of the contract, and the party aggrieved can recover damages if he has sustained any in consequence of fraud practised upon him by the other party. Misrepresentation merely goes to avoid the contract.

(iii) Discovery of truth by ordinary diligence. If consent to an agreement is caused by passive fraud (fraudulent silence) or innocent misrepresentation, the contract is not voidable if the representee had the means of discovering truth with ordinary diligence. But where consent to an agreement is caused by active fraud, the contract is truly voidable even though the party defrauded had the means of discovering with ordinary diligence.

COERCION

Coercion is defined by Section 15 of the Contract Act as "the committing or threatening to commit, any act forbidden by the Indian Penal Code, or the unlawful detaining, or threatening to detain, any property to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement." The doing of any act forbidden by the Indian Penal Code will still be coercion, even though such an act is done in a place where the Penal Code is not in force.

What is coercion in India is 'duress' under English law, but coercion covers much wider field. Duress is limited to actual violence or threats of violence to the person, or imprisonment or the threat of criminal proceeding to the person coerced or those near or dear to him, such as his wife, children or parents. Threats to property are not duress. Coercion, on the other hand, maybe against person or property, and the person coerced may be any person, not necessarily the party to the contract or his wife, parent or child.

In *Multhiah Chettiar v. Karuppan Chetti* (1927 50 Mad. 786), an agent refused to hand over the account books, bonds etc., of the business to his successor agent unless the principal gave him a release of all liabilities during the term of his agency. The principal did so but later succeeded in the suit to declare the release deed as vitiated by coercion.

In *Keshavji v. Harjivan* (1887 B om. 556), a son forged his father's endorsement to promissory notes on the strength of which the bankers advanced money. When the fraud was known the bankers wanted to launch a prosecution against the son. The father was induced to come to a settlement with the Bank to save the son. The settlement was set aside on the ground of coercion, as the father was not a free agent.

In *Cumming v. Ince* (L.R. 1 H.L. 200), an old lady was induced to settle property on one of her relatives by the threat of unlawful confinement in a mental home. Held, the settlement could be set aside on the ground of duress i.e., the threat of false imprisonment.

In *Kaufman v. Gerson* (1904 1 K. B. 591), K sued G on a contract, made in France, which K had coerced G into making by threats of prosecuting G's husband for a criminal offence which he had committed. Held, G was not liable under the contract, as per consent was obtained through coercion.

In *Ranganayakamnna v. Alwar Setti* (1890) 13 Mad, 214, an adoption by a girl, aged 13, was held not binding, when it had been obtained from her by her husband's relatives by pressure on her by obstructing the removal of her husband's dead body.

It should, however, be noted that mere threat by one person to another to prosecute him does not amount to coercion. There must be a contract made under the threat, and that contract should be one sought to be avoided because of coercion (Ramchandra v. Bank of Kohlapur, 1952 Bom. 715). It may be repeated that coercion may proceed from any person, and may be directed against any person, even a stranger, and also against goods e.g., by unlawful detention of goods.

UNDUE INFLUENCE

Under influence occurs where a party enters into a contract under any kind of influence, mental pressure of persuasion, which prevents him from exercising a free and independent judgement. It makes the contract voidable by the party influence or whose consent was not free.

Section 16 of our Contract Act states that a contract is induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

It further states that a person is deemed to be in a position to dominate the will of another (i) where he holds a real or apparent authority over the other, or (ii) where he stands in a fiduciary relation to the other; or (iii) he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress.

It is clear from this definition that contracts which may be rescinded for undue influence fall into two categories. Firstly, those where is no special relationship between the parties. Secondly, those where a special relationship exists.

In the first case under influence must be proves as a fact, by the party alleging it, in the second it is presumed to exist. In litigation, however, the two classes are not mutually exclusive and a plaintiff may allege both that undue influence be presumed and that it existed in fact.

It was stated in *Smith v. Kay* (1859 7. L.C. 750): "The principle of undue influence applies to every case where the influence is acquired or abused, where confidence is reposed and betrayed".

Undue influence is a kind of "mental coercion", it destroys the free agency of one and constrains him to do which is against his will, and which he would not have done if left to his own judgment and volition, so that his act becomes the act of the one exercising the influence, rather than his own act.

Where no relationship between parties exists? Where no special relationship exists between the contracting parties, the plaintiff (i.e. the party influenced) must prove two things: (i) that the other party was in a position to dominate his will, (ii) that the contract was substantially unfair giving the dominant party unfair advantage.

It was observed in *Bhola Ram v. Piari Devi*, (1962 Pat. 168), undue influence has its origin in coercion or fraud. Domination of the will of a person is a kind of mental coercion and the use of his position by a person who dominates the will of the other to obtain an unfair advantage to himself or to his near relations is a variety of fraud.

In *Karnal Distillery Co. Ltd. V. Ladli Prasad*, (1958 Punj 190), confirmed by the Supreme Court (in 1963 S.C. 1279), the elder brother was shown to have exercise undue influence over his younger brother in respect of a compromise arrangement, the transaction was held to be voidable at the instance of the younger brother. It was observed that when one member of the family exercises weightly influence in the domestic counsels either from age, from character or from superior position acquired from other circumstances an inference of undue influences has to be drawn.

The influence subjugates the other's will to his injury. It was further stated in this case that once the position of dominance is proved to exist, it is deemed to continue till its termination is established. So all transactions during such dominance are vitiated. However, a plea of undue influence can only be raised by a party to the contract and not by a third party, unless there was any connivance between the person using undue influence and the third party benefiting by the contract.

Where special relationship exists - In the second class of cases, undue influence is presumed either because of an exceptional authority one has over the other or he stands in a fiduciary position to the other and owes a duty to give that other a disinterested advice. The possibility that he may put his own interest uppermost is so obvious that he comes under a duty to prove that he has not abused the position.

Whether fiduciary or confidential relationship exists or not, the question is always the same - was undue influence used to procure the contract or gift? But the burden of proof is different. If B seeks to avoid a contract with A, then in the absence of any confidential relationship, the entire onus is on B to prove undue influence, but if he shows the existence of such relationship, the onus is on A to prove that undue influence was not used. A must rebut the presumption of undue influence.

To discharge the onus that he did not employ undue influence, the party must show that the other party to whom he owed the duty in fact acted voluntarily, in the sense that he was free to make an independent and informed estimate of the expediency of the contract or other transaction. The other party received independent advice before he completed the contract.

A few examples will illustrate undue influence.

i. A, having advanced money to his son B during his minority, upon B's becoming major obtained, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance. A employed undue influence.
ii. A, a man enfeedabled by disease or age, is induced by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his professional service. B employs undue influence.
iii. A Hindu, well advanced in years, with the object of securing benefits to his soul in the next world, gave his whole property to his Guru or spiritual adviser. There was undue influence. Similarly, where a cestui que trust (beneficiary) had no independent advice it was held a gift by him to the trustee of certain shares forming part of the trust fund was void.

But, as was held by the Supreme Court in Chandra v. Ganga Prasad, 1967 S.C. 878, there can be no presumption as to undue influence simply because the donor was related to the party and that he was of a weak disposition. What is essential of proof is the dominating will of the donee and if he used that position to obtain an unfair advantage over the donor.

In *Afsar Shaikh v. Soleman Bibi*, 1976 S.C. 163, the Supreme Court again emphasised that a general allegation in the plaint that the plaintiff was a simple old man of ninety who had reposed confidence in the defendant is much too insufficient to amount to an averment of undue influence. Merely relying on the other for advice does not amount to being unduly influenced. But if the transaction appears to be unconscionable, then the burden of proving that it was not induced by undue influence is to be upon the person who was in a position to dominate the will of the other.

A third party contracting with notice of the exercise of undue influence by another is in no better position than if he had exercised undue influence himself. In *Lancashire Loand Ltd. V. Black* (1934 1 K.B. 380), B, a married woman, under the undue influence of her mother, who was an extravagant woman, borrowed money on the security of her own property. The daughter did not understand the nature of the transaction, and the only advice she did not understand the nature of the transaction, and the only advice she received was from a solicitor acting for the mother and the moneylender. The moneylender, therefore, knew all the circumstances between B and her mother. Held, the moneylenders were in no better position that the mother, and the contract was voidable by the daughter.

Unconscionable Transactions

When a person, without being fraudulent forces another to enter into an agreement by making an unconscious use of his superior power he is said to make an: unconscionable bargain. Such a bargain is voidable. The test is that between two parties on unequal footing one has sought to make an exorbitant profit of the other's distress. Where a person is heavily indebted to another and for a fresh loan is made to agree to pay exorbitant rate of interest, it will be an unconscionable transaction. Similarly, where an heir to an estate borrowed Rs. 3,700 to enable him to prosecute his claim when he was without even the means of subsistence and gave the lender a decree only for Rs. 3,700 with interest at 50% per annum.

Also, where a spendthrift and a drunkard 18 years of age executed a bond in favour of his creditor agreeing to pay compound interest at 2 percent per annum with monthly rests; it was held the bargain was unconscionable.

In the following two cases the bargain was held unconscionable:

Where a poor Hindu widow borrowed Rs. 1,500 from a moneylender at 100% per annum for the purpose of enabling her to establish her claim for maintenance; and where an illiterate agriculturist heavily indebted to a moneylender sold his land worth thrice the amount of the debt under pressure of payment. It must be remembered that in such cases the moneylender must be "in a position to dominate the will" of the borrower, and the bargain must be unconscionable within the meaning of clause 3 of Section 16. The mere fact that the rate of interest is exorbitant is no ground for relief under this section unless it be shown that the creditor was in a position to dominate the will of the borrower. Nowadays, however, drastic legislation in most of the States has provided greater protection to debtors.

CONCLUSION

Mistake, misrepresentation, fraud, coercion and undue influence are the elements which affect the consent of the parties. Mistake generally takes place where the concerned parties are not fully aware of the terms of the agreement and they take the terms in a different sense. In an innocent misrepresentation, the party aggrieved may avoid the agreement, even though the statement was true at the time it was made but became untrue latter by reason of change of circumstances. The basic difference between fraud and misrepresentation is that in fraud the person making misrepresentation does believe it to be true and in misrepresentation he does not believe it to be true. An agreement, in which the consent is caused by coercion, is voidable at the option of the party whose consent was so obtained. When a party enters into a contract under any kind of mental pressure, unfair influence or persuasion by the superior party, the undue influence is said to be employed

DISCHARGE AND BREACH OF A CONTRACT

A valid contract creates certain obligations on all the contracting parties, and the parties become liable to fulfill their respective obligations. When the parties fulfill their respective obligations, their liability under the contract, comes to an end and the contract is said to be discharged. Thus, the discharge of a contract means that the parties are no more liable under the contract. In other words, when the rights and obligations created by the contract come to an end, the contract is said to be discharged. The discharge of a contract may, therefore, be defined as the termination of contractual relationship between the parties.

Modes of Discharge Of A Contract

Contracts may be discharged by any one of the following modes (for details see chart)

A. By Performance
B. By Consent or Agreement
C. By Impossibility of Performance
D. By Lapse of Time
E. By Operation of Law
F. By Breach of Contract

DISCHARGE BY PERFORMANCE

The obvious mode of discharge of a contract is by performance, for that is what the contract parties had contemplated at the time of entering into it. Every person who is bound by an obligation must be ready to perform it at the time when he had promised to perform it. According to Section (Sec.) 37 of the Contract Act, the parties to a contract must perform their respective promises, unless such performance is dispensed with or excused under the provision of this Act or of any other law. A person who is bound to perform a contract must be ready to perform it at the time when he has under taken to do so. When a contract is performed the parties are discharged and the contract is terminated. Performance may be of two types-actual and attempted.

a) Actual Performance - When the parties of the contract perform their promises, it is called actual performance. After such a performance the contract is discharged. It is the most common way of discharged of a contract.

b) Attempted Performance - Attempted performance or tender takes place when a person who is bound to perform a promise has been ready and willing to perform and has offered to perform his promise at proper time and place but the other party does not accept performance. In such a case, the contract is discharged of the wrongful refusal to accept the performance.

DISCHARGE BY MUTUAL AGREEMENT OR CONSENT

By agreement of all parties to the contract, or waiver or release by the party entitled to performance, a contract may be discharged. The discharge by consent may be expressed or implied; and an expressed consent may be given at the time of the formation of the contract or subsequently. For example, it may be agreed at the time of making the contract that on the happening of an event one or both parties will be absolved from performance. A buyer may be given the option to return the goods sold within a specified period of time, if certain conditions are not fulfilled.

In *Head v Tattersall* (1871) Ex. 7, the contract was for the purchase of a horse on the undersigned that the buyer could return the same within two days if the horse had not been hunted with the Bicester hounds. The horse was returned within two days as it had not been hunted with the Bicester hounds. The Court held the return valid.

Express consent subsequently to the formation of the contract may be given by waiver; release, abandonment, novation, remission, alteration, rescission and in English law, by accord and satisfaction. Each one of these methods is dealt with here. Sec. 62 and 63 expressly provide for these methods and are reproduced here:

"If the parties to a contract agree to substitute a new contract for it or to rescind of alter it, the original contract need not be performed." Section 62.

“Every promisee may dispense with or remit, wholly or in part, the performance of the promisee made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit.” Section 63.

The analysis of these sections reveal that the original contract is discharged when the parties enter into a fresh contract in place of original contract. And the following are the important methods for the discharge of a contract by a fresh contract:

a) Novation: Novation occurs when a new contract is substituted for an existing contract, either between the same parties or between different parties, the consideration mutually being the discharged of the old contract.

A owes money to B under a contract. It is agreed between A, B, and C that B shall thenceforth accept C as his debtor, instead of A. There is novation. The old debt of A to B is at an end, a new debt from C to B has been contracted.

A common example of novation arises in the case of partnership contracts. For a valid novation it is not enough that a new promiser agrees to assume original promisor’s obligation, the promises too should consent to the change.

The following pre-requisites must be established by a party to make out a case of novation –

(i) the old contract,
(ii) The existence of liability under that contract,
(iii) The assent of all parties to the extinguishment of liability under the old contract.
(iv) The assent of the all the parties to the creation of the liability under the new contract and
(v) the validity of the new contract.

A novation is ought to be before the time of performance expires, otherwise, there would be breach of contract, and the parties will by the new contract be only trying to adjust the remedial rights, which arises out of the breach of the old contract.

(b) Alteration: Alteration of a contract takes place when one or more of the terms of the contract are changed. Alteration is valid when it is made with the consent of all the parties to the contract. Where, however, an alteration of written contract is made by one party to the contract without the consent of the other party and of a material fact, so that the legal effect of the instrument is changed, the contract is discharged and the other party is also discharged from his duties.

Example: A agreed to supply to B 50 bags of rice at the rate of Rs. 100 per bag. The delivery was to be made in five equal installments, the first supply was to commence from 1st June. Subsequently, A and B entered into an agreement that the delivery would be made in two equal installments and the price would be Rs. 105 per bag. In this case, the old contract is discharged and the parties become bound by the contract with changed terms.

Following are various rules regarding the discharge of contract by alteration –

(i) Alteration must be by a party to the contract, or a stranger while the document is in the possession of a party of the contract, and for his benefit. But exception is made if it is caused by mistake or accident

(ii) it must be in a material part-what alternation can be said to be material depends upon the character of the instrument and other circumstances of the case.

(c) Rescission: A contract may be rescinded by agreement between the parties at any time before it is discharged by performance or in some other way. For example, a contract for the sale of goods can be discharged by mutual agreement between the buyer and the seller at any time before delivery of the goods or payment of the price.

Rescission may also take place in the following manner: Where a party to contract fails to perform his obligation, the other party can rescind the contract without prejudice to his rights to receive compensation for breach of contract. In avoidable contract one of the parties has the option of rescinding the contract.

Examples

- A promises to deliver certain goods to B on a certain date. Before the date of performance, A and B mutually agree that the contract will not be performed. The parties have rescinded the contract.
- A was induced to enter into an agreement by concern. He can rescind the contract.

(d) Remission: Remission is the acceptance of a lessor sum than what was contracted for a lessor fulfillment of the promise made. Sec. 63 specifically provides for remission of performance of promise. Thus, the law in India is different from that in England. In the latter country, remission must be supported by a fresh consideration. In India, under Sec.63, a promisee may remit or give up a part of his claim and a promise to do so is binding even though there is no consideration for doing so.

Examples

- A owes B Rs.5,000. A pays to B and B accepts in full satisfaction Rs. 2,000. The whole debt is discharged.
- A owes B Rs. 5,000. C pays to B Rs. 1,000 and B accepts them in satisfaction of his claim on A. This payment is discharge of the whole claim.

(e) Waiver: Waiver means the intentional relinquishment of a right which a person is entitled to. A party may waive its rights under the contract, whereupon the other party is released from its obligations. In the case of an executory contract, (e.g., an agreement to sell and buy), each party may excuse the other from paying for or from buying the goods. In the case of unilateral promise, the party entitled to performance may waive performance of it.

Example: A promised to paint a picture for B. Afterwards, B forbade him to do so. In this case, B has waived his right to claim the performance. And thus, A is no longer liable to perform the promise. However, the party who has waived the compliance with a particular condition, may withdraw his waiver by giving reasonable notice.

(f) Acceptance of any other satisfaction: Sometimes, the party entitled to claim performance accepts any other satisfaction instead of the performance of the contract. In such cases, the other party is discharged from the performance of his liability under the contract. Section 63 of the Indian Contract Act provides for this provision. According to this section, the party who has the right to demand performance, may accept any other satisfaction, which he thinks fit, instead of the performance of the promise made to him. And such acceptance, discharges the whole obligations under the contract.

Example: A owed B, under a contract, a sum of money, the amount of which had not been ascertained. Without ascertaining the amount, A gave Rs. 2000 to B. And B accepted this amount in satisfaction of the sum due under the contract. In this case, A is discharged of the whole debt due under the contract, whatever may be its amount.

DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE

The law relating to discharge by impossibility of performance of a contract is laid down in Sec.56 of the Contract Act. Section 56 states:

"An agreement to do an act impossible in itself is void. A contract to do an act which, after the contract is made becomes impossible, or by reason of some extent which the promisor could not present, unlawful becomes void when the act becomes impossible or unlawful.

Where one person has promised to do something which he knew, or with reasonable diligence, might have known, and which the promisee did now know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise."

Examples

a. A agrees with B to discover treasure by magic. The agreement is void.
b. A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.
c. A contracts to marry B, being already married to C, and being forbidden by the law to which he is subject to practise polygamy. A must make compensation to B for the loss caused to her by the non-performance of his promise.

This section covers a wide range causes and lays down certain clears rules. It is clear from the different parts of the section that impossibility is of various kinds. The impossibility may be absolute, i.e. inherent in the nature of the matter promised; or it may exist only relatively to the ability and circumstances of the promisor. The former is objective, (viz., inherent in the nature of the thing to be done) and discharges and contract. The latter is subjective impossibility, i.e. it is due to the inability of the individual promisor to perform his promise, and does not discharge a contractual duty.

The performance may be impossible as a matter of fact; or it may be impossible by the rules of law. The impossibility may exist at the time of contracting either with or without the knowledge of the parties or it may arise subsequently to the making of the contract, and in the latter case, it may be caused by events beyond the control of the parties or it may be caused by some act of the promisor or promisee.

<u>(i) Impossibility at the Time of Contract</u>

A contract to perform something that is obviously impossible, e.g. a promise to ride a horse to the moon, is void because there is no consideration for the contract. Here both parties were aware of the impossibility. It may be that at the time of the agreement both parties were ignorant of impossibility. In such a case also the contract is void on the ground of mistake. In their case the contract is void ab initio. In such a case, there is no contract to terminate and the parties are excused from performance (Sec.56, Para 1). Promises, which are manifestly impossible cannot be binding.

<u>(ii) Subsequent or Supervening Impossibility</u>

Para 2 of Sec.56 provides that subsequent or supervening impossibility or illegality will make the contract void in certain circumstances and the contract will be discharged. Supervening impossibility may occur in many ways, some of which are explained below.

Discharge by Supervening Impossibility

A contract will discharge by subsequent or supervening impossibility in any of the following ways:

<u>(a) Destruction of Subject-Matter</u>

When there is a contract in respect to a particular subject matter which is later destroyed without the fault of the parties, the contract is discharged.

In *Taylor v. Caldwell* (1863) 122 E.R. 299, the leading case on this point, a music hall was agreed to be let out for a series of contracts on certain days. The hall was burn down before the date of the first contract. The contract was held to have become void and the owner of the hall was absolved from liability to let the hall as promised. Blackburn J. observed in this case as follows: “In contracts in which the performance depends on the continued existence of given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance.”

(b) Non-existence of a state of things necessary for performance

When a contract is entered into on the basis of the continued existence of a certain state of things, the contract is discharged if the state of things changes or cases to exist. In this case there is no destruction of any property affected by the contract, but the use of that property contemplated by the contract has became impossible

In *Krell v. Henry* (1903) 2 K.B. 740, H hired a room from K for two days. The room was taken for the purpose, as both parties well known, of using the room to view the coronation procession of Kind Edward VII, although the contract contained no reference to the coronation. Owing to the King's illness the procession was abandoned. Held, that H was excused from paying rent for the room, as the existence of the procession was the basis of the contract, and its cancellation discharged the contract.

(c) Death or Personal Incapacity

Where the personal qualification of a party is the basis of the contract, the contract is discharged by death or physical disablement of that party. In other words the death or illness of a particular person whose action is necessary for the promised performance discharges the duty to render that performance.

In *Robinson v. Davidson* (1871) L.R. 6 Ex. 269 contracted with D that D should play the piano at a concert given on a specific day. D was ill on the day in question and unable to perform. The contract was discharged and D's illness excused him from performance.

(d) Discharge by supervening illegality

A contract which is contrary to law at the time of its formation is void. But if, after the making of the contract, owing to an alteration of the law or the act of some person armed with statutory authority the performance of the contract becomes impossible, the contract becomes impossible, the contract is discharged. This is so because the performance of the promise is prevented or prohibited by a subsequent change in the law.

In *Baily v. De Crespignay* (1869) L.R. 4 Q.B. 180, D leased some land to B and convenanted that he would not erect any but ornamental buildings upon the adjoining land. A railway company, under statutory powers, took this adjoining land and built a railway station on it. Held, D was excused from performance of his convenient, because the railway company's statutory power had rendered it impossible.

On the other hand, if at the time of the making of the contract, compulsory powers are in existence, the exercise of which may affect the contract, a party knowing of those powers cannot rely on the fact that they are subsequently exercised as a defence to his breach of contract. The exercise of the compulsory powers was event which might have been anticipated and guarded against in the contract. Also, a continuing contract is not discharged by a prohibitive regulation which may be determined or varied and leaves a substantial part of the contract capable of execution. So, where a notification regulating retail prices was issued which did not make performance of the contact impossible or unlawful, the parties were not discharged. But if a contract to be performed in a foreign country becomes illegal owing to a change in the law of that country, the contract is discharged.

(e) Declaration of War

A contract entered into during war with an alien enemy is void ab initio. A contract entered into, before the war commence, between citizens of countries subsequently at war remains suspended during the pendency of the war, provided it does not involve intercourse with the alien enemy or is not helpful to him or his country. Such a contract will be revived and may be enforced at he end of the war. If a contract entered into before the outbreak of the war amounts to aiding the enemy in the pursuit of war, it would be abrogated or discharged and not merely suspended. It will also be discharged if it cannot remain suspended, e.g., the contract involves the continuous performance of mutual duties.

Case which are not covered by the Doctrine of Supervening Impossibility (Impossibility not an Excuse)

Apart from the cases mentioned above, impossibility does not discharge contracts. Therefore, impossibility of performance is as a rule not an excuse from performance. He who agrees to do an act should do it unless absolutely impossible which may happen in any one of the ways discussed above. It may be stated, as a general rule, that impossibility to perform arising subsequently to the agreement will not, as a rule discharge the promisor, because when there is positive contract to do a thing which is not unlawful, the promisor must perform it or pay damages for not doing it, although the performance becomes unexpectedly burdensome or even impossible on account of unforeseen events. The supervening event should destroy the contract itself. Merely making the contract difficult cannot attract Section 56. Some of the circumstances in which a contract is not discharged on the ground of supervening impossibility are stated here:

- Difficulty of Performance
  The mere fact that performance is more difficult or expensive or less profitable that the parties anticipated, does not discharge the duty of performance. Increased or unexpected difficulty and expense do not, as a rule excuse from performance.

  Examples

(i) A sold to B certain quality of Finland timber to be delivered between July and September, 1999 No deliveries were made before August when war broke out and transport was disorganised so that A could not bring any timber from Finland. Held, B was not concerned with the way in which A was going to get timber from Finland and therefore the impossibility of getting timber from Finland did not excuse performance.

(ii) A promised to send certain goods from Bombay to Antwerp in September. In August war broke out, and the shipping space was not available except at very rates. Held, the increased freight rates did not excuse performance.

- Commencial Impossibility
  Commencial impossibility to perform a contract will not discharge the contract. A contract cannot be said to be impossible of performance because expectation of higher profits is not realised. A promisor's contractual duty to lay gas mains is not discharged because the outbreak of war makes it expensive to procure the necessary materials.

- Failure of third party
  The principle of supervening impossibility does not extend to the case of a third person on whose work the promisor relied.
  In *Gana Saran v. Firm Ram Charan*, 1952 S.C.9, a contract between the parties provided that 61 bales as noted below are to be given to you by us; we shall go on supplying goods to you of the Victoria Mills as soon as they are supplied to us by the said mill." In a suit for damages for non delivery of goods the defendants pleaded impossibility and frustration on the ground that the goods were not supplied to them by the mill. Held, that the law is contained Sec. 56 of the Act, and the worlds" as soon as they did not convey the meaning that delivery was contingent on their being supplied by the mills. The case did not fall within the provisions of Sec. 56, as the default was due to the fault of the defendant.

- Partial Impossibility
  Partial impossibility rarely discharges a promisor beyond the extent of the impossibility. This, if the state of things in question is not the sole basis of the contract, so that there will still remain a substantial portion, through not all, of what was contract for, the contract will not discharged. In other word, where there are several purposes for which a contact is made is made, failure of one of the objects does not terminate the contract.
  In *H.B. Steamboat Co. V.Hutton* (1903) 2 K.B. 683, the company agreed to let a boat to H to view naval review at the coronation and to cruise round the fleet. Owing to the King's illness the navel review was cancelled, but the fleet was assembled and boat might have been used for the intended cruise. Held, the Co. were not discharged from performance as the naval was not naval was not the sole basis of the contract.

- Strikes, lockouts and civil disturbances
  Strikes, lockouts and disturbances like riots do not terminate contracts unless there is a clause in the contract providing that in such cases the contract is not to be performed or that the time of performance is to be extended.

The lessee of certain salt pans failed to repair them according to the terms of his contract, on the ground of a strike of the workmen, Held, a strike of workmen is not sufficient reason to excuse performances of a term of the contract.

The Doctrine of Frustration

The Common law of England started with the harsh doctrine that unless the parties expressly stipulated to the contrary, impossibility was no defence to an action for breach of a contract. In course of time, however, exceptions were introduced to modify the severity of the Doctrine. In English cases, it has been now held that when the common object of a contract can not longer be carried out, the court may declare the contract to be at an end. This is known as the

The doctrine developed in England under the guise of reading implied to stick to a contract the purpose of which has disappeared.

Thus, when the performance depends on the continued existence of a given person or thing, a condition is implied that impossibility of performance arising from the perishing of the person or thing shall excuse performance. If the act became impossible subsequently be reason of some event which the promisor could prevent, the contract is discharged. This is based on the maixm *les non cogit ad imposibilia* - the law does not compel the impossible. This discharge of a contract rendered impossible of performance by external causes beyond the contemplation of the parties is known as frustration.

Frustration, as said above, is device by which the rules as to absolute contracts are reconciled with a special exception which justice demands. It has become a gloss on the older theory impossibility which it has greatly developed under the guise of reading "implied terms" into contracts. Therefore, as observed by Lord Radcliffe, Frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because circumstances in which performance is called for would render it a thing radically different from hat which was undertaken by the contract. Non haec in foedera veni- "It was not this that I promised to do."

Furthermore, under the doctrine of frustration the fundamental assumption underlying the contract becomes impossible, The performance of the contract may do not be actually impossible, but if the contract can not be performed as originally contemplated by the parties, there is frustration. In such a case, there is a frustration of the object of the contract. Where, for instance, goods were seized as prize and then released and transshipped so that they arrived two years late, the arrival was not such as was contemplated by the parties. The discharge of a contract by reason of frustration follows automatically when the relevant event happens and does not depend on the volition or election of either party. The doctrine applies if the disturbing cause goes to the extent of substantially preventing the performance of the whole contract. Thus, a contract may become frustrated or impossible of performance by an Act of Legislature, or by operation of law; it may be discharged by a subsequent declaration of war, or by emergency regulations. The frustration of venture may arise through an Act of God vis majeure. An Act of God or *vis majeur* is "an accident due to natural causes, directly and exclusively, without human intervention and which could not have been avoided by any amount of foresight or care."

The doctrine of frustration has no application to demise of land to a lease of furnished house, or to a building lease for 99 days. It does not extent to the case of a third person on whose work the promisor relied. Commercial impossibility also does not frustrate a contract. The doctrine does not apply where the event which is said to have frustrated the object of the contract arises from an international act or election of a party.

<u>Indian Law Regarding Frustration</u>

In India, the law is codified and Sec. 56 which deals with the subject provides for discharges of contract by impossibility of performance or frustration. Para 1 And 2 Sec. 56 read as follows.

"An agreement to do an act impossible in itself is void."

"A contract to do and act which after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful..."

It is clear from the language of the section that it departs from the English law to a large extent and lays down positive rules of law which according to English decisions are only matter of construction depending on the intention of parties. There is no question of reading implied terms if contract is equivalent to supervening impossibility or illegality. The point of frustration raises some difficulties but a recent pronouncement of the Supreme Court has clarified the position.

In *Satyabrat Ghose V. Mugneeram Bangur & Co.,* who were the owners of a large tract of land started a scheme for its development for residential purposes and accordingly divided in into a large number of plots for the sale of which they invited offers from intending buyers. The company's plan was to accept a small portion of the price by way of earnest money from the buyers at the time of agreement, construct the roads and drains itself and within one month after their completion call upon the buyers to complete the construction by paying one-third of the price at the time of the registration and the balance within 6 years bearing interest 6 percent per annum, time being deemed the essence of the contract.

B entered into a contact on those terms with M & Co., in 5-8-1919 and later on assigned the contract to S. Shortly prior to that assignment a portion of the land covered by the scheme was requisitioned for military purposes by the Government under the Defence of India Rules, and later the rest of the land was also requisitioned. M & Co., thereupon informed B that the land pertaining to the schemed was taken possession of by the Government and there was no knowing how long the Government would retain possession and that the company could not, therefore, take up the construction of roads and drains during the continuance of the war and possible for many years after its termination. The company also wrote to B to treat the contract as cancelled and take back the earnest money. This letter was handed over by B to his assignee S, who asserted that the company was bound by the contract and could not resile. S filed a suit for declaration that the contract date 5-8-19 was subsisting and that S, as assignee of B, was entitled to get the conveyance executed and registered by the company on payment of consideration mentioned in the agreement and in the manner and under the conditions specified therein. The company contended that the contract of sale became discharged by frustration as it became impossible of performance by reason of supervening events. On appeal the Supreme Court held that it could not be said the requisition order vitally affected the contract or made its performance impossible and accordingly the appeal was allowed and the suit was decreed.

The law relating to frustration in India as laid down by the Supreme Court in Satyabrat Ghose's case may be summed up as follows:

" The Court in India should look primarily to the law as embodied in Secs. 32 and 56 of the Indian Contract Act. Indeed, the above sections of the Contract Act embrace the whole of the Indian law on the subject. Sec. 32 applies in cases of contingent contract and Sec. 56 covers the rest. Under either, however, impossibility is the central or dominating idea and the determinating factor. "The essential idea upon which the doctrine of frustration is based is that of immpossibility of performance of the contract." In fact, impossibility and frustration are after used as interchangeable expressions. The changed circumstances made performance of it as they did not promise to an impossibility. The doctrine of frustration is in reality an aspect or part of the law of discharge of contract by reason of supervening impossibility or illegality of the act agreed to be done and hence comes within the purview of sec. 55.

In deciding cases in India the only doctrine that we have to go by is that of supervening impossibility as laid down in Section 56, taking work impossible in its practical and not literal sense.

Section 56 days down a rule of positive law and does not leave the matter to be determined according to the intention of the parties. Therefore, in India, the doctrine of frustration is applied not on the ground that parties themselves agreed to an implied term which operated to release them from performance; of the contract. The relief is given by the Court on the Ground of subsequent impossibility when it finds that the whole purpose or the basis of a contract was frustration by the intrusion of occurrence of an unexpected event or change or circumstances which was beyond what was contemplated by the parties at time when they entered into the agreement. When such an event or change of circumstances occurs which is so fundamental as to be regarded by law as striking at the root of the contract as a whole, is the Court which can pronounce the contract to be frustration and at an end.

In applying this rule the Court has to examine the nature and terms of the contract before it and the circumstances under which it was made and to determine whether or not the disturbing element which is alleged to have happened in the particular case has substantially prevented the performance of the contract as a whole. If the answer be in the affirmative, the contract will stand dissolved or discharged by virtue of Sec.

Effects of Supervening Impossibility or Frustration

Sections 56 and 65 of the Indian Contract Act expressly provide for the consequences of the impossibility of performance as follows.

1. When the performance of a contract becomes subsequently impossible or illegal, the contract becomes void. Section 56, para 2.
2. When a contract becomes void, any person who has received and advantage under it must restore it, or make compensation for it to the person from whom he received it.
3. Where one person has premised to do something which he knew or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise-Section 566, para 3.

A contracts to marry B being already married to C and being forbidden by the law to which he is subject to practice polygamy. A must take compensation to B for any loss caused to her by the non-performance of his promise.

DISCHARGE BY LAPSE OF TIME

The Limitation Act., in some circumstances, affords a good defence to suits for breach of contract, and in fact terminates the contracts by depriving the party of his remedy at law. For example, where a debtor has failed to repay the loan on the stipulated date the creditor must file the suit against him within three years of the default. If the three years expire and he takes no action, he will be barred from his remedy, and the other party is discharged of his liability to perform. The period of limitation for simple contracts is three years in India and six years in England, and in the case of Special Contracts it is twelve years.

Example: A borrowed Rs. 5000 from B, a moneylender, and agreed to repay the loan on 31st March 1983. On 31st March, 1983, A failed to repay the loan. But B did not take any legal action against A till 31st March, 1986. In this case, B cannot recover the amount of loan from A as the limitation period for the recover of loan is three years from the date of default, which has expired. And thus, A is discharged from his liability to pay the loan.

The different period of limitation for the enforcement of some of the important contracts/rights is as under:

Description of Suit	**Period of Limitation**	**Time from which the limitation period starts**
Sit for the recovery of money	3 years	When the loan is made

Suit by surety against principle debtor	3 years	When the surety pays the creditor
Sit for declaration	3 years	When the right to sue first acrues
Suit by mortgagor to redeem or recover possession of immoveable property.	30 years	When the right to redeem or recover possession.
Suit to enforce payment of money secured by a mortgage	12 years	When the money sued for becomes due
By a landlord to recover possession from a tenant	12 years	When the tenancy is determined.

DISCHARGE BY OPERATION OF LAW

Discharge under this head may take place as follows:

(a) By Death

Where contract requires personal skill or ability, the contract is terminated on the death of the promisor. In case of other contracts the right and liabilities of a deceased person are transferred to his legal representatives.

Example: A, an expert, agreed with B to translate some part of book from French to English. A died before the translation work started. In this case, the contract is of personal nature as it involves the personal qualification of the promisor (A). And thus, the contract is discharged on the death of A.

(b) By Merger

Where the parties embody the inferior contract in a superior contract, when between the same parties, new contract is entered into, and security of a higher degree, or a higher king is taken, the previous contract merges in the higher security. Where securities of the same kind of degree are taken there is no merger.

Example: A gave his land on lease to B. Subsequently, B bought the land which he was holding under the lease. In this cease, B becomes the owner of the property and his rights as a lessee merge into his rights as the owner. And thus, his rights as a lessee vanish, and are not to be enforced.

(c) By the unauthorized alteration of terms of the contract

Where a party to a contract in writings makes any material alternation without the knowledge and consent of the other, the contract can be avoided by the other party. An alternation every by a stranger will entitle the other party to avoid the contract, but where the alteration is due to mere accident or is not material, contract cannot be avoided.

Example: A contracted to sell his plot of 500 sq. yards to B for s. 100,000. The sale deed was executed which was in possession of A. Before the registration of the sale deed, A altered the deed and made it a deed for the sale of 300 sq. yards plot for Rs. 100,000. In this case, the contract is discharged and B is not bound to purchase the plot.

(d) By insolvency

The Insolvency Act provides for discharge of a contract contracts under particular circumstances. So where the Insolvency Court passes an order discharging the insolvent, this order exonerates or discharges him from liabilities on all debts incurred previous to his adjudication.

(e) Right and liability vesting in the same person

Where rights and liabilities under a contract vest in same person the contract is terminated and other parties to contract are discharged For example, when a bill of exchange passes in the hands of the acceptor, the parties are discharged.

DISCHARGE BY BREACH OF CONTRACT

We have seen contract must strictly perform according to its terms, But where the promisor has neither performed his contract nor tendered performance and where the performance is not excused by consent express or implied, or where the performance is defective, there is a breach of the contract by him. Which entitles the other party to file a suit. If the contract is unilateral the only remedy for the other party is to claim relief for beach can claim relief for breach and also in certain circumstances is exonerated from liability to perform his part of the contract.

The breach of contract may be (I) actual (ii) constructive or anticipatory. The actual breach may take place (a) at the time when performance is due, or (b) when actually performing the contract. The constructive or anticipatory breach of contract, i.e. a breach before the time for performance has arrived, may also take place in two ways, namely, (a) by the promisor doing an act which makes the performance of his promise impossible to perform his promise.

Actual breach of Contract

(a) Actual Breach of Contract at the time when Performance is due-where a person fails to perform a contract, when performance is due the other party can hold him liable for breach. But, if a party who has failed to perform the contract at the appointed time, subsequently expresses willingness to perform the question whether he can do so or not would depend upon whether time was of the essence of the contract or not. In all mercantile contracts time is the essence of the contract and breach of contracts results on failure to perform within the limited time. This specially so in shipping contracts. In a sale of goods subject to rapid fluctuations of market price, the time of delivery is of the essence. There are other transactions, e.g. contract relating to sale of land in which time is not deemed to be of the essence unless parties specially stipulate to the effect, But the terms of the contract, or the nature of the property sold, will determine whether time was of the essence. In the case of sale of a house to be immediately occupied or sale of a business as a going concern, time is not of the essence and the party express willingness to perform it after the appointed time, the law permits him to do so subject to payment of compensations for failure or due performance. The party accepting that he intends to claim compensation otherwise he is deemed to have waived the right to compensation (Sec. 55)

(b) Actual Breach during the Performance of the contract- where a party apparently performs the promise but the other party says that it is not a proper performance according to the contract, the question arises whether there is a breach of the contract exonerating the other party from performance of his part of the bargain. If breach is of a condition vital to the contract, the contract is discharged and the other party need not perform his part of the bargain. In the case of sale of goods by description, unless the goods answering to the description are offered, the buyer is not bound to take delivery or to pay for them. But if the breach is only of a collateral term (non-essential condition) this will not exonerate the party from performance of his part of the bargain, but only entitle him to claim damages. Where the buyer has obtained possession of goods and his right of enjoyment is disturbed in any way he can claim damages caused by the breach of the implied warranty of quiet possession. Where the promisor had made more than one promise, or a divisible promise his repudiation must either be of the whole contract, or of a part of it which is a condition precedent to the promisee’s liability, else the promisee will not be entitled to treat such repudiation as equivalent to the breach of the whole contract.

Constructive or Anticipatory Breach of Contract

It may sometimes happens that even before the time of performance arrives the promisor may do some act which makes the performance impossible or may definitely renounce the contract or show his intention not to perform it. Thus where A promised to assign to B within 7 years from the date of promise all his interests in 4 houses for Rs. 10,000 and before the end of the years assigned all his interests to another person, it was held that without waiting for the 7 years to elapse B could sue for breach of the promise.

In another case a carrier was engaged in April to accompany his employer on a tour of three months to commence on June, 1. On May 11 the employer wrote to the courier that he had changed his mind and declined his services but refused to make him an compensation. On May 22 the courier brought his action for breach of contract, and the defence was that there could be no breach before June 1. It was held that the courier was entitled to treat the letter of May 11, equivalent to breach of contract.

It is to be note that a constructive or anticipating breach of contract does not give rise to a right of action, unless the promisee elects to treat it as equivalent to actual breach, Thus, instead of bringing an immediate action as in the examples given above, the promisee may treat the conduct, act or notice of the promisor as inoperative, and wait for the time when the contract is to be performed, and then hold the promisor responsible for all the consequence of non-performance. But in that case the promisee keeps the contract alive for the benefit of the promisor not only to complete the contract in spite of previous repudiation, but also to avail him any excuse for non-performance which may have come into existence before the time fixed for performance.

Thus, in our second example, if the carrier had waited till June 1, the employer could withdraw his letter of May 11, and ask the carrier to accompany him on tour, or if performance had become impossible due to some cause, such as the declaration of war, the courier would have lost his remedy and the employer would have been excused from performance. A party putting and end to the contract must restore any advantage he may have received.

REMEDIES FOR BREACH OF CONTRACT

Where there is a breach of contract on the part of one party, the injured party becomes entitled to any one or more of the following reliefs:

1. Rescission of the contract with the result that the injured party is freed from all obligations under the contract;
2. Suits for damages;
3. Suit upon a quantum meruit;
4. Suit for specific performance of the contract;
5. Suit for an injunction.

Rescission

In one party has broken his contract, the other party may treat the breach as discharge, and refuse to perform his part of the contract. He may also successfully defend an action for non-performance, or an action brought for specific performance. Sec.75 further entitles him to compensation for any damage he may have sustained through the non-fulfillment of the contract.

For instance, A singer, contracts with B manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her Rs. 100 for each nights's performance. On the sixth night, A willfully absents herself from the theatre, and B in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non-fulfillment of the contract.

Damages

Where a contract has been broken, the party who suffers by such breach is entitled, under Sec.73 to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when make the contract, to be likely to result from the breach of it.

But compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach. Compensation is also available against a party for breach of a quasi-contract. Sec73 is based on the leading case of *Hadley V. Baxendale* (1854) 9 Ex. 34 the facts the which are as follows:

The plaintiff, an owner of a mill, delivered a broken shaft to the defendant common carrier to take to a manufacturer to copy it and make a new one. The carrier delayed delivery of the shaft beyond a reasonable time, as a result of which the mill was idle for a longer period than should have been necessary. The plaintiff did not make known to the defendant carrier that delay would result in a loss of profits. Held, the carrier was not liable for loss of profits during the period of delay.

Alderson, B observed in this case, "When two parties have made a contract, which one of them has broken, the damage which the other party ought to receive in respect of such breach should be either such as may fairly be considered as arising naturally, i.e., according to the usual course of things from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both the parties a the time the contract was entered into as a probable result of the breach." This statement of law is known as the Rule in *Hadley v. Baxendale*.

The Principle enunciated in Sec. 73 is that a party who suffers by the breach of contract is entitled to:

a. Such damages as naturally arose in the usual course of things, as a result of the breach;
b. and if he claims special damages for any loss sustained (which would not ordinarily flow from the breach) he must prove that the other party knew at the time of making the contract that the special loss was likely to result from the breach of the contract;
c. Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach;
d. Compensation for quasi-contract as damage is the same as for a contract.

Following examples has been given under Sec. 73 of the Act-

A contracts to sell and deliver 50 maunds of saltpetre to B at a certain paid on delivery a breaks his promise. B is entitled to receive from A, by of the price for which B might have obtained 50 maunds of saltpetre of like quality a the time when the saltpetre ought to have been delivered.

<u>Liquidated Damages and Un-liquidated Damages</u>
Where there is breach of contract by one party, the other party is entitled to sue for damages. Therefore, unless the court passes a decree for a specified amount, the claim for damages is merely a right to sue and not a debt or actionable claim. Consequently, this claim can be assigned or transferred, since it is not a debt under the law.

The suit may be for liquidated damages or un-liquidated damages.

Liquidated damages are damages agreed upon by the parties in the contract itself to be paid by the party breaking the contract in case of breach. The plaintiff has only to prove the breach of contract, and no proof of loss is required. But liquidated damages must appear to be a genuine pre-estimate of the loss that will be caused to one party if the contract is broken by the other. Where no damages are fixed by the contract, but the amount of compensation claim for a breach of contract is left be assessed by the court, damages claimed are called unliquidated damages.

Unliquidated damages may be classified as Ordinary Or Compensatory Damages.

In deciding a suit for damages, the court has to answer two questions: (I) Proximity and remoteness of damage (ii) Measure of damages.

Proximity and remoteness of damage
The judge has to first decide whether or not the damage has resulted from proximate consequences of the breach, for remote consequences are not regarded. Once the court has decided that the damage is sufficiently proximate, it will the turn to the measure of damages, that is the amount of money that will compensate the plaintiff. The question of remoteness of damage is governed by the maxim recognised in *Hadely v. Baxendale* and Sec. 73 our contract Act. *in jure unon remota causa, sed proxima spectatur*- “In law not the remote cause, but the proximate cause is taken notice of.”

Thus, if the damage of loss suffered by reason of the breach of the contract is remote or indirect no compensation would be allowed. The aggrieved party however, would in case of breach of contract, be entitled to recover compensation for damage or loss caused to him thereby, if such loss or damage arose naturally and directly in the usual course of things from such breach, of which the parties to the contract knew, at the time of making the contract, to be likely to result from breach of contract. The first part of this rule states the case for ordinary damages and the later concerns with special damages.

In *Hadley v. Baxendale*, the common negligence delayed delivery of the broken shaft to the manufacturer who has to copy it and make a new one. On account of the delay by the common carrier the mill remained idle for a longer period that should have been necessary. The plaintiff did not make known to the defendant, the common carrier, that for want of the shaft the mill would remain idle which would result in a loss of profit. The plaintiff was held entitled to recover damages for delay in delivery but not for loss of profits occasioned by the closure of the mill since there was no way the common carrier could have been foreseen that the mere absence of a shaft would cause the closure for the mill. The mill-owner could have recovered damages for loss of profit if he had informed the carrier of the likely result of delayed delivery.

Measure of damages

The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events, from the breach of contract. The injured party is to be put in the same financial position as he would have been if the contract had been performed according to its terms.

In the case of sale and purchase, the damages, payable would be the difference between the contract price and the market price at the date of the breach. The damages are calculated as on the date of breach and any subsequent change of circumstances tending to an increase or reduction of damage cannot be taken note of.

A cow was sold with condition that it was free from disease. The cow was suffering from foot and mouth disease at the time of sale. Not only the cow die but it also infected other cows of the buyer. Held damages could be recovered for the entire loss.

Special Damages

Special damages are those resulting from a breach of contract under some special circumstances. If at the time of entering into a contract a person has notice of special circumstances which make special loss the likely result of the breach in the ordinary course of things, than upon his breaking the contract and the special loss following the breach, he will be required to make good the special loss. If therefore there be any special damage which is attributable to the wrongful act, then special damages, if proved, will be awarded. Hence if an unusual damage is likely to be sustained as the result of a breach of contract, its nature should be communicated to the other party before the contract is made so that he contracts subject to the prospective liability. Thus, if in Hadley v. Baxendale, the mill-owner had told the carrier that delay would result in a loss of profits through stoppage of the mill, he would have recovered damages for such a loss.

Exemplary or Punitive Damages

These damages are sum awarded beyond the pecuniary loss sustained by the injured party. Ordinarily, damages for breach of contract are intended to compensate the plaintiff, not to punish the defendant. The object of exemplary damages is to punish the defendant and to deter him and others from similar conduct in the future. Award of exemplary damages is made in only two cases:

(I) Breach of promise of marriage cases, (ii) where a bank wrongfully dishonors a commercial customer’s cheque.

In a breach of promise to marry, the amount of the damages will depend upon the extent of injury to the party’s feelings. It is really and additionally sum known as a solatium awarded to the jilted women as a solace for her injured feelings. In the case of wrongful dishonor of a cheque of a customer who is a trader the rule is the smaller the cheque dishonored the greater the damage.

Nominal Damages

Nominal damages consist of a small of money, e.g., a rupee. They are a token award where there has been an infringement of contractual right, but no actual loss has been suffered. These damages are awarded to establish the right to decree for breach of contract.

Contemptuous Damages

Damages are said to be contemptuous, when the court finds that a breach has been committed, but that the breach is so insignificant or petty that a reasonable man would not have filed a suit. A rupee or even less may be awarded to mark the court's disapproval of the plaintiffs conduct in bringing the action. The law does not take account of trifling things; and where it does, It awards also something of a contemptuous character. Such damages have been awarded to male plaintiffs in breach of marriage actions.

Liquidated Damages and Penalty

Where the parties have fixed at the time of contract the damages that would be payable in case of breach, a question may arise (in English law at least) whether the provision amounts to "liquidated damages" or a "penalty" Courts in English give effect to liquidated damages, but they relieve against penalty.

The test of the two is that where the amount fixed is a genuine per-estimate of the loss in case of breach; it is liquidated damages and will be allowed, and if the amount fixed is without any regard to probable loss, but in terrarium, is a penalty and will not be allowed.

In Indian law, there is no such difference between liquidated damage and penalty, as Sec. 74 specifically provides payment of only "reasonable" compensation "sec. reads:

"When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach or if the contract contains any other stipulation by way of penalty the party complaining of the breach is entitled whether or not actual damage or loss is proved to have been caused thereby, to received from the party who has broken the contract a reasonable compensation not excluding the amount so named or as the case may be the penalty stipulated for. A stipulation for increased interest from the date of default may be stipulation by way of penalty....."

The party suffering from breach is entitled to get the actual damages he has suffered. With regard to the amount named in the contract, the compensation payable is the reasonable amount up to the stipulated amount whether it is by way of liquidated damages or penalty.

a. A contracts with B to pay BB Rs. 1,000 if he fails to pay B Rs. 500 on a given day. A fails to pay B Rs. 500 on that day. B is entitled to recover from A such compensation not exceeding Rs. 1000 as the Court considers reasonable.
b. A contracts with B that, if A practices as a surgeon within Calcutta he will pay B Rs. 5,000 A practices as a surgeon in Calcutta. B is entitled to such compensation, not exceeding Rs. 5000 as the court considers reasonable.
c. A gives a recognizance binding him a penalty of Rs. 500 to appear in Court on a certain day. He forfeits his recognizance. He is liable to pay the whole penalty

Payment of Interest: With regard to the payment of interest the following rules have been laid down.

a. Payment of interest in case of default. Where a contract provides that the amount should be paid by a particular date and in default, it will be payable with interest, the court will give effect to the stipulation if the interest is reasonable. Where the interest is exorbitant the Court will give relief.

b. Payment of interest as higher rate Where the bound provides that in default of the payment of the principal by a stated date enhanced interest should be payable, if the enhanced interest is made payable from the date of default and is reasonable, it is regarded compensation and is allowed. But if the enhanced interest is exorbitant, e.g. increase from 12 percent to 75 percent, it will be penalty and relief will be granted against it.
c. Payment of compound interest. The Court do not lean towards compound interest, they do not award in the absence of stipulation but where there is a stipulation for its payment it is the absence of disentitling circumstances, allowed i.e. it will be allowed only if it is the absence of disentitling circumstances allowed, i.e. it will be allowed only if it is not an enhanced rate.

Suit for Quantum Meruit

Quantum meruit as much as he has earned. Suing on quantum meruit is the suing for the value of so much as is done. The in jured party can use for quantum meruit, i.e. if the injured party has done can estimated at a money value of so much as he has already done.

A places an order with B for the supply of 100 chairs to be delivered by installments. B delivers 20 chairs when A informs him that he will require no more. In this case A's erudition discharges B from the obligation to supply the remaining chairs. He can sue A for the breach of contract for the value of 20 chairs already supplied. The later will be called suit for quantum meruit.

Suit for Specific Performance

Instead of, or addition to awarding damages to the injured party a decree for specific performance may be granted. Specific performance means the actual carrying out by the parties carrying out their agreement. This remedy, however, is discretionary and will not granted in the following cases.

1. Where monetary compensation is an adequate remedy.
2. Where the Court can not supervise the execution of the contract, e.g. a building contract.
3. Where the contract is for personal services.
4. Where one of the parties is a minor.

Specific performance is usually granted in contracts connected with land, e.g. purchase of particular plot of house, or to take debentures in company. In the case of sale of goods, it will only be granted in the case of specific goods and is not ordered as a rule unless the goods are unique and cannot easily be purchased in the marked or are of special value to the party suing by reason of personal or family associations

Suit for Injunction

An injunction is a mode of securing the specific performance of negative terms of the contract. It is an order of the court whereby an individual is required to refrain from the further doing of the act complained of. It may be used to prevent many wrongful acts, e.g. torts, but in the context of contract the remedy will be granted to enforce a negative stipulation in a contract in a case where damages would not be an adequate remedy. Thus, where a party to a contract is doing something which he had promised not to do, the court may in its discretion, issue and order to the defendant restraining him from doing what he promised not to do. Its application may be extended to contracts where no actual negative stipulation is but where one may be inferred.

MODULE II: INTERNATIONAL CONTRACT LAW: NORMS AND DRAFTING GUIDELINES

TENDERS AND TENDERING PROCEDURES

CONCEPT AND MEANING OF TENDER

The Government in a welfare state is the re**g**ulator and provides large number of benefits and dispenses of services to its people. In the process of dispensing the benefits and services, the Government enters into contracts i.e. contracts between private individuals, on the one hand and Government or its instrumentalities on the other. A large body of individuals seek to deal with the Government as the modern welfare state, the Government is increasingly assuming the role of dispenses of large monetary benefits including jobs, contracts, licenses, quotas, mineral rights out sourcing, the services of many individuals and many more business enjoy the largesse in the form of contracts. Many enterprises set up primarily to do business with Government. The basic question is to regulate and discipline the Government discretion to confer such benefits. Simultaneously it is necessary to ensure that injustices are not done to an individual by the state or its instrumentalities. As such, wealth assumes greater and greater importance in the life of the nation, there is going to be greater competition amongst the seeking of such wealth. The constitutional reorganization of Government contracts is to be found in Article 298 and 299(1) of Constitution. Article 298 provides that the executive power of the union and each state shall extend to the making contracts for any purpose. So it provides the state can enter into a contract in exercise of its executive power. Article 299(1) mandates the requisite conditions which contracts in exercise of the executive power of the union each state is required to fulfill. These provisions in the constitution relating to form of contract on behalf of the Government is mandatory

Meaning of Tender: Tender is an invitation to offer denoting a type of takeover bid. The tender is a public, open offer or invitation (usually announced in a newspaper advertisement) by a prospective acquirer to all stockholders of a publicly traded corporation to tender their stock for sale at a specified priced during a specified time, subject to the tendering of a minimum and maximum number of shares. In a tender offer, the bidder contacts shareholders directly.

As pointed out by the Supreme Court of India in *R. D. Shetty Vs. International Airport Authority*1979 (3) SCC 489, that "The Government cannot be permitted to say that it will give jobs or enter into contracts or issue quotas or licenses only in favor of those having grey hair or belonging to a particular political party or professing a particular religious faith. The Government is still the Government when it acts in the matter of grating largesse and it cannot act arbitrarily. It does not stand in the same position as a private individual". The Hon'ble Supreme Court while agreeing with the observations made in the case of *V. Punnah Thomas Vs. State of Keral*a AIR 1969 Ker 81 stated that "The Government is not and should not be as free as an individual in selecting the recipients for its largesse".

Since the Government no longer enjoys the absolute discretion to enter into contract with anyone the Government must choose the party in a non – discriminatory manner. The state must act fairly and make a choice in the selection of a contracting party by affording equal opportunity to all contenders by examining their claims fairly. Government discretion is not unlimited that it can give or withhold largess in its arbitrarily but its action must be confirm with some principle which meets the test of reason and relevance. Hon'ble Supreme Court in Rammanna's Case followed the Judgment as held in *E.P.Rayappa Vs. State of Tamilnadu* (1974 (4) SCC3) and *Maneka Gandhi Vs. Union of India* (1978 (1) SCC 248) that Article 14 strikes arbitrariness in state action and ensures fairness and equality of treatment. The court further observed in Para 21 that:-

" It must, therefore follow as a necessary corollary from the principle of equality enshrined in Article 14 that though the state is entitled to refuse to enter into relationship with any one, yet if it does so, it cannot arbitrarily choose any person it likes for entering into such relationship and discriminate between persons similarly circumstanced but it must act in conformity with some standard or principle which meets the test of reasonableness and non – discrimination and any departure from such standard or principle would be invalid unless it can be supported or justified on some rational and non – discriminatory ground"

The above principle laid down by the Hon'ble Supreme Court was subsequently affirmed in*Kasturilal Vs. Jammu & Kashmir* reported in 1980(4) SCC page 1 held that "Every activity of the Government has a public element in it and it must, therefore be informed with reason and guided by public interest. Every action taken by the Government must be in public interest. The Government cannot act arbitrarily and without reason and if it does, its action would be liable to be invalidated."

Therefore, there is restriction of Government power in respect of the persons, with whom the Government may enter into a contract. The Government or its instrumentalities are not free, as an ordinary individual, as it selects the party with absolute and unfettered discretion.

Another application of Article 14 of Constitution was considered in *Becil Vs. Arraycom India Ltd*2010(1) SCC 139 that "in contracts to be given by Government authorities or statutory bodies or instrumentalities of the state, Article 14 of Constitution applies. Hence, there should be transparency by holding an open public auction or tender because such contracts often involve huge amounts of public money".

The Supreme Court further in *Siemens public communication Net Work(P) Ltd Vs. Union of India* AIR 2009 SC 1204 unambiguously observed that the decision making process of Government or its instrumentality should exclude remote possibility of discrimination, arbitrariness and favoritism. It should be transparent, bona fide and in public interest. In another case, the Supreme Court approved the Swiss challenge method under taken by the state in the case of *Rani Development Vs. Shre Krishna Prathisthan* 2009(7) SCC 462. The Supreme Court further examined the award of contract in light of Article 14, and held that the action taken by authorities in awarding contract can be judged and tested in the light of Article 14 as in the case of *Meerat Development Authorities Vs. Ass. Of Management Studies*2009 (6) SCC 171. Concerning binding nature of tender conditions (NIT condition)the Supreme Court in Ramanna Case held that "It is well settled rule of administrative law that an executive authority must be rigorously held to the standards by which it professes its action to be judged and it must scrupulously observe those standards on pain of invalidation or violation of them". This rule was enunciated by U.S. Supreme Court in *Vitervalli Vs. Saton* 359 U.S. 535 in the following words.

"An executive agency must be rigorously held to the standards by which it professes its action to be judged --------
This Judicially evolved rule of administrative law is now firmly established ------------
He that takes procedural sword shall perish with the sword."

The Supreme Court accepted this rule as valid and applicable in India in A. *S. Ahmewalia Vs. Punjab* 1975(3) SCC 503, in *Sukhadev Vs. Bhaghathram* 1975(1) SCC 421. The above said rule subsequently affirmed in *B.S. Minhas Vs. Indian Statistical Institute* 1983(4) SCC 582.

In *Harmindar singh Arora Vs. Union of India* 1986(3) SCC 247 the court dealt with a case, in which Tenders were invited for supply of milk the contract was awarded to state undertaking by rejecting the offer of a private party which was more suitable in that situation, the Supreme Court cancelled the grant of tender by holding that the instrumentalities of state cannot act arbitrarily. If it chooses invite tenders, it must abide by the conditions specified in the tender notice. If the party fails to fulfill the conditions of the tender notice, it cannot be accepted.

However, in respect of conditions of eligibility, its strict compliance is required, in other words the state, and its instrumentalities are required to adhere norms. Standards and procedures cannot be departed from, arbitrarily. The award of contract, its action would be tested for its validity.

In another case wherein it is reported in AIR 1982 Gahuathi 37 in the case of *Omega Advertising Agency Vs. State Electricity Board* where the state Electricity Board issued a notice inviting offers from advertisements fulfilling certain conditions as per NIT. One of applicants fulfilled the essential conditions, while the others had not, in this situation, the state electricity board decided to split its work between the two. The Assam High Court set aside the division of splitting the work by declaring the action of instrumentalities as being against the tenor of notice inviting offer, and further declared that the action amounts to discrimination under Article 14, as authority had awarded the contract to a person who was not qualified according to the prescribed standards.

The Hon'ble High Court of A.P. examined the law in the case of M/s.Nandini Deluxe 2005 (6) ALT 748 wherin the court held that "the state is bound to adhere to the norms, standards and procedures laid down by them and cannot depart from them arbitrarily. If the Government indicates preconditions of eligibility and evaluates the technical bid ignoring such norms and standards, the entire decision making process must suffer the wrath of Article 14 of constitution of India".

However, the Supreme Court classified the requirement in NIT into two categories, those which lay down the essential conditions of eligibility and others which are merely ancillary or subsidiary to the main object to be achieved by this condition. If there are essential tender conditions, the same must be adhered to and in other cases it must be open to the state or its instrumentality to deviate from and not to insist upon strict compliance. In the case of *Poddar Steel Corporation Vs. Ganesh Engineering Works* (1991 (3) Sec. 273) the question arose concerning conditions of the tender as the successful bidder made payment of the earnest money by sending a cheque drawn on Union Bank of India not of State bank of India. The Supreme Court held that 'as a matter of general proposition it cannot be held that an authority inviting tenders is bound to give effect to every terms mentioned in the notice in meticulous detail and is not entitled to waive even a technical irregularity of little or of no significance".

If the action complained of is shown to be violative of constitutional or mandatory statutory provisions or is initiated due to mala fides or patent arbitrariness, the Court has always interfered with such decision and laid limitation on judicial review while reviewing the decision making process and not just the merits of the decision. The Hon'ble Supreme Court after considering the Judgment on the subject held in TATA Cellular Vs. Union of India (1994 (6) SCC 651) held.

"It cannot be denied that the principles of judicial review would apply to the exercise of contractual powers by Government bodies in order to prevent arbitrariness and favoritism. However, it must be clearly stated that there are inherent limitations in exercise of that power of judicial review. Government is the guardian of the finances of the state. It is expected to protect the financial interest of the state. The right to refuse the lowest or any other tender is always available to the Government. But the principle laid down in article 14 of the Constitution have to be kept in view while accepting a refusing a tender. There can no question of infringement of Article 14 if Government tries to get the best person a best quotation. The right to choose cannot be considered to be an arbitrary power. Of course, if said power is exercised for any collateral purpose the exercise of that power will be struck down".

Subsequent to the above, the Hon'ble Supreme Court in *Asia foundation and Construction Ltd.Vs. Trafalgas House Construction* (I) Ltd. (1997 (1) SCC 738) held that "Though the principle of Judicial review cannot be denied as far as exercise of contractual powers of Government bodies are concerned but it is intended to prevent arbitrariness or favoritism and is exercised in the larger public interest and is brought to the notice of the court if the power has been exercised for any collateral purpose."

In *Raunaq International Ltd. Vs. I.V.R co ltd* . (1999 (1) SCC 492) the Supreme Court further laid down propositions that are to be considered while evolving the case on hand. The Supreme Court further held that the court is entitled to examine whether these requirements have been considered. The court held that "if any relaxation is granted for bona fide reasons, the tender conditions permits such relaxation and the decision arrived at for legitimate after fair consideration of all offers, the Court should hesitate to intervene."

In *B.S.N. Joshi & Soni Ltd. Vs. Nair Coal Services Ltd*. (2006 (11) SCC 548) the Hon'ble Supreme Court after reviewing the judgment on the subject laid down the legal principles are applicable to the award of Government contract/tenders.

Further the Hon'ble Supreme Court in *Jagdish Mandal Vs. State of Orissa* (2007 (14), SCC 517) further held that "If the decision relating to award of contract is bonafide and is in public interest, the courts will not, in exercise of power of judicial review, interfere even if a procedural aberration or error in assessment or prejudice to a tender, is made out."

In view of the same it can be stated that the aggrieved person can invoke the jurisdiction of the High Court under Article 226 of Constitution of India in the matter of contractual transactions between the state and persons who are dealing with the State or its instrumentalities.

TENDERING PROCEDURE

Meaning: It is a method where Indian government, as well as municipalities and most corporations issue a procurement notice in newspapers, official government publications and over the Internet for purchasing goods or services. In India the tender process is same as conducted in other parts of the world.

Objectives: The objectives of a Tender are to purchases the best at the lowest price, infuse healthy competition amongst prospective suppliers/contractors to achieve the above objective, adopt a method of selection of the supplier / contractor which is fair to all the suppliers/contractors particularly where competition is heavy and avoid malpractices.

Prerequisites: Tendering action has to be preceded by several steps i.e. the purchaser must be clear as to what he wants (requirement) and its specifications and performance parameters, with no ambiguity, the purchaser must have a fair idea about a reasonable price and tender documentation to be complete and self contained. If these are not followed and tenders are floated in a hurry, it will lead to enormous delays in the evaluation of the tenders (bids) and finalization of the award. Disputes may also arise during implementation, thus defeating the objectives of the system.

Notice Inviting Tenders: Notice inviting tenders must contain the following i.e., notice must be clear, specific and certain, no ambiguity, failure to mention is just sowing seeds for disputes, it must mention time, floated by the employer, specifications may vary so GCC or SCC must be laid, Contractors must visit the proposal site and must take the stock of the site (with all particulars)

Requisites of a Valid Tender: A valid tender must be unconditional, must be made at a proper place, must confirm to terms of the obligations, must be made at a proper time, must be made in proper form, person by whom tender is made must be able and willing to perform his obligations, reasonable opportunity of inspection to be given and tender must be made to the proper person.

Tendering Methods: There are three tendering methods which are

(i) Open Tender (open to all),
(ii) Limited Tender (top 10 Companies will be selected and tender is floated only to those ten companies) and
(iii) Single Tender.

Basic Rules of Procedure: The procedure applied in tendering procedure is: rejection of late tenders, which need not even be opened and can be removed, tenderers or their authorized representatives are invited to be present when the tenders are opened and the names of the bidders and the total amount of each bid are read out and recorded, tenders should be opened preferably by a committee of at least three persons, each of whom shall authenticate each page of the tender, and initial corrections, if any, there should be a well laid down procedure for the safe custody of the tenders from the time they are opened up to the time the award is made, no changes will be allowed to be made by the tenderers after they are opened, as far as possible, discussions – even technical discussions and negotiations should be avoided, and the whole process of evaluation and finalization of award should be carried out confidentially and speedily.

Earnest Money Deposit: Obtaining an earnest money deposit is an important part of the tender system. Earnest money deposit is provided by a tenderer (bidder) to confirm his earnestness in taking up and fulfilling the order, if it is awarded to him and conveys as assurance that he will not back out of his offer at any time till the decision about the award is taken by the principal, when these deposits will be returned to the unsuccessful tenders/bidders. Clauses like Bank Guarantees, Discharge of unsuccessful bidders, forfeiture of deposit if withdrawn or forfeiture if successful bidder fails to sign the contract can be added to the tendering procedure.

Form and Content of Tenders: The second important part of a tender system is the actual form and contents of the tenders. Two Envelop System is the Tender system followed in India. One containing the technical bid and the other containing the commercial and financial bid. It is not unusual to increase the number of envelops to three by separating the commercial bid from the financial bid. The World Bank Tendering Procedures provide for a single envelop system, however, in major contracts two envelop system is adopted. In the first sate, un-priced technical proposals on the basis of a conceptual design or performance specifications are invited subject to technical and commercial clarifications and adjustments and in the second stage when bidding documents have bee amended, final technical proposals and priced bids are submitted by the bidders.

While a two state tendering procedure may be justified in exceptional cases involving large contracts or new technology, the two envelop system which prescribes the tenders being submitted simultaneously in two envelops, one containing the technical proposal and the other containing the price and other commercial conditions (terms of payment, mode of payment, price variation formula etc.) invariably leads to two indications i.e., (i) these are that the Buyer has not firmed up the technical specifications, performance parameters and tolerances of the equipment he wants to procure and therefore is inviting technical proposals (ii) the second aspect is whether there is a need at all for getting a price bid at this stage which is related to each tenderer's technical proposal, in the absence of declared and frozen technical specifications of the Buyer. In practice, since the technical bid is first opened, and the technical bids are obviously diverse to some extend, a need variably follows, for technical discussions.

Negotiations: The third important aspect relates to price negotiations, which runs counter to the basic concept of tendering. Price negotiations have two disadvantages. Firstly, if the prospective Suppliers and tenderers know that the organization which has floated the tenders always resorts to further negotiations of prices, there is a tendency on the part of all the Suppliers and Contractors, to add to their already calculated prices, what is known as a 'Negotiation Margin'. The second disadvantage is the possibility of reaching a stalemate during negotiations and the Buyer having to go through the whole procedure again.

Evaluation of Tenders: The objectives of evaluation of tenders are (i) to bring all the bids on par and on a like to like basis, after eliminating offers not technically or otherwise acceptable and (ii) to draw up ranking amongst the acceptable tenders, to enable the award being finalized on the lowest tenderer. The evaluation is usually carried out by Committees of functionaries known as Tender Committees constituted for this purpose. It has a representation from the technical department, finance department and purchase or stores department.

Acceptance of Tenders: After all the evaluations are completed, the Tender Committee makes recommendations about the lowest technically acceptable offer. After the recommendations are approved by the authority in the organization competent to do so, the stage of issue of a Letter of Acceptance (LOA) is reached. When this is issued, a binding contract comes into being, even if the letter is a one line letter of award to the Supplier or Contractor. When tenders are floated inviting offers, the tendering cycle starts. The tenders received are offers and the letter of award is the acceptance of the offer, with which the tendering cycle is legally completed. The letter of acceptance is followed by a formal contract document.

Tendering by Government/Public Authority and Element of Public Interest: An important judgment (in *Raunaq International Ltd. v. IVR Constructions Ltd. & Ors* (1998) SLT 137) about the tender procedure was delivered by the Supreme Court of India on 9th December, 1998, in which the Court considered another dimension of tender procedure and inter alia held that the elements of public interest involved should also to be considered while entertaining a petition challenging award of a contract by a public authority or the State.

Guidelines issued by the Central Vigilance Commission (CVC), Government of India:

The CVC has issued circulars from time to time containing guidelines in respect of Tendering Procedures, Appointment of Consultants, Preference to Public Sector Undertakings and other related matters. Some of the guidelines are

(i) transparency in tendering system,
(ii) Receipt and Opening of Tenders,
(iii) Members of Tender Committee,
(iv) Tender Process,
(v) Tenders,
(vi) Shortcomings in Bid Documents,
(vii) Irregularities in the Award of Contracts,
(viii) Notice Inviting Tenders,
(ix) Clause about submission of samples,
(x) Delays in Payments,
(xi) Appointment of Consultants,
(xii) Mobilization of Advances,
(xiii) Back to back Tie up by Public Sector Undertakings,
(xiv) Works/Purchase/Consultancy Contracts awarded on Nomination basis and
(xv) Transparency through effective use of Websites.

CONTRACTUAL BIDDING

Bidding is an offer (often competitive) of setting a price one is willing to pay for something or a demand that something be done. A price offer is called a bid. The term may be used in context of auctions, stock exchange, card games, or real estate. Bidding is used by various economic niche for determining the demand and hence the value of the article or property, in today's world of advance technology, Internet is one of the most favorite platforms for providing bidding facilities, it is the most natural way of determining the price of a commodity in a free market economy.

Biddings are arranged by first disclosing the time and space location of the place where the bid is to be performed, so that more interested bidders may participate and the most "true" price of the commodity may come out, in terms of bidding on Internet the time frame for posting the bids may be a topic of interest.

Many similar terms that may use or may not use the similar concept have been evolved in the recent past in connection to bidding, such as reverse auction, social bidding, or many other game class ideas that promote them self as bidding. Bidding is also sometimes used as ethical gambling in which the prize money is not determined solely by luck but also by the total demand that the prize has attracted towards itself.

Bidding Process:

During the bidding process, sufficient attention should be placed on the key good procurement principles of "transparency" and "equal treatment", which will help bolster the legitimacy of the PPP and its acceptance by stakeholders.

These good procurement principles must be respected from the time the formal tendering process begins. Informal discussions with companies may take place before the process formally begins (this is particularly important in respect of large projects). For example, while keeping in mind that achieving a level playing field amongst potential bidders is the eventual goal, the Authority may organize information days, technical briefings, early public release of technical documents and so on. As soon as the procurement notice is published, all potential bidders must be given equal treatment and a careful audit trail of all contacts with potential bidders must be kept. The equal treatment principle dictates that information provided to one potential bidder should be made available to the other potential bidders in a timely manner.

Authorities are encouraged to seek advice on all procurement activities, in particular on how to ensure that the procurement activities described here comply with the requirements of national law. The proper handling of procurement activities is crucial to the success of the PPP project in achieving value for money but also to avoiding legal challenges that could adversely delay the implementation of the project.

Procurement notice

Publication of the public procurement notice marks the start of the formal procurement process. The Authority must comply with all requirements related to the publication of notices in the Official Journal of the European Union (OJEU). It is good practice to also publish the procurement notice in one or more international periodicals. The OJEU notice is followed by a questionnaire to enable interested companies to demonstrate their qualifications (also known as the submission of an "expression of interest").

Prequalification

The wording of the brief project description contained in the OJEU notice should be broad enough for it not to need to be subsequently changed (which might then require the procurement process to start all over again). The purpose of prequalification is to include only those bidders that appear to be capable of carrying out the PPP project in an adequate manner. Typically, interested parties that respond to an initial notice are sent a short statement of information about the project and instructions or a questionnaire. These form the basis of a qualification submission that such parties must make to demonstrate their ability to implement the project. The invitation to prequalify (or prequalification questionnaire, as it may be called) should contain at least the following:

- the broader context of the project;
- an overview of the project, including the intended allocation of major risks and envisaged responsibilities of each party;
- a list and summary of the major studies that will be made available to bidders concerning the project;
- the intended procurement process;
- the qualifications that companies can put forward (e.g. parent or subsidiary companies' qualifications);
- the criteria and tests that will be used to evaluate the prequalification statement (but not necessarily the precise details to be used in any scoring or ranking since that could lead to some manipulation by the candidates); and
- a timetable.

It is standard practice for the Authority's legal advisers to draft both the PPP procurement notice and the prequalification questionnaire.

Shortlisting

The purpose of shortlisting is to reduce the number of bidders to generally between three and five. Bidding for a PPP project, especially a complex one, is a costly undertaking for a bidder. Evaluating bids is also a time-consuming exercise for the Authority and its advisers. The aim of the bidding process is to maximize competition, not the number of bidders. Just as the presence of too few bidders results in poor competition, the presence of too many bidders on the shortlist may reduce the interest of some in participating and cause good bidders to drop out.

In some cases the public sector has sought to encourage candidates to bid by agreeing in advance to make a payment to each losing bidder that would partially reimburse it for the costs of bid preparation. Such payment could be made from money that the Authority would receive from the winning bidder (once again, specified in advance). The size of the payment has to be calibrated to discourage frivolous bids. Practice varies widely between countries. The Authority should ask their advisers about current market practice in the relevant sector and jurisdiction.

In evaluating the qualification submission, the Authority will focus on the technical capability, business capability and financial position of the potential bidders. In line with EU public procurement legislation, these capacities must be, in principle, demonstrated jointly, rather than individually, by the members of a consortium.

The prequalification submission will usually be required to describe the following:

- the business activities of the consortium (e.g. how many projects of a similar nature, the consortium has implemented over a specified number of years);
- financial information (e.g. thresholds involving turnover and net worth);

- legal information about the PPP consortium, including any relevant litigation involving the companies; and
- the quality of personnel to be involved in the project.

The first step of the prequalification and shortlisting process is often to determine which consortia have passed the thresholds in all the relevant respects (i.e. pass/fail tests). Most of the criteria (e.g. company revenue) are expressed in terms of clear and objective thresholds. If this results in a number of consortia that exceed the maximum number pre-specified for the shortlist, then a systematic and predetermined process for scoring or ranking should be used to narrow down the list to arrive at a shortlist.

Sometimes shortlisting is done partly on the basis of responses that are submitted to a set of open-ended questions about how the companies would address certain key issues if they were to win the PPP contract. For example, in the competitive dialogue procedure, initial shortlisting can be based partly on an assessment of the outline or indicative solutions given by the candidates.

At the end of the process, a well-substantiated prequalification report should be prepared to provide a good audit trail. Unsuccessful bidders should be debriefed.

Online Bidding:

<u>Introduction</u>

The use of e-Technology is being increasingly adopted in today’s business environment. Regular visitors to the CIC website may already have come across the Liability Briefing on e-Business, which deals with all sorts of e-Issues such as e-Contract formation, e-Drawings and such like. As stated in the Introduction to the Liability Briefing on e-Business, the use of e-Technology has clear benefits for businesses and projects generally, allowing for improved efficiency, speed and accuracy.

One of the ways in which e-Technology has been adopted by the construction industry is in the procurement process. Whilst there may be benefits in the use of e-Technology for this process, there may also be risks. This guidance note has been prepared by the Construction Industry Council (CIC), with the participation and endorsement of the Specialist Engineering Contractors’ Group (SECG) to explain the procurement of construction products and services through on-line bidding.

On-line bidding is known by several names, including ‘electronic reverse bid auctions’, ‘reverse auctions’ or simply ‘e-Auctions’. The phrases ‘on-line bidding’ and ‘e-Auctions’ are used interchangeably throughout this guidance note.

The use of on-line bidding should only be used where the requirement can be ‘accurately specified’ by the client (although this is not to say the requirement cannot be complex). The on-line bidding should only take place once the brief has been fully developed.

Factors other than price (e.g. delivery, quality, etc.) should be taken into account by the client prior to the on-line bidding in order to 'weigh' the price bids in which to determine the overall position of the bidder. The on-line bidding process should be open and transparent as a matter of good practice. There are many ways of setting up an e-Auction, which will affect the way in which a bidder will be able to view his ranking. For instance, a bidder may see his position on a graph amongst other bidders' bids or he may see his own position only - it is up to the client to select the most appropriate e-Auction design.

On-line bidding has been used in other industries for some time but was subsequently adopted by some – usually very large portfolio – construction industry clients in purchasing not only products but also professional services and complex services including major contracts for construction that may include design elements and considerable subcontractor input.

This expansion of the use of on-line bidding to include the purchase of services in the procurement of professional and complex services has faced significant opposition from many representatives of the construction industry, primarily because of the process's apparent focus on price rather than quality or value.

<u>The On-line Bidding Process</u>

The process involved in on-line bidding varies depending upon the products and services procured. Generally speaking however, the process is as follows:

1. Bidders are pre-qualified using the criteria expressed at the outset by the contracting authority.
2. Pre-qualified bidders will be invited by the client to submit a 'technical' proposal containing everything (except the price) and to participate in the auction on a specific date and at a specific time. Specifications and instructions on how to participate in the auction will be provided in advance of the event. Bidders will be advised after prequalification that an e-Auction will take place.
3. Client will provide software and practice/training as necessary.
4. Client will review the technical proposals and resolve any qualifications and apply weighting, if appropriate. In the case of weighted bids the prices submitted at the e-Auction stage may be subjected to an overall weighting, which takes into account criteria other than price alone, so the display bid will not purely be based on price alone.
5. The on-line bidding exercise will usually be conducted on behalf of the client by an IT service provider. It is usually specified that bidders can only bid downwards and the minimum decrement is usually specified.
6. The bidding exercise will have a specified opening and closing time. The e-Auction will close when no new bids are received and the closing time has expired. If however, a new (lower) bid is received just before the scheduled closing time, the allocated bidding time will be extended.
7. The bidders' identities will be kept confidential during the event although the number of bidders will usually (but not always) be apparent from the screen.

8. The client may sometimes display an opening bid price; this will be an indicative guide to bidders. From this point onwards, all bids will progress downwards during the duration of the e-Auction. The client may set the e-Auction parameters so as not to allow bidders to start their bidding higher than the opening bid price.
9. Each bidder will receive feedback on its own ranking in relation to the other bidders.
10. Each bidder will be able to submit as many new bids as they wish up to the closing time of the e-Auction; the rankings will be revised accordingly.
11. All bidders will be notified of their results.
12. The client will have an opportunity to review the bids to ensure that quality, service and other value-adding considerations are met.
13. Once the review process has been carried out, the contract will be awarded to the successful bidder against the criteria that were established at the outset.

Advantages and Disadvantages of On-line Bidding

There has been a large amount of publicity generated in the press about the disadvantages of on-line bidding. With a few notable industry exceptions, the level of usage is still relatively low therefore it is difficult to be definitive. The advantages and the disadvantages of on-line bidding set out below should help in making an informed decision on whether or not to participate in such a process.

Advantages:

Many of the advantages listed can also be found in other procurement processes.

- On-line tendering is a method of standardizing the procurement process
- Preferred bidders are all contained within a single database
- Bidders can be monitored
- Good control of bidders' submissions
- Easy comparison of bids
- Confidence in validity and integrity of contractual documentation
- Time benefits: reduction in paperwork, postage, photocopying
- Ease and speed of communication to multiple bidders
- Audit trail for documentation
- Secure bidding environment
- Better efficiency in the process
- Potential for access to competitors' bids
- The ability to submit more than one bid

Disadvantages:

Again, many of the disadvantages listed can also be found in other procurement processes.

- e-Auctions do not appear to take into account the current innovative industry practices for procurement in the construction industry. The perception of on-line bidding is based upon 'lowest price' rather than the 'best value' initiative as set out in 'Re-Thinking Construction', although the client has the opportunity to set the criteria against factors such as quality and performance. 'Re-Thinking Construction' also seeks to discourage tendering as wasteful, recommending instead the development of partnering and team working arrangements; e-auctions could continue to reinforce industry fragmentation at the expense of such arrangements.
- The time pressure to submit a bid lower than that shown on the screen may lead to errors of judgment. Contracts subsequently awarded under the on-line bidding process may therefore, create an even greater likelihood of errors, disputes, bad faith and an increased risk of claims than in traditional tendering processes.
- Where there is insufficient weighting, there may be a risk of 'cut-throat' pricing by bidders where corners may be cut and quality compromised.
- As with all procurement processes, there may be jurisdictional issues to be clarified.
- Because of the time pressure, it is very difficult (if not impossible) in real time to include the bids of the entire supply chain in the bidder's bid.
- The process can lack transparency when it comes to evaluation procedures by the client where those procedures are not seen by the bidders.
- The process might still discourage firms from taking part because of the perception that the process depends solely on low price bidding.
- Bidders may not be given the opportunity to negotiate or discuss their contract terms prior to taking part in the e-Auction; nor may they have time to check with their insurers to ensure that the contract will be covered under their policies. This may therefore, result in many uninsured risks.
- Unscrupulous clients could introduce ghost bidders. Further information on this can be found in an e-Ethic statement issued by the CIPS.

Is On-line Bidding Right For You?

The objective of the on-line bidding process must be to obtain best value and not purely lowest price. It cannot be possible to achieve best value outcomes whilst the focus remains on price. The ultimate decision on whether or not to bid using the on-line bidding process will of course rest with potential bidders. The on-line bidding process should be carefully utilized as one part of a complex procurement process and not as a separate tool. Where the relationship of strategic critical goods and/or services cannot be specified, it may be unwise to run an auction.

Both the client and the bidders should have an appropriate knowledge of the e-Auction subject, its market, its market price and of the process itself, if the e-Auction is to be successful.

On-line bidding is considered by some major industry observers as totally contrary to the Egan principles and recommendations of the Rethinking Construction and Accelerating Change reports insofar as it perpetuates tendering practices, detracts from partnering and teamworking and ignores best value. This is because the perception of on-line bidding process is that it appears to be price-driven whereas Egan encourages the selection of contractors and suppliers based upon value and quality. However, Accelerating Change was not averse to the general concept of the use of electronic means for procurement, which had been observed to achieve cost and time savings.

Other parties in the industry believe that if on-line bidding is approached correctly within the whole procurement process, then it will not be ‘harmful’ to the Egan principles. The focus then should be on harnessing an intelligent approach to procurement in construction products and services. Unfortunately, the on-line bidding market has witnessed few clients adopting this suggestion for the purchase of construction products and services, employing rigorous pre- qualification procedures and conducting extensive interviews to select the bidder– in the same way as they would do on traditional contracts.

On-line bidding for construction products and services should be considered a method for purchasing only if it is used in a proper context, within a sound procurement process, and under the right expertise. It still carries some adversarial aspects embedded in any on-line bidding process, and lessening those aspects and their impacts will come through better guidance and practice codes for implementing the on-line bidding method.

Reliance Airport Developers Private Limited vs. Airport Authority of India

The Reliance Airport Developers case was decided in November 2006 by a two-judge bench in Supreme Court. This was a very significant decision which came in the wake of the Government’s scheme of privatizing the Delhi- Mumbai airports.

The process for restructuring and modernization of Delhi and Mumbai airports had gained momentum as part of the first step of Indian Government’s avowed policy of privatization of strategic national assets. But the whole process came under a big question mark with Reliance Group’s petition whereby they alleged that the whole project was infested with several major defects, in view of which the project should be grounded. The case brought up a number of key issues relating to the privatization of the airports, ranging from the discretion handed out to the public functionaries in so far as accepting the view of any one of the committees set up as part of a multi-tier system is concerned, to the question of judicial review of such actions. The case saw “reasonableness” of the government’s decision being discussed, along with the possibility of any mala fide intentions behind the scenes.

The Supreme Court ended up removing the final roadblock on the Rs 5100 crore airports modernization scheme by rejecting the Anil Ambani-owned Reliance Airport Developers Limited’s (RADPL) appeal against rejection of its bid for both Delhi and Mumbai terminals. The appeal was held to be sans any merit at all. But the judges also put the evaluation committee in the dock by questioning its decision to alter the scoring norms.

This case not only saw a range of important legal issues being discussed and mulled upon, but also clarified the current position as regards many moot points of law. But at the same time, a lot was left hazy, and in want of clearer legal directions.

Factual Background:

In February 2006, Reliance Airport Developers Private Ltd.4 (Reliance) filed a petition in the Delhi High court challenging the results of the bidding process for the privatization of the Delhi and Mumbai Airports. The plea contested the 'arbitrary and illegal' way in which the Government of India (GoI) had awarded the bids. With this development, the GoI's hope that the long drawn out process of privatization of Delhi and Mumbai airports was reaching a fruitful end, received another jolt. The privatization of the two premier airports of India had been postponed repeatedly since 1997. Successive governments sought to initiate the process by bringing in the required changes in airport infrastructure policy, but the process was always hindered by roadblocks.

In May 2004, the Congress (I) led-UPA5 government came to power and commenced the process of privatization of the Mumbai and Delhi airports by inviting bids from interested parties. It was delayed until September 2005. Then again, the bidding process became controversial. While some players left the fray because of certain bid conditions, others were rejected by the evaluators. The bid results that were announced in December 2005 led to public outcry and dissatisfaction. Allegations of lack of transparency and apparent favoritism were made. Subsequently, the GoI appointed several committees to lend credibility to the much maligned process

Arguments and Judgment:

The appellant in this case contended that the very appointment of GETE was illegal and unauthorized, and that its constitution was without jurisdiction as it was outside the RFP. GETE competence to express any view was questioned by RAL, as it imputed that GETE was not competent to deal with the issues relating to airports.

The court held that the constitution of GETE did not suffer from any infirmity. Since the decision making process was to involve inputs from series of 'in house' committees, the creation of GETE was in fact a part of 'in house mechanism', which is clear from the fact that several Committees were constituted like EC, GRC, IMG and COS. In view of the existence of various tiers in the decision making process, EGOM who has delegated the power of Cabinet did not exceed the powers by setting up the committees.

These committees do form part of the 'in-house mechanism' for evaluation of the bids. Their reports were to be used as inputs in the final decision making process and thus, in a way, imparted a great deal of transparency. More so, this contention of the appellant doesn’t seem to hold its ground, as despite having challenged the constitution of GETE, the appellant, in uncertain terms, asked the GETE to assess the materials placed before it by the appellant. As the court too observed, the EGOM had given reasons for the appointment of GETE. If the appellant's submission is accepted, even the GRC, IMG and COS being not the committees mentioned specifically in the RFP, their constitution would be illegal. This certainly cannot be the case of the appellant and none of these were external agencies.

The Evaluation by EC v Evaluation by GETE

The primary stand of the appellant in this case was that the EGOM/ GOI should have accepted the recommendations of the EC and should not have asked the GETE to make further examination. According to RAL, GETE did not examine the queries relating to GMR as raised by the IMG and the reduction of technical qualification from 80% to 50% that it made, was impermissible- especially when at all stages EGOM had emphasized that there shall not be any compromise with quality. Also, RAL imputed that uniform pattern of assessment has not been followed by GETE. In the initial assessment, only the GMR and the appellant had crossed the bench mark. If in respect of one airport GMR was given the option of matching the financial bid of the appellant, in respect of the other airport similar option should have been given to the appellant who was at the relevant point of time and even now willing to match the financial bid of GVK. Appellant had scored over 80% on the development side and fell short of merely 6% less than 80% on the management side. The award of contract to the third ranked bidder i.e. GVK who had scored only 59% on the development side and whose bid had been adversely commented upon by all committees was against public interest. RAL forcefully contended that GETE's evaluation of appellant's bid was wrong and it should not have interfered with EC's evaluation. GETE’s report, which was totally subjective in nature, was never independently examined by EGOM.

The respondent, on the other hand, argued how GETE had formed its view as to how the allotment of marks made by EC was clearly not in line with the prescription made in the RFP. Marks had been allotted by EC on irrational basis and even marks had been awarded when no marks were to be awarded. It was pointed out that EC on whose evaluation appellant has led great stress found only one flaw with the plan given by GVK, i.e. lack of re-use of existing facilities and the high cost limits to assess it as medium, which the respondent contended, was really a non- factor. More of such technical nuances find place in the text of the judgemnent. The respondent alleged that there was departure by EC from the norms in various cases without good reasons.

A careful reading of the facts tells us that different weightages were allotted by the EC in case for criteria 1.2.2 and 1.2.3 and also in respect of criteria 3.1.1 and 3.1.2, while evaluating the bids at RFP stage. A curious feature of the four changes is that at least three of them were in principle designed to enable the appellant to get over the shortcomings in its bid. The appellant had no property development experience. It had projected less than 40% non aeronautical revenue and had a partner from an OECD country. In any event, the court did not go into the question whether EC was partial to the appellant or not, because that is nobody's case. The researcher cannot comment upon the propriety of the technical parameters laid down or altered, but at the same time, the fact that after opening the bids, EC made the variations and beneficiary was the appellant, deserved more attention of the bench. GETE's was essentially not an exercise of re-evaluation, but of a re-allocation consistent with RFP.

As for the challenge made by the appellant to the lowering of the bench mark, the appellant had come into the zone of consideration only because of lowering of the bench mark as otherwise after the modifications were made by GETE, it had not crossed the bench mark. The appellant's stand that if none was found eligible on the basis of 80% bench mark, there should have been a fresh bid, was not accepted by the court. The court found more substance in the respondent's contention that the number of bidders was small, and after opening of the bid, they knew the merits and demerits of all the bids. There was an urgency for early completion of the airports keeping in view the 2010 Commonwealth Games, which had to be kept in mind. The researcher feels that although in the present case, the stand taken by the Supreme Court makes sense in view of the impending Commonwealth games and incidental public interest, the court still should have taken up this issue and analysed it in a more detailed manner. This kind of a situation throws up questions of administrative expediency, flexibility, and new limitations on the scope of judicial review. The Court should have delved deeper and sought answers for these questions, rather than leaving them untouched as was done in this case.

Were the RFP norms well adhered to?

RAL contended that EC has given marks on the basis of RFP parameters. According to it, the parameters were fixed by the GOI or the EC. Excerpts from the report on findings of GETE , relating to the marks allotment and subsequent evaluation of the bids, display a very clear lacuna in the whole process till then.

The question of allotting marks has already been dealt with in the previous section of the case comment, the real issue here is whether right parameters have been applied for the evaluation or not. The court observed that modifications in RFP were resorted to by EC after the bids were opened. The researcher too feels that this could be the principal reason for which EGOM may have sought views of the COS, and the COS was equally entitled to invite a group of experts to examine the matter (the GETE in this case). Infact, what would have been more fair and transparent was that if EC felt that the priorities and weightages as indicated in the RFP were inappropriate, then it should have requested AAI/GOI to amend the RFP before the bids were received, and not modify them on its own after opening of the bids.

This issue found a special mention in the verdict of the second judge Justice Kapadia, according to whom the basic controversy in the present case is: whether the E.G. had exceeded its authority in the assessment of technical pre-qualification. His opinion was that in the scoring system objectivity has an. important role to play . This objectivity which was the underlying principle of Clause 5.4. is completely lost either by expanding the enumerated factors like aeronautical revenue, overall capability vis-a-vis capacity to absorb existing work-force and comparison of property development with infrastructure development, or by allocating un-even marks to sub-factors. Justice Kapadia felt that the E.G. had no business to expand or narrow down the scope of any of the above factors as it was beyond its authority and contrary to the scoring system.

Can the propriety of the decision of accepting the findings of one Committee over the rest, in a multi-tier system, be brought under scrutiny?

RAL had emphasized that the while the other Committees consisted of mainly bureaucrats or persons with inadequate technical knowledge, only the EC was an expert body and, therefore, its view had to be given primacy. EGOM should have examined the conflicting reports given by the experts. Since no reason has been given by EGOM to adopt the report of the GETE by giving its preference over the report of EC, same cannot be maintained.

The Supreme Court held that in a multi tier system in the decision making process, the authority empowered to take a decision can accept the view expressed by one committee in preference to another for plausible reasons. It is not bound to accept the view of any committee. These committees are constituted to assist the decision making authority in arriving at the proper decision. It is a matter of discretion of the authority to modify the norms and not a case of absolute discretion.

The researcher agrees with the Supreme Court on this count. EC was not the only advisor to assist the EGOM in arriving at a decision. It was not designated in the RFP as an external expert agency on whose evaluation the Government was obliged to act. In fact at the first stage itself GRC was constituted to review the evaluation done by EC. The report of EC had no binding effect on the IMG much less the EGOM. The ultimate decision making authority was EGOM. Considering the fact that this was a first case of private JV, UOI enabled the EGOM to take note of various view points and take the final decision. These discussions would help strengthening the decision making process, and the researcher sees no impropriety in that. It was within the powers of EGOM to decide as to what inputs it can take note of and the source of these inputs. EC was a Committee constituted as a part of the decision making process like other Committees vis. GRC, COS and IMG.

But at the same time, researcher has her reservations on the fact that in a similar situation, if a similar decision is taken by the authority, without there being any indications or plausible reasons for the authority have done so, then would the decision still be validated in the court of law? In this case, doubtful findings could be seen in EC’s reports, and hence the acceptance of the independent evaluation carried by other committees appeared to have made perfect sense. But in a case where there is no such loophole in any one of the findings, what should be the criteria followed by the executive and if situation be, by the judiciary? Also, researcher feels that the concern of the appellant as regards the composition of the Committees was very valid, and that Court should have taken it into account before going ahead with its decision.

One of the main issues was whether the bidding should have been scrapped in totality? RAL contended that as GMR has been allowed to match the financial dealing of appellant for Mumbai airport, the same modality should have been adopted for the other bidders. SC had a very firm approach to this argument, not accepting it for the simple reason that when bench mark is crossed, financial consideration is the determinative factor because of revenue sharing. The court also felt that though emphasis was led that the constitution of Committees of non technical persons could not have thrown much light on the ultimate decision, yet it is to be noted that all the three Committees were part of the government machinery, and that the real issue was to assess correctness of the EC's decision.

The researcher does not fully agree with this stand off the court, for if a committee is constituted of the members of government, this fact alone does not ensure its fairness and justness. Such a committee cannot be held to be outside the pruview of judicial review. Also, a committee made up of technical experts does hold a greater say on matters as relating to this case.

Carrying on with its argument, the court agreed with the respondents on the fact that the RFP has to be considered in the context of other documents like substantial document OMDA, execution of the agreements culminating to the final master plan. Initial development plan is nothing but a projection which has to be broadly in line with OMDA. Undisputedly, OMDA is prepared by the GOI and AAI. One of the documents in the transaction documents is OMDA. If no one was qualified, two alternatives were available- either to scrap or abandon the process and second to re-conduct the tenders. Scrapping the process was not feasible in view of public interest, as has been discussed before in the project. The safety valve is the OMDA. The ranking becomes irrelevant after the bidders have come to the arena and then finally the financial bid which determines the ultimate bid. It is to be noted that GETE wanted to know as to whether the variation for allotment of marks in respect of the development side area was done before opening the bids or after opening it. EC had given a very evasive answer stating that same was done before allotting marks. GETE's job was not the evaluation but verifying the evaluation process. GETE's examination was restricted to see whether alignment with RFP was correctly done. GETE was not expected to give fresh opinion and no evaluation was necessary. The criterion adopted by GETE appears to be more rational. It proceeded with the idea that more objectivity was necessary. So it has called the process to be validation process. There was a question of urgency and subsequent public interest involved in the case, which was acting as a propellant. The practical compulsion which made the choice of scrapping or rebidding avoidable cannot be termed as perverse or lacking rationality. If the RFP was to consider at the final phase of evaluation there would be only one bid for each of the airports. In that event, there would be no question of finding out difference between the various bids or comparing bids. That left no option with the EGOM but to either vary RFP or to award one of the airports to GMR and to cancel the process for the second or cancel the entire process. The latter course would not have been in larger public interest. Therefore, the EGOM exercised its option. In final analysis, what the EGOM has done is to accept the report of EC subject to validation done by GETE.

INTERNATIONAL CONTRACTUAL NEGOTIATIONS

The law governing contract formation is typically analyzed in terms of the traditional common and civil law rules of offer and acceptance. The complex processes that lead to modern contracts are typically articulated in documents that seldom lend themselves to these classical rules. Particularly the International transactions are frequently completed without clearly discernable offers, counter offers, or acceptances and the agreements usually result from numerous rounds of negotiations and successions of draft agreements.

There is significant change in the contract jurisprudence during the 1980s. The changes that take place are mostly centered on the development of theories for the expansion of pre-contractual liability. The emerging jurisprudence has strengthened with a steep increase in claims arising from pre-contractual negotiations and preliminary agreements. In the recent past there are several major developments in American case law on the subject. The developments arising from the Second Circuit's landmark decision in Texaco, Inc. v. Pennzoil, Co., may be specified for this purpose. With this landmark judgment the international traders have become increasingly concerned with the need to identify the circumstances in which liability may arise from negotiations and preliminary agreements.

In the advent of the process of globalization, the Law of Contract has become more international in recent years. One of the significant developments in the area is the ratification of the United Nations Convention on Contracts for the International Sale of Goods (CISG) by over thirty nations. The CISG was established with an intention to facilitate international transactions through the elimination of inconsistent treatment by different countries in various contractual obligations. However, it cannot be estimated at what degree the resolutions of CISG can be interpreted for governing the disputes arising from pre-contractual negotiations and preliminary agreements. But it could be said that it has some bearing on the issues aroused out of the pre-contractual negotiations and preliminary agreements.

This chapter addresses the issues of act of contractual negotiations, the scope of negotiations, the methods of ascertaining credit worthiness of the foreign party, major legal considerations and alternative choices to be made by the parties and the types of liability that can arise from breach of contract.

PRE-CONTRACTUAL LIABILITY

When negotiations fail and a court determines that no final agreement materialized during the course of those negotiations a variety of problems may arise. There may arise some questions about possible liability from a party's failure to negotiate in good faith. Even though the damages are available, some more issues may surface concerning the scope of the duty and the appropriate measure of damages. While civil law jurisdiction has historically proved more receptive to claims based on pre- contractual liability, common law jurisdictions have shown an increasing willingness to entertain similar complaints in recent years.

The Common Law Approach

Earlier the English courts use to refuse to regulate the pre-contractual period except in exceptional circumstances. The most important tool seems to be the theory of unjust enrichment. In American law, emphasis is on the theory of promissory estoppel as an explanation of pre-contractual liability. It is opined by the jurists that, the American approach is more fruitful and satisfying than the English, because estoppel can be applied in far more cases than unjust enrichment and is as an equitable remedy and more flexible .

Pre-Formation Negotiation

The Pre-Formation Negotiation is the process of bargaining that precedes an agreement. Successful negotiation generally results in a Contract between the parties.

Example: A wishes to purchase a property from B. A is willing to pay up to a certain price and desires certain conditions placed on the sale. B will accept anything over a certain price and may be willing to help finance the purchase for a higher price. In negotiation A and B attempt to come to an agreement over the price and conditions. When they agree, a sales contract is executed.

Post-Formation Negotiation

The Post-Formation Negotiation is a method of dispute resolution where either the parties themselves or the representatives of each party attempt to settle conflicts without resort to the courts; an impartial third party is not involved.

Example: Arbitration, Mediation, Negotiation is the process of two individuals or groups reaching joint agreement about differing needs or ideas. Oliver (1996) described negotiation as "negotiators jointly searching a multidimensional space and then agreeing to a single point in the space."

The traditional common law view sometimes referred to as the "aleatory view," holds that mere participation in pre-contractual negotiations is not enough to create binding obligations, even if the parties reach a preliminary agreement. As one English jurist expressed, a party to negotiations "undertakes this work as a gamble, and its cost is part of the overhead expense of his business which he hopes will be met out of the profits of such contracts as are made." The parties' freedom to negotiate is preserved at the risk that their efforts will go uncompensated if negotiations fail. Another objective of the common law view is to avoid finding the existence of a contract based on perceived reprehensible conduct rather than on the traditional benchmark of mutual expectation. It is a fact that, the preliminary agreements serve a valuable function in the marketplace in recent years and the courts are becoming more aware of this fact.

In *Schwanbeck v. Federal-Mogul Corp*., the Massachusetts Court of Appeals noted that, reaching a definitive, binding agreement soaks up time, effort, and intimidating professional fees. When they memorialize key elements of a deal, parties may be in a position to decide that enough is agreed upon to risk the substantial resources, which will be consumed in contract formation. The letter of intent focuses attention that, it has certain moral force in pressing parties to proceed toward a conclusion of the transaction on the terms outlined and it assists in obtaining loan financing and capital investment in that the proposed transaction has progressed beyond "just talk".

These sentiments have become more common in recent years as American courts seek to enforce and preserve preliminary agreements that the parties intended to be binding. Without judicial enforcement, parties are left with the prospect of expending large sums of money negotiating every detail into the final contract before they may rely on their agreements.

In some ways, the modern approach of enforcing pre-contractual agreements may seem to be a complete reversal from the previous approach. The traditional view seeks to protect negotiating parties from involuntary, judicially imposed contracts. It also preserves the parties' freedom to negotiate, as well as the corollary freedom not to negotiate, by providing contractual remedies only when a completed contract exists. The modern view primarily focuses on the intent of the parties and creates contractual obligations only if the parties intend to be bound to the duty of good faith by the preliminary agreements. However, the two views are not entirely incompatible. Given the proper framework, both views may support the proposition that "the law of contracts attempts the realization of reasonable expectations that have been induced by the making of a promise."

International Negotiating

In International Negotiations, obstacles arise when negotiating teams possess conflicting perspectives, tactics, and negotiating styles. Negotiators often assume that shared beliefs exist when, in reality, they do not. Examples are different uses of time; individualism versus collectivism; different degrees of role orderliness and conformity; and communication patterns that differ widely worldwide. These cultural factors affect the pace of negotiations; negotiating strategies; degree of emphasis on personal relationships; emotional aspects; decision making; and contractual and administrative elements. The goal of the negotiator should be to "look legitimately to the other side by their standards".

The most significant changes in contract jurisprudence during the 1980s centered on the development of theories for the expansion of pre contractual liability. The emerging jurisprudence stems from a steady increase in claims arising from pre-contractual negotiations and preliminary agreements. International traders are becoming more concerned with the liability arising out of pre contractual negotiations in case *Texaco, Inc. v. Pennzoil, Co*.

Recovery based on restitution is measured by the benefit of the party that improperly received the idea of services. The measure of damages for misrepresentation is reliance interest, expectation interest and lost opportunities. The same is true for pre-contractual liability grounded upon the doctrine of promissory estoppel. No case law is available as to whether an American court would order specific performance of either continued negotiations or of entering the envisaged contract. The overall view is that specific performance might not be a realistic sanction in the case of a breach of the obligation to negotiate, because the possibility of success in a forced negotiation will be quite slim. It is most likely that in a pre-contractual situation, reliance damages will be granted.

ASCERTAINING CREDIT-WORTHINESS OF THE FOREIGN PARTY

The models of ascertaining the credit worthiness of the foreign party may be divided in to three types. The first model may be the methods used by lenders to determine the creditworthiness of loan applicants and how these methods cause investment capital to sidestep inner city communities. The second model deals with the methods of lending decisions that cause this disinvestment of inner cities are indeed "rational" business judgments from the perspective of lenders. And the third model deal with the debilitating effect that the “rational” inner city disinvestment has on inner city communities.

Need for Creditworthiness of a Foreign Party

“From time to time I have suggested that a useful way to explain, and perhaps predict the future directions of, modern contract law is that it seeks to give effect to the reasonable expectations of the parties”. The point was well put by Steyn L J (as he then was) in First Energy (UK) Ltd v Hungarian International Bank Ltd. A theme that runs through our law of contract is that the reasonable expectations of honest men must be protected. It is not a rule or a principle of law. It is the objective, which has been and still is the principal moulding force of our law of contract. If the prima facie solution to a problem runs counter to the reasonable expectations of honest men, this criterion sometimes requires a rigorous re-examination of the problem to ascertain whether the law does indeed compel demonstrable unfairness.

Writing extra-judicially, Lord Steyn later expanded on his argument that the central objective of the law of contract is to uphold the reasonable expectations of honest men. In particular, he discussed a number of areas where English law might be considered deficient in this regard. One of those areas was the approach of the courts to the concept of good faith. He had "no heroic suggestion for the introduction of a general duty of good faith in our contract law". Indeed, he said: It is not necessary. As long as our courts always respect the reasonable expectations of parties our contract law can satisfactorily be left to develop in accordance with its own pragmatic traditions. And where in specific contexts duties of good faith are imposed on parties our legal system can readily accommodate such a well-tried notion. After all, there is not a world of difference between the objective requirement of good faith and the reasonable expectations of parties. However, his Lordship did express surprise and concern regarding the decision of the House of Lords in *Walford v Miles* that an express agreement to negotiate in good faith is unenforceable.

After noting that "judges in the greater part of the industrialized world usually have no difficulty in identifying a case of bad faith" and that "it is not clear why it should perplex judges brought up in the English tradition", he said: Lord Ackner observed that the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. As the [UNIDROIT Principles of International Commercial Contracts (1994)] make clear it is obvious that a party is free to negotiate and is not liable for a failure to reach an agreement. On the other hand, where a party negotiates in bad faith not intending to reach an agreement with the other party he is liable for losses caused to the other party. That is a line of reasoning not considered in *Walford v Miles.* The result of the decision is even more curious when one takes into account that the House of Lords regarded a best endeavors undertaking as enforceable. If the issue were to arise again, with the benefit of fuller argument, I would hope that the concept of good faith would not be rejected out of hand.

It seems that, with the notable exception of Hammond J, the concept of an agreement to negotiate in good faith continues to perplex the English and New Zealand judges. The New Zealand Court of Appeal in the recent case of Wellington City Council v Body Corporate 51702 (Wellington), seemingly without the benefit of Lord Steyn's words of wisdom (not to mention the substantial volume of other academic literature), decided to follow *Walford v Miles*. The Court, in a judgment delivered by Tipping J, held that a bare agreement to negotiate in good faith, i.e. an agreement where no specific procedure for the negotiations is laid down, is unenforceable even if it is intended to be binding and supported by consideration. The essential reason given was that such an agreement is not justiciable.

Honesty as an Objective Concept

In no area of the civil law is the existence of dishonesty determined by applying a purely subjective standard. The courts have consistently rejected a "Robin Hood" test of dishonesty "whereby a person is only regarded as dishonest if he transgresses his own standard of honesty, even if that standard is contrary to that of reasonable and honest people". The point was neatly made by Sir Christopher Slade in Walker v Stones: A person may in some cases act dishonestly, according to the ordinary use of language, even though he genuinely believes that his action is morally justified. The penniless thief, for example, who picks the pocket of the multi-millionaire, is dishonest even though he genuinely considers the theft is morally justified as a fair redistribution of wealth and that he is not therefore being dishonest.

In fact, there is substantial modern authority for the view that honesty is, at least for the most part, an objective standard. The leading case is the decision of the Privy Council in *Royal Brunei Airlines Snd Bhd v Tan*. In delivering his "magisterial opinion" concerning the scope of accessory liability for breach of trust, Lord Nicholls of Birkenhead said: ... "Acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behavior".

The individual is also expected to attain the standard, which would be observed by an honest person placed in the circumstances. It is impossible to be more specific. Knox J captured the flavor of this, in case of *Cowan de Groot Properties Ltd v Eagle Trust Plc* with a commercial setting, when he referred to a person who is "guilty of commercially unacceptable conduct in the particular context involved". Although spoken in the context of accessory liability, there seems no reason why, assuming for the moment that good faith means honesty in fact, these remarks should not be considered equally relevant to the question of the scope of an obligation to negotiate in good faith. So considered, they completely undermine the Court's assumption in WCC that honesty is a purely subjective standard. In deciding whether the obligation to negotiate has been met, the primary task is to determine whether the defendant has acted as an honest person would in the circumstances. And a negative answer will be justified if the defendant is "guilty of commercially unacceptable conduct in the particular context involved" .

Lord Nicholls' opinion was recently the subject of detailed analysis and reinterpretation by the House of Lords in the important case of *Twinsectra Ltd v Yardley*. Their Lordships were divided, but not in a way that affects the main point being made here, concerning the justifiability of the honesty standard. In brief, the division of opinion concerned whether Lord Nicholls laid down a wholly objective test of dishonesty so that "a person can be held to be dishonest even though he does not realize that what he is doing is dishonest by the ordinary standards of honest people". Lord Millett, who delivered a powerful dissenting judgment, could find "no trace in Lord Nicholls' opinion that the defendant should have been aware that he was acting contrary to objective standards of dishonesty". In his view, except "where, for example, liability depends upon intent to defraud", such a requirement was not "an appropriate condition of civil liability, which does not ordinarily require a guilty mind". In civil law "dishonesty" usually referred to a course of conduct rather than a state of mind. His Lordship summarized his view as follows:

In one opinion Lord Nicholls was adopting an objective standard of dishonesty by which the defendant is expected to attain the standard which would be observed by an honest person placed in similar circumstances. Account must be taken of subjective considerations such as the defendant's experience and intelligence and his actual state of knowledge at the relevant time. But it is not necessary that he should actually have appreciated that he was acting dishonestly; it is sufficient that he was. The majority, on the other hand, preferred a so-called "combined test" requiring that: before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realized that by those standards his conduct was dishonest .

On this approach, a plaintiff seeking to establish breach of an obligation to try honestly to reach an agreement would need to prove, not only that "the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people", but also that the defendant actually "realized that by those standards his conduct was dishonest"--a difficult task, but rather less difficult than having to establish dishonesty according to a purely subjective standard (i.e. the defendant transgressed his own standard of honesty).

MAJOR LEGAL CONSIDERATIONS AND ALTERNATIVES

The scant legal regulation of the evaluation of creditworthiness by lenders and how the applicable laws represent a tacit endorsement of current lending practices and the harmful effects caused by "rational" inner city disinvestment . The law functions to legitimate the stagnation and alienation caused by this disinvestment by framing the lender/loan applicant relationship in the ideal paradigms of Economic Theory and Liberal Legal Theory.

When determining where to allocate investment capital, lenders make decisions based upon the creditworthiness of those who apply for loans. Lenders evaluate the creditworthiness of an applicant by focusing solely on the applicant's financial ability to repay the loan. In deciding where to lend, lenders do not consider where a loan may do the most social good. Lenders are compelled to focus on the individual financial abilities of loan applicants because they operate in a competitive market in which their survival depends on their ability to maximize profits. Unfortunately, the sole emphasis on the financial abilities of individual loan applicants means that less wealthy inner city residents and businesses tend to be out-competed by stronger loan applicants elsewhere. The result is "rational" inner city disinvestment: the river of available investment capital flows from lending institutions to bustling suburbs while inner city communities are marred by economic drought.

Lenders Evaluation of Creditworthiness

What does it mean to be "creditworthy"? Although the answer to this question might be incitingly indeterminate and subject to debate, lenders agree that “creditworthiness" entails a narrow concept relating to the risk of loss from a potential loan. A loan applicant is considered creditworthy, if the risk that the applicant will default on the loan is acceptably small and the value of the transaction to the lender sufficiently outweighs its costs. Thus, lenders choose to evaluate the creditworthiness (assess the risk) of applicants solely on the basis of their individual financial ability to repay. Other criteria, such as the social value of a particular loan, which could be included for consideration, are absent from the creditworthiness evaluation .

The historical development of evaluation practices used by lenders to make home mortgage loans exemplifies the weight lenders place on the financial characteristics of applicants when determining creditworthiness. Although lenders making home mortgage loans have over time altered the particular financial characteristics that they consider essential, they have consistently determined the recipients of their loans based upon these individual characteristics. During the first three decades of this century, mortgage lenders emphasized the value of the collateral a loan applicant could offer to secure the loan. Then, starting in the 1930's, home mortgage lenders shifted their inquiries from emphasizing collateral to stressing the individual financial characteristics that indicate whether the applicant will have a steady stream of income.

The shift in the individual-oriented criteria emphasized by lenders reflected changes in both the homes mortgage market and structure of mortgage transactions that occurred in the 1930's. Before the 1930's, a mortgage was structured with a short repayment term and a large balloon payment due at the end of the term. Consequently, lenders demanded collateral sufficient to secure the loan in the event the borrower could not make the final balloon payment. Lenders thus limited the availability of loans and home-ownership to the upper classes already owned property. Beginning in the 1930's, banks began to offer loans with longer repayment terms and payments structured evenly throughout the life of the loan. For the first time, banks provided home mortgage loans that the American middle class could afford. As a result of this new loan structure, the borrower's ability to maintain a regular payment schedule over time superseded collateral as the crucial characteristic of creditworthiness.

In current lending practice, lenders use one of two methods to evaluate the creditworthiness of a loan applicant: the judgmental method or the statistical method. In some instances, they combine the two. Judgmental scoring is a subjective process in which the loan officer personally evaluates an applicant's income, employment, and credit history. Pertinent information usually includes the applicant's current and future income, length and type of employment, credit history, credit references, and accumulated wealth. Traditionally, these factors have been referred to as the "three C's" of credit: capacity, character, and collateral. Judgmental scoring relies on the professional judgment of the loan officer to determine if the applicant seems willing or will be able to pay back the loan.

Statistical scoring employs empirical statistics to predict the probability of repayment by the applicant. The system assigns a series of point scores to a list of financial and non-financial characteristics that indicate the financial ability of the applicant to repay the loan. For example, it may assign points for possession of a home phone, a checking account, a savings account, or a credit card, existence of other debts, homeownership or rental status, employment, and the length of residence or employment. The loan officer evaluates the applicant and gives a point score for each characteristic to arrive at a total score. The applicant's total score is then compared to a statistical sampling of applicants with similar credentials to see if she falls above the predetermined cut-off point. If the applicant's score falls above the cut-off, she will likely be approved for the loan.

In choosing the individual-oriented characteristics to evaluate creditworthiness, lenders have excluded from consideration other arguably relevant criteria, such as which applicant "needs" the loan more, which community would benefit the most from a particular infusion of capital, or which loan would yield the highest social utility. The numbers of factors potentially pertinent to creditworthiness are infinite. Yet, both the judgmental and the statistical scoring systems choose to examine only the ability and willingness to repay. In order to understand why creditors assign importance to individual financial capacity and not to broader societal interests, one must understand the pressures generated by the competitive and unforgiving economic environment in which creditors find themselves.

The Economic Forces Shaping the Creditworthiness Evaluation

The individual-oriented criteria chosen by lenders in their creditworthiness scoring systems reflects their raison d'être as determined by the competition of the private capital market: maximizing profits to lure depositors and investors. In the United States, capital is privately controlled and directed. The government does not provide lending institutions with capital reserves to lend and invest. Not only do lenders compete with one another for deposits from the general public, they also face intense competition from other investment institutions, such as mutual funds.

Lenders attempt to attract depositors and investors by offering higher rates of return on both deposits and equity than their competitors. In order to maximize the return that they offer to depositors and investors and still maintain margins sufficient for survival, lenders must maximize the return on their loans. Ensuring the repayment of loans offers greater certainty, and thus a greater margin of profit. As a result, lenders choose the creditworthiness standards that they believe are most consistent with the goal of maximizing profits through maximizing the return on loans. Lenders choose individual-oriented criteria such as character, capacity, and collateral, because these criteria predict with relative accuracy whether a particular loan will result in a profit. It is arguable that different evaluation criteria, such as aggregate social good, may also maximize profits for lenders. Spreading out the allocation of investment capital so that it consistently reaches a broader area should increase overall participation in the economy and consequently increase aggregate wealth. Such an increase should expand both the overall base of depositors and investors and the pool of creditworthy loan applicants, resulting in an increased volume of business for lenders. However, the intensely competitive nature of the private capital market does not encourage lenders to invest in such long-term and potentially large-scale growth strategies. Unsure of the risk of such a strategy and in need of a positive quarterly report to lure investors, lenders focus on short-term, tangible, and certain return; that is, the interest on loans paid back in full. Thus, the financial ability of the applicant to repay is the obvious choice for what constitutes "creditworthiness."

Serafin Mariel, the president of New York National Bank, one of only ninety minority-owned banks in the United States, explained "rational" inner city disinvestment--how the competitive environment of the private capital market discourages lenders from making loans to small inner city businesses. He described three major disincentives to inner city lending. First, loans to minority-owned businesses are small loans, which major banks believe do not provide sufficient margins of profit. Second, lending to small, minority-owned businesses, which tend also to be undercapitalised, creates greater risk for the lender. Third, the interest rates that these high-risk loans would require to assure profitability frequently violate state usury laws. Thus, lending to better-capitalized businesses, often in areas other than the inner city, is the more sensible choice for lenders.

Protection to Lenders' Negative Economic Rights

Although the onerous effects of "rational" inner city disinvestment seem harsh, we encounter and live with its effects on a daily basis. How do we manage this? How do we, and in particular our lawmakers, look past the stagnation afflicting inner city communities and conclude that this is a "just outcome" of our economy?

This section of this Note seeks to explain how the scant legal framework that regulates creditworthiness evaluation by lenders functions to legitimate "rational" inner city disinvestment and to justify its degenerative effects on inner city communities. Even though the current practice of creditworthiness evaluation subjects inner city residents to conditions of poverty and economic disenfranchisement, current laws leave the evaluation process predominately unregulated. The legal doctrines and statutes chosen by lawmakers defer to lenders' judgments of what constitutes "creditworthiness" and implicitly ratify the evaluation methods they adopt, thus tacitly endorsing the arguably oppressive effects of "rational" inner city disinvestment. The law legitimates "rational" inner city disinvestment and its effects by framing the relationship between lenders' and loan applicants in the paradigm of negative economic rights. By conceiving the lender/loan applicant relationship in these terms, the law makes the social decay associated with inner city disinvestment seem to be the necessary and inevitable result of protecting individual rights and promoting economic efficiency.

Legal Framework Regulating Evaluation Methods of Lenders

The evaluation of creditworthiness by loan applicants is regulated by both contract and property law and by a Federal Statute, the Equal Credit Opportunity Act. The combinations of these laws impose minimal restrictions on how lenders may evaluate creditworthiness. Essentially, lenders possess a legally protected privilege to establish their own criteria for granting credit.

Historically, property and contract law has governed credit transactions between lenders and loan applicants. A loan transaction is essentially a contract involving the transfer of a type of personal property: money. Specifically, a loan is "a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrows." Under the principles of contract law, lenders are under no obligation to make loans to any person and are free to contract with whomever they choose. Although no case explicitly expounds upon the right of lending institutions to determine the criteria by which they extend credit, under these contract and property principles, it seems clear that banks are free to determine their own creditworthiness criteria. Indeed, with the exception of the criteria prohibited by the Equal Credit Opportunity Act, which was not enacted until 1974, it is hard to imagine a case in which a rejected loan applicant would seek to compel a loan transaction on the grounds that the lender improperly decided against entering into such a contract. A few cases do hold that banks may refuse to make a loan for any reason, implying that they are free to determine the creditworthiness standards on which they will lend free of judicial interference. Thus, lenders possess an implied right to determine the criteria by which they will extend credit.

The Equal Credit Opportunity Act ("ECOA") imposes scant restrictions on the criteria and methods lenders may use to determine the creditworthiness of loan applicants. First, the ECOA prohibits lenders from associating certain personal characteristics of loan applicants with their ability and willingness to repay a potential loan. The ECOA makes it unlawful for lending institutions to turn down a loan applicant because of the applicant's "race, color, religion, national origin, sex or marital status or age." In addition, lending institutions may not reject an applicant because "all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the ECOA." Second, the ECOA minimally restricts the methods that lenders may use to evaluate creditworthiness. Under regulations promulgated to enforce the ECOA, lenders may not use practices that have the "effect" of discriminating against a class of individuals protected by the ECOA. Pursuant to the ECOA, the Federal Reserve Board issued regulations governing the evaluation criteria lenders may use. The regulations, known collectively as "Regulation B," place restrictions on the information a creditor may obtain for the evaluation process and on how that information may be used. Regulation B expressly regulates the two types of evaluation systems available to lending institutions. The regulation further states that in addition to intentional discrimination, creditors may not use facially neutral evaluation practices that have a discriminatory effect. Thus, even though creditors may not intend to discriminate and the credit decisions may appear neutral, if their lending practice has "a disproportionately negative impact on a prohibited basis," it is considered unlawful. The regulatory impact of the ECOA on how lenders may evaluate credit is limited by the "business necessity" exception stated in Regulation B. Although the "effects test" of Regulation B apparently has the capacity to remedy "rational" inner city disinvestment, the "business necessity" exception of Regulation B limits the statute's reach. The "effects test" restricts lenders from using evaluation methods that appear neutral on their face, such as consideration of an applicant's wealth, but have a disproportionate impact on minorities who apply for loans. However, evaluation methods with a disparate impact on minorities are legal under the ECOA if they meet "a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact." The comments to Regulation B expressly state that even though a practice may result in greater rejection of women and minorities, Regulation B does not limit creditors from using such criteria as "income in excess of a certain amount" as long as there is a "demonstrable relationship" between the criteria and creditworthiness for the level of credit involved. Thus, the ECOA imposes few "real" restrictions on how lenders may evaluate the creditworthiness of loan applicants, and lenders maintain vast control over the evaluation process. The ECOA does not impose on lenders a mandatory procedure for creditworthiness evaluation. Instead, the statute merely removes certain personal characteristics from the universe of factors that lenders' may use to determine creditworthiness. In addition, the statute restricts lenders from using those methods that have a disparate impact on minorities and have no business necessity. However, as was highlighted by the earlier discussion of "rational" inner city disinvestment, most of the evaluation methods that result in the flow of capital away from inner cities are founded on legitimate and necessary business reasons in light of the competitive environment in which lenders must operate.

Form letters included in Regulation B indicate the extensive leeway lenders still have to determine their own methods and criteria for evaluating the creditworthiness of loan applicants. Regulation B provides lenders with form "rejection letters".

CHOICES TO BE MADE BY THE PARTIES

It is necessary to know the philosophy of creditworthiness evaluation for exercising choice by the parties. The French philosopher of the twentieth century, Michel Foucault has theorized that normative judgments cast through social institutions order society. The creditworthiness evaluation illustrates the subtle operation of power in American society as a machine, and not as an instrument. The creditworthiness evaluation exemplifies how power operates through lenders (and is not implemented by them) to compare, differentiate, and hierarchize loan applicants by assigning them an identity as either "creditworthy" or "uncreditworthy." Essentially, the evaluation of creditworthiness by lenders is a "disciplinary technique" that functions to train individuals to conform to societal norms--in other words, to become economically productive and politically inert. The creditworthiness evaluation disciplines individuals because it has a punitive impact on those who resist the norms of creditworthiness and have the effect of herding "potentially dangerous" nonconformists into depressed inner city communities.

Choice of Law

A choice of law issue inevitably arises when two or more legal systems or jurisdictions are involved in a transaction (e.g., a contract) or incident (e.g., tortious conduct or harm). A determination must be made as to which law shall apply to the controversy in question. Thus, for a case in which choice of law becomes relevant, the most distinctive nature is "foreign" or "outside jurisdictional territory." In the United States for example, each state is regarded as an independent "sovereign" under the framework of the federal system. Therefore a choice of law issue arises when a dispute spill. Thus in conflict of law issues in the United States, the word "foreign" would contain the meaning of both sister state and foreign country. Consequently, a foreign case in the United States for purposes of conflict of laws could be either a domestic case that involves different states or an international case that concerns a foreign country.

Law Applicable to Foreign Contracts – A Chinese Approach

In a country like China where the nation has a unitary legal system, the term "foreign" is interchangeably used with "international." Although China is divided into different provinces and municipalities, they are not independent sovereignties; rather they are local government units (or sub-political divisions) under the leadership of a central government. Therefore, a foreign case in China typically means an international one.

Whatever the term "foreign" may denote, the reality facing every country today is that the increasing mobility of people and products crossing country borders and the globalization of business transactions all make people more exposed to a multitude of diverse systems of law. As a result, a question of how to effectively dispose of the legal rights and obligations of individuals in conflicting legal systems in the international arena becomes a question that requires special attention. The issues involved not only enhance the need for the determination of which law governs, they also complicate the way in which the choice of law is made.

As noted, conflict of laws in China is commonly considered private international law. Moreover, conflict of laws in China is generally deemed a part of private international law, as opposed to the unified substantive law contained in international treaties as well as international customs. What is peculiar is that private international law in China, as compared with conflict of laws in the United States, has a much broader scope, which includes rules regulating the civil status of foreigners as well as the rules of international civil procedure. Therefore, in Chinese conflict of laws literature the rules are often characterized as the rules that provide which law will apply to what foreign civil and commercial legal relations. In this sense, the conflict of law rules in China is often regarded as equivalent, if not identical, to choice of law rules.

Thus, in a contract, there would be no choice of law matters in China unless and until the contract becomes or is marked "foreign." In this context, it is important to define the term "foreign" and to distinguish a domestic case from a foreign one. The importance lies with the fact that if the case falls within the category of "foreign," a special set of rules and provisions would apply because in Chinese law, foreign cases are treated and handled (at least in part) differently from domestic ones.

Application of Foreign Law

A direct result of the application of a nation's choice of law rules on a contract is that the contract in whole or in part may be governed by a foreign law or the law of a foreign country. In conflict of laws theory, it has long been debated why courts should ever apply foreign law. Scholars never seem to reach a consensus on this matter because of concerns regarding the forum's legislative power. The fundamental question is how such power could be abdicated by allowing the application of a foreign law. For a period of time after 1949, no foreign law was applied in the people's courts in China. The dominant theory was that judicial sovereignty is absolute and should not yield to any foreign jurisdiction. One possible rationale for this theory was, perhaps, a fear of "foreign influence." The cause of such fear came from at least two sources. On the one hand, there was the belief that laws in different countries were mutually exclusive and that no domestic court would directly apply a foreign law. On the other hand, there had long existed a bias against western countries that were perceived to possess a constant desire to move China away from communism. Such a bias reached its peak in China during the Cultural Revolution (1966-1976), when everything associated with western countries had to be destroyed.

The "foreign influence" syndrome seems to have become less acute in China since the nation started to move closer to the rest of the world both economically and socially in the 1980s. Ever since foreign investments flooded in business transactions with foreign countries have become an indispensable part of the Chinese economy. An unavoidable consequence of business interactions with foreign countries is the occurrence of "foreign" civil disputes, to which the special attention of the people's courts was called, and a great deal of which involved contracts. In response, all people's courts at the intermediate level or above have designated civil divisions to handle foreign cases. In addition, given their complexity and importance, foreign civil cases that were deemed significant could be commenced at the intermediate people's courts, as opposed to a lower level court.

Accompanying the influx of foreign cases in the people's court is the perceived possibility or need to apply foreign laws in China. Many Chinese private international law scholars share the idea that the application of foreign law in a domestic court produces two results: direct application of foreign law (adjudication of cases on the basis of foreign law) and indirect application of foreign law (recognition of rights acquired under foreign law). In either case, it is suggested that to apply foreign law grants the foreign law an "extraterritorial effect."

With regard to the reason for the application of foreign law, many western conflict-of-law theories are well received (or discussed) in China. In fact, some of them are very influential. It is important to note, however that China is a country where people would prefer to apply laws and rules that could be claimed as their own. A very popular term used in China is "Chinese characteristic," meaning something, which is "unique" to China or "distinct" from any other country. As applied, this term has transformed into a stereotype, if not a psychological conception, that China is willing to take advice from others but will not simply follow that advice without adapting it to the Chinese reality.

Against this background, while attempting to develop a Chinese school (or doctrine) of private international law, scholars in China have been exploring new grounds to explain why foreign law should be applied in the forum court. Since contract law is deemed the area where choice of law issues arise not only in the most complicated ways but also with a high recurrence, Chinese scholars have devoted much of their efforts to this area in an attempt to develop a new theory for the application of foreign law.

The scholars in China generally have a tendency to emphasize principles on which a legal theory shall be premised before the theory is addressed. Choice of law in contracts is no exception. There are two principles that are acclaimed by a majority of Chinese private international law scholars as fundamental to the application of foreign law. The two principles are "national sovereignty" and "equality and mutual benefits." The national sovereignty principle seems somewhat elusive or abstract because it is rarely applied to choice of law issues. The equality and mutual benefit principle, however, has been widely employed. In fact, this principle has even been regarded as the cornerstone that enables the courts to apply foreign law in China.

International Law Conflicts: A New Challenge

Although China has a unitary legal system, the "unitary" status affects only the mainland; it excludes Hong Kong and Macao despite the fact that these two regions became part of China in 1997 and 1999 respectively. This creates a factual pattern that represents a unique type of interregional conflict of laws and imposes challenges to the country as to how the law conflicts between Mainland China and those regions are to be resolved effectively.

Under the Chinese Constitution, Hong Kong and Macao are each governed by their "basic law" and retain the status of "Special Administrative Regions" ("SAR") after their return to China. One of the most important features of the SAR status is that regions possessing it have the right to maintain their own legal systems, which differ from that of the mainland. The SARs have virtually all-governing powers over their region, excluding defence and foreign affairs.

As a result, there are actually three legal systems that now exist concurrently in China. The legal system in Hong Kong is basically the common law inherited from the British legal system, while in Macao the legal system has Portuguese origins. Although the mainland and Macao may share certain civil law traditions within their legal systems, the law clearly differs. Given this reality, a notable characteristic of interregional conflict of laws in China, therefore, is the conflict among multiple legal systems.

To reflect this reality, foreign contract classification in China is extended to include contracts that have Hong Kong or Macao elements. Only in this regard would the term "foreign" be used to mean "jurisdiction-based sovereignty" rather than "territory-based sovereignty," and the choice of law rules governing foreign contracts will analogically apply. Note, however, that although Hong Kong and Macao are deemed foreign in the context of choice of law, some special arrangements are being made in order to facilitate smooth business transactions and intimate civil relations between the mainland and the SARs.

It should be pointed out that compared with interstate conflict of laws in other countries with a federal system; the interregional conflict of laws in China bears its own distinctions. The most striking one is that the SARs are structured under the notion of "one country with two systems," meaning the socialist system on the mainland will not be practiced in the SARs. As a result, the differences in laws between the mainland and the SARs are necessarily intertwined with the different social systems (e.g., socialism v. capitalism). Another distinction worthy of mention is the fact that both the mainland and the SARs each have their own supreme court--the highest judicial body--and they are all equal in terms of authority. To put this in another way, the Supreme People's Court of the mainland has no power over the courts in the SARs.

Thus, if a contract that is concluded in the mainland is to be performed in Hong Kong or Macao, or vice versa, choice of law would necessarily become an issue. The different legal systems together with the different social systems between the mainland and the SARs would complicate the determination of governing law for the contract. For example, since the mainland differs sharply from either Hong Kong or Macao, a contractual right lawfully acquired in the SARs may not necessarily be recognized in the mainland although the acquisition of such rights took place within the territory of the country.

Choice of Remedy

Assuming that the arguments in this paper are accepted, it is necessary to consider, albeit briefly, the remedies available for breach of a binding agreement to negotiate. The agreement would not, in view of the nature of the obligation assumed, be amenable to a decree of specific performance but, if it included an exclusive negotiation ("lock-out") term obliging a party to refrain from negotiating with others for a stated period, that term might be enforced by way of injunction. In ordinary circumstances, therefore, the only remedy available to an aggrieved party would be damages. How would such damages be measured?

In *Courtney & Fairbairn Ltd v Tolaini Bros (Hotels) Ltd,* Lord Denning MR refused to recognize a contract to negotiate because: it is too uncertain to have any binding force. No court could estimate the damages because no one can tell whether the negotiations would be successful or would fall through: or if successful, what the result would be. Such an argument has rightly been described as "specious". It fails to give sufficient weight to the fact that the plaintiff is suing for loss caused by breach of the agreement to negotiate, not for the lost benefits of "the prospective ultimate agreement". Subject to what is said below, there will ordinarily be no question of recovery in respect of the plaintiff's lost expectation under the latter.

The appropriate measure of damages for breach of an agreement to negotiate in good faith will vary according to the nature of the breach and the other circumstances of the case. The fundamental question in each case will be: what, if any, loss has the plaintiff suffered as a result of the defendant's breach? The object, as in other damages claims for breach of contract, will be to place the plaintiff in the same situation, so far as money can do so, as if the contract had been performed. Sometimes only nominal damages will be recoverable. The negotiations may have been broken off at an early stage before the plaintiff had incurred out-of-pocket or lost opportunity costs. On the other hand, it is not difficult to envisage situations where considerable time and expense has been invested in preparing for and conducting the negotiations only for the plaintiff to discover, for example, that the defendant has all along been "going through the motions" without any intention of concluding the agreement. Here, subject to the rules on remoteness of damage, the plaintiff could recover in respect of its wasted expenditure and any proven lost opportunity for gain elsewhere.

Different considerations will arise, however, where one party breaks off the negotiations in bad faith after they are well advanced and a substantial measure of agreement has been reached. In such a situation the other party may have a realistic claim for substantial damages in respect of the loss of the chance to secure the benefits that would have resulted from conclusion of the agreement being negotiated. Exceptionally, it may even be possible to establish with sufficient certainty that, but for the defendant's bad faith, a particular contract would have been concluded, in which case damages equivalent to an expectation level of recovery could be justified.

The principle was explained as follows by Judge Richard Posner in a recent American case: Damages for breach of an agreement to negotiate may be, although they are unlikely to be, the same as the damages for breach of the final contract that the parties would have signed had it not been for the defendant's bad faith. If, quite apart from any bad faith, the negotiations would have broken down, the party led on by the other party's bad faith to persist in futile negotiations can recover only his reliance damages--the expenses he incurred by being misled, in violation of the parties' agreement to negotiate in good faith, into continuing to negotiate futilely. But if the plaintiff can prove that had it not been for the defendant's bad faith the parties would have made a final contract, then the loss of the benefit of the contract is a consequence of the defendant's bad faith, and, provided that it is a foreseeable consequence, the defendant is liable for that loss--liable, that is, for the plaintiff's consequential damages ... The difficulty, which may well be insuperable, is that since by hypothesis the parties had not agreed on any of the terms of their contract, it may be impossible to determine what those terms would have been and hence what profit the victim of bad faith would have had ... But this goes to the practicality of the remedy, not the principle of it.

Although it did not involve a typical agreement to negotiate scenario, the first instance decision of Wild J in the WCC case illustrates the principle. If one accepts his Honour's findings that the council breached its good faith obligation and that, but for the breach, a sale of the freehold to Alirae at around market value would have been concluded, the award of damages in respect of the loss suffered through not being able to proceed immediately with the development of the premises seems well justified.

Choice of Venue

The choice of Venue is another type of choice of Law. At the time of drafting the contract some parties are careful enough in including the clause of choice of forum or home court or place of arbitration. Whenever there is dispute in a contract, the litigator looks for a choice of forum clause or an arbitration clause in the contract. The choice of forum or arbitration clause becomes more important when the business is more International. The party that has indicated choice of forum will have an advantage of understanding the rules and procedures of the home court, in case if the dispute is aroused in some other court jurisdiction. They can be able to avoid the future complications of challenging the dispute in a court of jurisdiction of which the party do not know the rules and procedures.

In light of conflict of laws, a major difference between a country with a federal system and a country with a unitary system is how the term "foreign" is defined. In China, under the unitary system, the central government has the authority to exercise its power all over the nation; the national laws in terms of legal hierarchy preempt any rules and regulations adopted at the local level. Therefore, the term "foreign," as used in the context of choice of law, refers generally to "outside the territory of the country." A civil case that has an "outside territory element" will then be classified as a foreign civil case. A commonly used phrase in China to indicate "foreign" in civil cases is "foreign civil relations." Under the 1986 Civil Code, any case that involves foreign civil relations shall be governed by the special provisions of the Civil Code if the application of law would need to be determined. According to the interpretation of the Supreme People's Court, foreign civil relations are the civil relations in which one or both parties are foreign, a stateless person or a foreign legal person, the subject matter underlying such relations is located outside the territory of China, or the legal facts that cause the relation to be established, changed or extinguished occurred outside of China.

Equally then, a contract is foreign when (a) at least one party is not a Chinese citizen or legal person, (b) the subject matter of the contract is in a foreign country (e.g., the item to be sold or purchased is located outside of China), or (c) the conclusion or performance of the contract is made in a foreign country. When a contract is characterized as foreign, the question as to which law shall govern the contract becomes relevant. If a contract is domestic in nature, it is without question that the contract will be subject to Chinese law only.

Choices of Arbitral Institution

One criterion for attributing a choice of law to the parties, in the absence of any express choice, is that based on a choice of forum by the parties. If the parties make no express choice of law, but agree that any disputes between them shall be litigated in a particular country, it is generally assumed that they intend the law of that country to apply to the substance of their disputes. This assumption is expressed in the maxim *qui indicem forum elegit ius*; a choice of forum is choice of law.

The assumption makes sense when the reference is to a court of law. For instance, if the parties fail to put a choice of law clause into their contract but provide for the resolution of any disputes by the courts of New York, it would seem to be a reasonable assumption that they intended those courts to apply their own law--that is to say, the law of New York. The assumption is less compelling, however, when the dispute resolution clause provides for choice in a particular country, rather than litigation in the courts of that country. A place of arbitration may be chosen for many reasons, unconnected with the law of that place. It may be chosen because of its geographical convenience to the parties; or because it is a suitably neutral venue; or because of the high reputation of the arbitration services to be found there; or for some other, equally valid reason. In one case before the arbitration institute of the Stockholm Chamber of Commerce, the tribunal highlighted the fallacy of the principle that a choice of forum is a choice of law in the context of arbitration in the following terms: "it is highly debatable whether a preferred choice of the situs of the arbitration is sufficient to indicate a choice of governing law. There has for several years been a distinct tendency in international arbitration to disregard this element, chiefly on the ground that the choice of the place of arbitration may be influenced by a number of practical considerations that have no bearing on the issue of applicable law ." Nevertheless, where the parties have not made an express choice of the substantive law of their contract, but have included a reference to arbitration and have chosen the place of arbitration, that choice may influence the decision as to what the substantive law of the contract should be. First, the choice of a particular place of arbitration is sometimes taken as an implied choice of the law governing the contract. The fact that the contract was in the English language may also have played some part in the court's decision. . Secondly, the choice of a place of arbitration may be taken as an indicator that the arbitration clause itself is to be governed by the law of that place, irrespective of the law, which governs the contract containing the arbitration clause. Thus, in a case where the choice of the substantive law of the contract was unenforceable, because it was too uncertain, but the arbitration clause was clear in its provision for arbitration in London, it was held that the arbitration agreement was a valid agreement and was governed by English law .

The lasting solution to the inequitable allocation of investment capital will not necessarily derive from regulating the practice of creditworthiness evaluation by lenders. The meaningful changes in the allocation of investment capital require a re-evaluation of how power works in society and a normative shift from a capitalism based on short-term individual consumption and gratification to a spiritual capitalism based on a concern for long-term community.

The law functions to legitimate the stagnation and alienation caused by this disinvestment by framing the lender/loan applicant relationship in the ideal paradigms of liberal legal theory and economic theory. The creditworthiness evaluation illustrates the subtle operation of power in American society as a machine, and not as an instrument. The meaningful changes in the allocation of investment capital require a re-evaluation of how power works in society and a normative shift from a capitalism based on short-term individual consumption and gratification to a spiritual capitalism based on a concern for long-term commitments.

PRINCIPLES FOR DRAFTING INTERNATIONAL COMMERCIAL CONTRACTS

The written contract is an agreement enforceable by law. The contracts could be made between the individuals, statutory persons, private parties of the same nation and some times in the practice of International business the different Nations for executing a work or supply of goods specified to fulfill the conditions of a party. The parties involved in a particular contract may be two or more than two statutory persons or two countries for which they need to come to proper understanding prior to contracting. After coming to an understanding the parties need to frame the terms and conditions of the contract and finally sign the contract. The terms, rules, conditions and clauses laid down in the contracts are being violated by the contractees or the executants for various reasons. In a situation where there is a breech of contract, the litigators will search for the various clauses that are available in the contract agreements for presenting the case before the concerned relief machinery. In such situation if there is no basic safety clauses laid down in the contract the party affected may not be in a position to claim the damages and the agreement may become void for want of a safety clause. In view of the safety, the contracts shall be drafted based on the complications and problems, which may arise in future. The basic safety clauses have to be incorporated in the contract at the time of drafting the contract itself. Particularly the International contracts have to be drafted carefully by taking the basic facts of the field of execution, conventions, statutory obligations, customs, usage and practices of the countries involved in the contract.

As the drafting of contracts plays an important role in making of a good contract, it is necessary to follow the important Norms and Conditions of International Trade and Contracts.

A well-written contract serves to preempt misunderstandings along with managing the legal risks of an international transaction. The latter half of the twentieth century has seen a broad expansion of international trade and business. Trade liberalization and the rapid expansion of the exporting and licensing have resulted in the acceleration of international conventions thereby leading to further globalization. In order to do international business the businesspersons should incorporate the fundamental principles of international business practices. The International based conventions and principles are proved to be a vehicle for overcoming the cultural, language and legal differences often involved in cross border trade.

IMPORTANT NORMS AND CONDITIONS OF INTERNATIONAL TRADE CONTRACTS

It is important for the contract negotiators and drafters to know the differences between national and international contracting. The ideologies of the businessmen's are different from that of the normal usage. It is evident that focus is on the private law issues that are controllable by the entrepreneur and his attorney. The impact if government into trade matters is dealt with tangibly. Therefore many business executives are indifferent whether the agreements constitute the binding contracts, business dealing are regulated more by mutual trust and shared conventions.

Sources of failures of International Contracts

The failure to incorporate the private international law developments would result in unexpected legal liability. A failure in negotiations often means that the written contract has failed to provide a solution to a disputed issue. So while drafting a contract it is better to organize the thinking to visualize all of the potential plaintiffs and to speculate about all of the potential causes of action that they may assert against the seller.

If the Merchant of Venice had executed contracts with bankers of Florence instead of sending his wealth East and West (India, Tripolis, etc.), he would still have engaged himself in international trade. The Doge of Venice would have called--as he did--a lawyer from Padua to explain the law. That was the time of a world of cities. Today, wood pulp producers from Georgia trade in Europe; a pool of international investors gather to build a dam in China; a French company builds a tramway in Jerusalem; and when an Indian investor based in the United Kingdom offers a takeover bid on a French company, the protest of the French authorities, as well as the French decree restricting foreign investments, may be regarded as a breach of European Community ("EC") and International law. Now that we have gone from a world of cities to a worldwide city, or a "global village," the global market needs, just as well, the rule of law. Is that all very new? International trade goes far back in history, and commercial treaties or contracts can be traced to Ancient Egypt and the merchant law of the eleventh century. For example, in 1417 a most favoured nation clause could be found in a treaty between Burgundy and England.

The main sources of failure of International Contracts can be categorized as two types. The primary sources of failure of International contracts are faulty language, inherent culture, language difference, poor writing, lack of clarity, failure to recognize and memorize key substantial issues and fundamental difference in the national default rules. The secondary sources of failure of International contracts are contractual misunderstandings. The secondary reasons sources of failure of International contracting can be broadly made in to two categories.

1. The International conventions or regional initiatives aimed at harmonizing rules pertaining to specific issues commonly found in cross border transactions.
   Example:
- Hague rules on liability of international carriers of goods by sea.
- Agreement on Trade Related Aspect of Intellectual Property (TRIPS)
- Within the General Agreement on Tariffs and Trade (GATT).
- The Organizations of regional harmonization i.e. NAFTA and European Union (EU) along with Organization for Economic Coordination and Development (OECD).

2. Lex-Mercatoria: It includes the customs or International Trade Usages to bridge the language, cultural and legal differences between businesspersons throughout the world. Example:
- International Chamber of Commerce (ICC), Paris.
- Uniform Customs and Practices for Documentary Credits (UCP 500).
- International Commercial Terms (INCOTERMS)

The customs have risen to near universal acceptance in the International banking and business communities. Even though many legal issues arise due to poor drafting of the written contract, it doesn't mean that clarity of writing will overcome differences in the immutable rules of a given country. A poorly written contract is one that lacks clarity or substantively fails to deal with an issue.

The basic thing to be kept in mind is that, in some national regimes the writing is not required for the enforceability of a contract. If we take an example of CISG i.e. United Nations Convention on Contracts for the International Sale of goods, we find that a writing is not required and a contract may be proved by 'any means including the witness testimony'. It is to be noted that many businessmen in the world are indifferent that whether their agreements constitute the binding agreements or not. It is often seen that the business dealings are often regulated by mutual understanding and trust.

Many legal disputes arise from written contracts are associated with the vast difference of culture, language, potential difficulty of obtaining a legal remedy in a national diverse contractual relationship. The poorly written contract lacks the clarity and substantively fails to deal with an issue. The careful drafting will diminish the likelihood of a dispute due to the factors leading to the interpretation of contracts. It is to be kept in mind that contracts should be drafted with a view to avoid contract breach and disputes.

Principles of Contract Drafting

A contract that has been drafted with a view to avoid the breach and disputes shall be based on certain principles. There are two areas on which the drafter has to concentrate while drafting any International Contract. The first one is to understand the difficulties in the culture, language and the legal system of the parties to the contract. Most of the times a legal dispute can be avoided by a careful drafting. The second one is to understand the legal general principles of international contract law, which are found in national laws and in supranational customary law.

The *Bernina Distributors v Bernina Sewing Machines* 646.F2d 434 (1981) case is a best example, which focuses on the limitations of language and difficulties therein. There were more risks than anticipated due to the fluctuation in the currency rates. Even though the contract was covered the extent of increase of the invoice cost, the extent of increase in duty charges, the extent of increase in insurance, foreign, handling, broker, and port fees or other similar charges, the court held that there is no provision for fluctuation in currency in the contract . The difference in the legal system, language and culture, often doesn't lead to the proper understanding of the intention of the parties to the contract. Therefore the parties to the contract must carefully express their rights and obligations in a written contract. The parties must clear their reasonable doubts and understand the core issues from their attorneys at the time of drafting so that the relative degree of comprehension is reached. When a certain level is reached then both the parties to initial each page then both the parties should initialize each page. Usually there is no set pattern, which both the parties can follow. What they usually do is make their own forms, so in that case both the parties should exchange their forms and carefully review the terms and conditions found in the other parties form before finally signing the document. This phase is important because the parties must know that up to what extent their clauses do binds the other party. In case of an artificial entity the other party's authority to bind his company is needed to be verified before entering the contract.

Roots for Contract Ambiguity

There are two reasons due to which the ambiguity arises in the contract. 1) Due to the parties negotiating the contract are businessmen and not attorneys, there is always a difference of approach while it comes to final drafting. 2) Those charged with drafting the contract are counsels and they are not involved at the initial drafting of the contract. This is the reason why there is always an ambiguity in the terms negotiated and the terms arrived at.

<u>Limitations of Language</u>

Words have no meaning in themselves but are infused with meaning based upon practical experiences of the words. The promise made is never the same as promise received. The courts interpret this based on the community standards i.e. customs, trade, usage and prior dealings. The courts even implied the terms to fill the gap. The rationale behind it is to extend the subjective intent of the two parties. However Uniform Commercial Code i.e. UCC and Convention for International sale of goods i.e. CISG provides the gap filling provisions for the court to interpret.

<u>Interpreting the Contracts</u>

The drafting is an exercise of anticipating the future complications of a contract. The courts recognize the reasonable person through an examination of the customs of the times and of a business in order to determine the knowledge and skills of the contracting parties. The Custom, usage and practice clarify the ambiguities of any contractual instrument. However if there is no clarity, the courts decide whether recourse available to a person or not. But, the courts may sometimes recognize the customs and elevate them to a position equivalent to the legal rules as the Custom, usage and practice can be seen as the background of contractual obligation.

The Custom and Usage are the vehicles to amend the common law, whereas the common law derives its source from the habits, manners and customs of people. The customs and law are reciprocal in nature. The Custom is a source of law and law impacts upon Custom. The relationship between the Customs provides a stop gap that allows the judicial process to render decisions which reflect objective or commercial reality. The words of a contract are interpreted through the two lenses of Customs and Practice. The interpretation of Customs and Practice serves as a baseline for legal impact. The court normally has to see through the lens of practice. The words are interpreted first in the light of trade usage and second in the light of the common meaning to the hearer and the course of the dealing of the parties.

The drafting of a contract is impossible without the knowledge of the substantive law. At the time of drafting the national laws of both the parties as well as the international contract law or the *lex-mercatoria* has to be considered. The following aspects of contracting referred by the ICC in the form of a checklist are to be considered as useful parameters while drafting a contract.

- Exclusion of trade usage
- Four corners clause (integration or merger clauses)
- Time of performance, early performance, late performance
- Order of performance
- Place of performance, place of payment
- Form of payment
- Currency of Payment
- Transportation costs, other expenses
- Government approvals
- Hardship clause
- Force Majeure clause
- Termination clause, notice provisions
- Forum selection & arbitration clauses
- Limitation of liability clause
- Interest on delinquent payments
- Damages. Liquidated damages clause

STANDARD FORM CONTRACTS

The lawyers usually take the prewritten contracts and amend the language as per their requirement. In international contracts the terms of Uniform Commercial Code (UCC) or the Contracts for the International Sale of Goods (CISG) for specific contract clauses are to be used. For example: In Force Majeure clause- UCC doctrine of impracticability and in Disclaimer of Warranty Clause- UCC, Sec 2-316 is to be used. The model laws and principles are provided no so much for their potential roles as mandatory or customary international law but as a source material for the development of substantive contract clauses. They help in avoiding particularities of national laws. International arbitration permits international approach to contract interpretation and enforcement. However the terms not chosen are at the liberty of the parties to be deleted. The basic problem, which arises, is that how to maintain the mutual assent if one supplied it and the other party has the option to take it or leave it. The courts work is to eliminate the unnecessary and unreasonable term. The courts work is not make the detailed contracts for the parties but to mark out the permissible limits.

The model forms as provided by the International Chamber of Commerce (ICC) are as follows:

1. The UNIDROIT Principles of International Commercial Contracts.
2. The European Union and European Contracts Law.
3. International Commercial Terms (INCOTERMS)
4. UNCITRAL Model Law on Electronic Commerce.
5. The United Nations Centre for Trade Facilitation and Electronic Business (UNCEFACT)

The International Institute for the Unification of Private Law (UNIDROIT)

As to the working method, obviously it was not impossible to take into account the law of every single country of the world, nor could every legal system have an equal influence on each issue at stake. From among the national codifications or compilations of law greater attention was naturally given to the most recent ones, such as the United States Uniform Commercial Code and the Restatement (Second) of the Law of Contracts, the Algerian Civil Code of 1975, the 1985 Foreign Economic Contract Law of the People's Republic of China, the drafts of the new Dutch Civil Code and of the new Civil Code of Quebec, which finally entered into force in 1992 and 1994 respectively. As far as international legislation is concerned, such an important and universally applied instrument as the United Nations Convention on Contracts for the International Sale of Goods (CISG) was an obligatory point of reference. Whenever appropriate, account was taken also of other international instruments prepared by UNCITRAL. Moreover special attention was given to non-legislative instruments elaborated by professional bodies or trade associations and widely used in international trade .

The year 1994 marked a turning point for two remarkable projects in the field of contract law. It was in that year that the Governing Council of the International Institute for the Unification of Private Law (UNIDROIT) gave its imprimatur to the publication of the Principles of International Commercial Contracts (hereinafter UNIDROIT Principles) , and the Commission on European Contract Law concluded its work on the first part of the Principles of European Contract Law (hereinafter European Principles).

The International Institute for the Unification of Private Law (UNIDROIT) is an organization, headquartered in Rome, devoted to developing generally accepted rules and procedures for international trade and commerce. Most of the major trading nations have representatives on the governing council, and the council pursues a number of different projects . These Principles set forth general rules for international commercial contracts. They shall be applied when the parties have agreed that their contract be governed by them. They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like. They may be applied when the parties have not chosen any law to govern their contract. They may be used to interpret or to supplement international uniform law instruments. They may be used to interpret or to supplement domestic law. The Principles do not apply if the parties do not want them to apply, but they may be useful "default" rules when there is a lack of clarity about applicable principles or about the choice of domestic law. They obviously do not supplant the requirements of laws or of treaties such as the U.N. Convention on Contracts for the International Sale of Goods (CISG). They may be useful references for both parties and governing authorities in much the same way that the various ALI Restatements have been used as references by courts and commentators in this country. The Principles, by their terms, apply only to contracts that are "international"—but this is meant to have the broadest possible interpretation and to exclude only those contracts "where all the relevant elements of the contract in question are connected with one country only." Likewise, the Principles apply only to commercial contracts; but, the drafters intended to exclude only those contracts that are essentially “consumer transactions,” which, in most states, are subject to a wide range of consumer protection statutes, regulations, and judicial decisions.

As an independent intergovernmental organization, The International Institute for the Unification of Private Law (UNIDROIT) studies methods for modernizing, harmonizing and coordinating private and in particular commercial law as between States and groups of States. With respect to legally binding instruments such as international conventions, the “UNIDROIT Principles of International Commercial Contracts” are a non-binding or “soft-law” instrument of commercial practice. As a close partner to UNIDROIT, ICC monitored the process and appreciates its results.

Particularly in the field of international agency agreements, the lack of uniform rules creates difficulties for the parties. They have to rely on national laws. These laws differ not only from country to country, but also not take into account the international nature of the contract .

The “ICC Model Commercial Agency Contract” provides an alternative solution. To assist business people engaged in international trade and using uniform contractual rules, the model incorporates prevailing practice in international trade as well as the principles generally recognized by the domestic laws on agency. The revised 2002 version includes the “UNIDROIT Principles of International Commercial Contracts” in the appendix. Those principles offer a legal framework to the majority of general contractual problems (e.g. formation of contract, validity, performance, non-performance, damages, etc.).

Additionally, “ICC Model Distributorship Contract” as well as “ICC Model International Franchising Contract” gives parties the opportunity to contract into the “UNIDROIT Principles of International Commercial Contracts”. “UNIDROIT Principles of International Commercial Contracts” are also permanently subject of discussion during ICC conferences and seminars.

The European Principles and Contract Law

As the world's largest and most representative business organization that speaks on behalf of enterprises from all sectors in every part of the world, ICC takes the opportunity to provide comments on the European Commission's work and occasionally asks governments to urge the European Commission to consult its expertise.

Recently, ICC has been working with the European Commission in the following three areas:

- The European Commission's initiative to harmonize European Contract Law.
- The European Commission's revision of the Rome I Convention.
- The European Commission's draft proposal for a Rome II Convention.

The European Commission is currently looking at contract law as an area for potential harmonization and/or development of a new legislative instrument. ICC has been following this initiative closely and provided input on several occasions. ICC expertise is present in the European Commission's “Common Frame of Reference" network of experts.

The Rome Convention (Contractual Obligations)

The uniform rules of the Rome Convention apply to any contractual obligations. They aim at ensuring that the courts of all EU-Member States apply the same rules in case of a conflict of laws to dispute.

In 2003, The European Commission provided a “Green Paper on the conversion of the Rome Convention of 1980 on the law applicable to contractual obligations into a Community instrument and its modernization". The latter was put forward in order to meet today's needs for the application of the Rome Convention. The former was considered, because the Rome Convention is the only private international law instrument still in the form of an international treaty, but at a community level. A conversion into a Community Instrument shall achieve the advantage of greater consistency in community legislation on private international law and facilitate the application of standardized conflict rules in the new member states.

Referring to these developments, ICC has highlighted major sensible issues such as the proposed link between a future Rome II Regulation and the initiative to harmonize European Contract Law.

The future Rome II Convention (Non-Contractual Obligations)

In 2003, the European Commission put forward a “proposal for a regulation on the law applicable to non-contractual obligations". The initiative focuses on the question of civil liability for damage caused to a third party (e.g. traffic accidents, accidents caused by a defective product, invasion of privacy) and to harmonize conflict rules on both, contractual and non-contractual obligations. Referring to these developments, ICC has highlighted major sensible issues such as the conflict with the E-Commerce Directive.

Hague Conference

The purpose of Hague Conference on Private International Law (HccH) is to work for the broad unification of the rules of private international law. Therefore, HccH develops and supports international conventions in the domains of Protection of Children, Family and Property Relations, Legal Cooperation and Litigation as well as Commercial and Finance Law.

As the world’s largest and most representative business organization, ICC contributed its expertise to the following HccH commercial and finance law initiatives:

- Hague Judgments Project.
- International Conference on the Legal Aspects of an E-Commerce Transaction

Hague Judgments Project

“Hague Judgments Project” aims at a global convention on jurisdiction, recognition and enforcement of foreign judgments in civil and commercial matters. ICC appreciates the decision of HccH to focus the prepared convention on the choice of court provisions between businesses (B2B) . The “Draft Hague Convention on Exclusive Choice of Court Agreements” achieves more predictability and certainty in international contracts . It has the potential to become valuable for companies engaged in cross-border transactions. To contribute to the effort of HccH and in particular to the work of the informal working group on “The Hague Judgments Project”, the “ICC Task Force on Jurisdiction and Applicable Law” conducted a survey among businesses about business practices with regard to choice of court agreements. Once the new Convention enters into force, ICC is prepared to support HccH and its member states in raising awareness about this new legal instrument and its benefits to companies as well as their legal advisers around the world.

International Conference on the Legal Aspects of an E-Commerce Transaction

In October 2004 HccH, International Chamber of Commerce and the Dutch Government have hosted an international conference in The Hague on the legal issues raised by E-Commerce. The programme not only focused on the areas of private law and private international law, but other areas such as international tax law. The conference raised general and political awareness of the vast range of legal questions raised by E-Commerce (e.g. pre-contractual phase, conclusion of contract, its performance and post-contractual phase) and provided a forum for dialogue between legislators, academics, lawyers and businesses. Furthermore, the conference assessed whether the current legal framework reflects business realities. As a result, possibilities for coordination among the different actors have been identified.

International Commercial Terms (INCOTERMS)

Incoterms are standard trade definitions most commonly used in international sales contracts. Devised and published by the International Chamber of Commerce, they are at the heart of world trade. Among the best-known Incoterms are EXW (Ex works), FOB (Free on Board), CIF (Cost, Insurance and Freight), DDU (Delivered Duty Unpaid), and CPT (Carriage Paid To). The ICC introduced the first version of Incoterms - short for "International Commercial Terms" - in 1936. Since then, ICC expert lawyers and trade practitioners have updated them six times to keep pace with the development of international trade.

Most contracts made after 1 January 2000 will refer to the latest edition of Incoterms, which came into force on that date. The correct reference is to "Incoterms 2000". Unless the parties decide otherwise, earlier versions of Incoterms - like Incoterms 1990 - are still binding if incorporated in contracts that are unfulfilled and date from before 1 January 2000. The versions of Incoterms preceding the 2000 edition may still be incorporated into future contracts if the parties so agree. However, this is course is not recommended because the latest version is designed to bring Incoterms into line with the latest developments in commercial practice.

The English text is the original and official version of Incoterms 2000, which have been endorsed by the United Nations Commission on International Trade Law (UNCITRAL). Authorized translations into 31 languages are available from ICC national committees. The Correct use of Incoterms goes a long way to providing the legal certainty upon which mutual confidence between business partners must be based. To be sure of using them correctly, trade practitioners need to consult the full ICC texts, and to beware of the many unauthorized summaries and approximate versions that abound on the web.

The ICC now publishes a brief introduction to Incoterms on a new special section of its website. The section does not provide all the answers but will help understanding of what Incoterms are for and how they are organized. We describe how to order Incoterms in the original English version and many of the world's main languages from ICC Publishing in Paris and New York, or ICC national committees around the world. The site includes for the first time the Preambles to each term, in read-only format. The Preambles explain the areas the terms cover but do not spell out the obligations of buyer and seller - information that can be obtained only by consulting the full published texts of the 13 Incoterms. As the guardian and originator of Incoterms, ICC has a responsibility to consult regularly all parties interested in international trade to keep Incoterms relevant, efficient and up-to-date. This is a long and costly process for ICC, which is a non-governmental, self-financed organization. The work is financed out of sales of Incoterms 2000 and related publications, which are protected by copyright.

Electronic Contracting

ICC offers e-Terms 2004 in response to the challenges and opportunities through new technologies, which shape the business practice. By agreeing to abide by ICC eTerms 2004, the parties make it clear to arbitrators and judges resolving any disputes they might have on the workings of the substantive contract between them that they do not have a dispute about the technical means by which they had contracted. With ICC eTerms 2004 in place, the parties have intentionally agreed to contract electronically. The effect: one dispute less, to resolve and to spend money.

ICC e-Terms 2004

- ICC e-Terms 2004 are designed to enhance the legal certainty of contracts made by electronic means.
- ICC e-Terms 2004 provide with two short articles, easy to incorporate into your contracts, which make it clear that the contractee and the contractor intend to agree to a binding electronic contract.
- ICC e-Terms 2004 do not affect the subject matter of contract, and do not interfere in any way with any terms the contract may have otherwise agreed upon: they simply facilitate the procedures and the use of electronic means in concluding a contract.
- One can use ICC e-Terms 2004 for any contract for the sale or other disposition of goods, rights or services.
- One can use ICC e-Terms 2004 wherever you contract through electronic means whether through a website, by e-mail, or by EDI.

ICC Guide to e-Contracting

ICC also provides a product accompanying ICC e-Terms 2004 to explain how one can apply ICC e-Terms 2004 to the contract. ICC recognizes that the speed and ease of electronic contracting is a balance of risks and chances on a knife's edge. These anxieties can frequently more easily be allayed in-house, through sensible, practical and flexible precautions, rather than through international legislation or through contract terms. With this in mind, the ICC Guide to electronic contracting provides flagging steps, which might be taken by businesses to reassure them when contracting electronically.

The United Nations Commission on International Trade Law (UNCITRAL)

The United Nations Commission on International Trade Law (UNCITRAL) is the core legal body within the United Nations (UN) to harmonize and unify international trade law. It coordinates the work of organizations, which are active in the field of International Trade, and encourages cooperation across borders in the first place. Secondly, The UNCITRAL promotes acceptance of existing as well as new international conventions or model and uniform laws . As a close advisor to the United Nations, International Chamber of Commerce (ICC) is presently working with the UNCITRAL working groups (WG) in four areas of expertise:

- Procurement (UNCITRAL WG I)
- Arbitration and Conciliation (UNCITRAL WG II)
- Transport Law (UNCITRAL WG III)
- Electronic Commerce (UNCITRAL WG IV)

Procurement

The ICC Commission on Trade and Investment Policy serves as an advisor to UNCITRAL WG I to update the 1994 “UNCITRAL Model Law on Procurement of Goods, Construction and Services" . The review was decided in 2004 as a result from the experience gained in the use of the Model Law as a basis for law reform in general, and the increased use of electronic communications in public procurement in particular. ICC provided its “ICC E-Terms 2004 “as a major input to UNCITRAL WG I .

Arbitration and Conciliation

Longstanding ICC experience in administering international arbitration has led parties such as UNCITRAL, to seek its assistance in selecting arbitrators for cases not conducted under the “ICC Rules of Arbitration". Since 1982, ICC has had rules setting out a procedure for the appointment, challenge and replacement of arbitrators conducted under the rules of arbitration of UNCITRAL. Furthermore, the ICC Commission on Arbitration attends and observes the sessions of UNCITRAL WG II. From 2000 to present, the aim of WG II has been to discuss the desirability and feasibility of further improvement of the laws, rules and practices of international commercial arbitration.

Transport Law

With its committees on both, Maritime and Air Transport, the ICC Commission on Transport and Logistics acts as an advisor to UNCITRAL WG III in the field of transport law. The work programme goes in line with the UNCITRAL efforts in the domain of E-Commerce. It is considered as a review of current practices and laws in the area of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving greater uniformity of laws.

Electronic Commerce

Recently, ICC has been following the UNCITRAL efforts to regulate companies' use of data messages (e.g. electronic contracting via email). Observing the sessions of UNICITRAL WG IV and providing “ICC E-Terms 2004" as well as the “ICC Guide to Electronic Contracting", ICC helped to develop the “international draft convention on the Legal Aspects of Electronic Commerce" and offered business expertise. Additionally, ICC worked closely with UNCITRAL on the “UNCITRAL Model Law on Electronic Signatures” and the “UNCITRAL Model Law on Electronic Commerce" . The projects allow for legal certainty regarding the use of electronic signatures and utilization of modern means of communications as well as the storage of information.

The United Nations Centre for Trade Facilitation and Electronic Business (UNCEFACT)

The United Nations Centre for Trade Facilitation and Electronic Business (UNCEFACT) is an organisation of United Nations of America, which supports activities dedicated to improve the ability of business, the trade and administrative organizations to effectively exchange products and relevant services. Its focus is to facilitate national and international transactions, through the simplification and harmonization of processes, procedures and information flows. This reinforces the growth of rules-based, open international trade. The International Chamber of Commerce (ICC) coordinates its work with international organizations and contributes its world business proficiency to the initiatives of UNCEFACT such as Electronic Invoicing and Unified Business Agreements and Contracts (UBAC) etc.

Electronic Invoicing

Recently, private companies have invested substantially to provide the technical infrastructure for electronic invoices. Meanwhile governments have approved the relevant laws and regulations designed to provide the necessary legal infrastructure (e.g. Directive 2001/115/EC amending Directive 77/388/EEC). The lack of usage of common international standards for layout and data requirements as well as differences in the local implementation of existing directives and recommendations avert a harmonization in this field. Through its different Task Forces, ICC has been actively following UN/CEFACT initiatives on electronic invoicing and calls for participation in the UN/CEFACT ITPWG-TBG15. The purpose of this project is to revise the “UN/CEFACT Recommendation on Aligned Invoice Layout Key for International Trade” (Recommendation 6) to ensure that it contains the elements required to exchange information electronically (e.g. data, electronic signature, layout).

Unified Business Agreements and Contract (UBAC)

Prior to message exchanges, the parties agree to do business electronically. This agreement consists of an infrastructure level agreement (e.g. EDI, ebXML) and a business level agreement (e.g. Business Collaboration Framework). UBAC is conducting research for legally enforceable business agreements. The project amplifies the UN/CEFACT Business Process Working Group efforts to develop a framework for E-Businesses defining their external information interchanges and related business activities as a means of a Business Collaboration Framework. UBAC extends the support for executable E-Business relationships through agreements and contracts. It rescheduled the target date for the end of the requirements phase to end of February 2004.

ICC model contracts and clauses

The Commission on Commercial Law and Practice (CLP) develops ICC model contracts and ICC model clauses, which give parties a neutral framework for their contractual relationships. These contracts and clauses are carefully drafted by experts of the CLP Commission without expressing a bias for any one particular legal system. The idea behind ICC model contracts and clauses is to provide a sound legal basis upon which parties to international contracts can quickly establish an even-handed agreement acceptable to both sides. The contracts are the products of some of the finest legal minds in the field of international commercial law. They are constructed to protect the interests of all the parties, combining a single framework of rules with flexible provisions allowing the parties to insert their own requirements.

Contracts and Clauses being developed	
ICC Model Selective Distributorship Contract	ICC Model Technology Transfer Contract
ICC Mergers and Acquisitions Model Contracts II - Business and Assets Agreement	ICC Model Major Project Turnkey Contract
ICC Business Guidance on Electronic Contracting	ICC Model Clauses on Electronic Contracting
Existing model contracts and clauses	
ICC Model International Sale Contract	**ICC Model Commercial Agency Contract**
ICC Model Distributorship Contract (sole importer-distributor)	**ICC Short Form Agency & Distributorship Model Contracts**
ICC International Franchising Contract	ICC Model Occasional Intermediary Contract
ICC Model Turnkey Supply of an Industrial Plant Contract	**ICC Mergers and Acquisitions Model Contracts I - Shares Purchase Agreement**
ICC Force Majeure Clause 2003	ICC Hardship Clause 2003

COMMERCIAL CONTRACTS

Some corporate clients have a tendency when negotiating with foreign authorities to present maximum positions on politically sensitive issues, only to cave in completely when they encounter a harsh response from the other party. It may be more effective in protecting the company's interests to present more subtle solutions which have some chance of being accepted. It is important that the client consider at the outset what its firm objectives are in respect of political risks.

Risks in International Commercial Contracts

It is important issues to be resolved to face the political risks and the major legal problems that arise in dealing can be identified as follows:

- The first is the civil law concept of the administrative contract, a troublesome doctrine that engenders uncertainties for companies contracting with foreign authorities.
- The second relates to new legislation enacted by Congress this week that strengthens the role of arbitration as a remedy for breach of contract and expropriation by foreign states.

Parties that invest in foreign countries or that enter transactions with foreign states or government agencies face a wide variety of political risks. If the venture prospers, no political problems may arise. If the deal should turn sour, however, or there is a political or financial crisis in the host country, disputes are likely. Then, the investment or the project could be threatened in many different ways. If the client has an agreement with a foreign government agency, that agency may fail to meet its obligations or its performance may be blocked by an act of state by the host government. In an extreme case, the host government could expropriate the assets of the venture or terminate its license to do business. Alternatively, it might decide to take a controlling interest in the local venture company by nationalizing part of the shares. It could enact legislation raising taxes or wages to confiscatory levels, or establish price controls that make the venture unprofitable. It could pass legislation compelling the transfer of technology or permitting violations of the investor's intellectual property rights. There is always the risk of exchange controls blocking the repatriation of profits or payment of debt. The possibilities are too numerous to mention.

Remedies

In the event the client encounters a political act affecting its property or contract rights, it must be doubted that the courts of the host country will be helpful, particularly if the host is a developing country. The independent judiciary we know in the United States is rare in other political cultures, and even here we see instances where political passions influence the courts. Sometimes the State Department or an insurance agency may suggest the exhaustion of local judicial remedies. In my experience, that course of action can be a terrible mistake. On the other hand, one can prefer to bring a lawsuit in the United States or a third country, you may face difficult, even insuperable problems, of jurisdiction, sovereign immunity, or the act of state doctrine. In some cases, you may have problems establishing a cause of action for breach of international law. I am thinking particularly of cases involving foreign exchange regulations, termination of a license to do business where there is no taking of assets, unilateral changes in administrative contracts, regulatory action and cases of partial compensation where the fair market value of an investment may be difficult to establish.

There are three routes to jurisdiction in a U.S. court under the FSIA in cases involving foreign transactions.

1. First, under Section 1605 (a)(3), an action for damages can be brought if "rights in property taken in violation of international law are in issue,". Either the property taken (or property

exchanged for it) is present in the United States, or the foreign government agency controlling the expropriated property is engaged in a commercial activity in the United States. This is a narrow grant of jurisdiction. The only decision sustaining jurisdiction under this provision is my Kalamazoo Spice case against Ethiopia.

2. Second, an action based upon a commercial activity may be brought under Section 1605 (a) (2) of the Act if the claim is based on a commercial transaction having substantial contacts with the United States. It may be that a financial loss suffered in the United States is sufficient to establish jurisdiction, but most of the cases relying on such a loss have involved other contacts, such as letters of credit payable in the United States

3. The third, and the cleanest, path to jurisdiction under the FSIA is an express or implied waiver of sovereign immunity under Section 1605 (a) (1)). The statutory scheme equates a waiver of immunity with consent to the jurisdiction of the court. However, to avoid any constitutional questions relating to personal jurisdiction, it is best to stipulate such consent expressly along with the waiver of immunity.

Act of State Doctrine

If a client is making an investment in a foreign country where that investment is subject to political risks, but no contract with the host government is required, my first recommendation is to consider the feasibility of establishing a formal contractual relationship with that government. Although a breach of contract may or may not constitute a taking of property or meet the requirements of the second Hickenlooper amendment, a claim for breach of contract may have advantages for your case both on the merits and in terms of the act of state doctrine.

Application of the principle, *pacta sunt servanda*, to agreements between private parties and foreign sovereigns is still controversial, but there are respectable authorities that give effect to stabilization clauses in expropriation cases involving the breach of concession agreements that contain such clauses. These clauses may be helpful where either the fact of the taking or the measure of damages is at issue. For instance, it is far from clear at what point a radical increase of taxation passes from un-compensable regulatory action to the status of a compensable, albeit indirect, taking of property. If you can negotiate contractual protections concerning taxation, it may be easier to establish a compensable breach of contract than a taking. In the Libyan oil cases, stabilization clauses were argued to support restitution damages. Professor Dupuy accepted that argument in the Topco case. The arbitrators in the Liamco and BP cases did not.

It is well established that the act of state doctrine applies only to property situated within the territory of the sovereign, and there are several cases, including the second Allied Bank decision in the

Second Circuit , holding that a debt is situated where it is payable under the contract. There is also a well-reasoned theory that the act of state doctrine is properly viewed as a choice of law rule.

There is also a strong current of reasoning in some act of state cases, particularly the bank home office liability cases and the Mexican C.D. cases , that the outcome should reflect the reasonable expectation of the parties. If a bank promises a foreign depositor that it will make payment in New York, a court is likely to hold the bank to its promise regardless of any foreign act of state. Likewise, a citizen who deposits money in a foreign bank at a rate of interest reflecting the higher risk will have difficulty persuading a court to relieve him of the risk he was paid to run. Nothing is certain in this world, but I believe it is worthwhile to attempt to contract out of the act of state doctrine, if the transaction lends itself to that approach and your client has the necessary bargaining power.

Arbitration

Many of the obstacles presented by the Foreign Sovereign Immunities Act and the act of state doctrine can be avoided by negotiating an agreement to arbitrate disputes with the foreign state or government agency. The legislative history of the FSIA indicates the intent of Congress that a sovereign's agreement to arbitrate in another country or under the law of another country constitutes an implied waiver of immunity in an action brought to enforce the agreement to arbitrate or an award made pursuant to such an agreement.

This week Congress is considering a new measure which would improve the legal framework relating to the enforcement of international arbitration agreements. At the initiative of Senator Mathias, a rider was added to legislation implementing the Inter-American Convention on Commercial Arbitration. That rider would make three significant changes in U.S. law:

First, the Federal Arbitration Act would be amended to ensure that the act of state doctrine is not applied to bar the enforcement of an agreement to arbitrate or an arbitral award. This provision would eliminate the doubts on this point created by the unfortunate decision of the district court in *Liamco v. Libya*.

Second, the FSIA would be amended to spell out the jurisdiction of the U.S. courts to enforce agreements to arbitrate and arbitral awards. Under this amendment, it would not be necessary to show a waiver of immunity in order to execute an award that is rendered in the United States or a foreign award that falls within a treaty to which the United States is party calling for the enforcement of arbitral awards. The purpose of this amendment is to codify the District Court decision in *Ipitrade International, S.A. v. Federal Republic of Nigeria*, 465 F.Supp. 824 (D.D.C. 1978) which enforced a foreign arbitral award on the theory that Nigeria's agreement to arbitrate under ICC Rules and Swiss law constituted an implied waiver of immunity as regards enforcement of the award in the United States courts. A similar rule has been adopted by statute in the United Kingdom and Australia, and an amendment clarifying the FSIA was sought because the Ipitrade decision had been criticized in dicta in subsequent U.S. cases.

Third, the execution provisions of the FSIA would be amended to provide that a judgment against a foreign state entered on an arbitration award may be executed against any property of that foreign state which is used for a commercial activity in the United States. This provision may make an arbitral award more valuable than a judicial judgment, because execution of the latter is still limited to property of the foreign state used for the commercial activity upon which the claim is based.

These amendments are the result of a considerable effort made by the ABA and others interested in perfecting the remedies available to parties with claims against foreign governments. I had the honor to coordinate this effort for the ABA, and we will continue our effort to improve the provisions of the FSIA in the years to come.

In the *Aminoil* case, the arbitration agreement left it to the tribunal to determine the applicable law "having regard to the quality of the Parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world." The tribunal found it easy to discharge this duty; it concluded that the law of Kuwait incorporates public international law including "the general principles of law."

Another formula used in international contracts is borrowed from Article 42(1) of the ICSID Convention which provides, if the parties have not stipulated the law governing the contract, for application of "the law of the Contracting State party to the dispute … and such rules of international law as may be applicable." This is a helpful formulation, but its utility has been damaged somewhat by constructions made of it in recent annulment proceedings brought under Article 52 of the ICSID Convention.

However, the further development in the International Commercial Law is essential to establish an international legal order conducive to international commerce and economic development.

ENGINEERING CONTRACTS

Engineering Contracts

The Engineering and construction contract is a product of the Institute of Civil Engineers, and first appeared as a consultative draft in 1991. the first edition was published in 1993 under the title ‘ The New Engineering Contract’ by which name it is commonly known. There were various amendments done in the second model in the year 1995 and came under the title ‘the Engineering and Construction Contract’

However the Guide for International Engineering Contracts, drafted by the Economic Commission for Europe of the United Nations (Geneva, 1983) expressly qualifies as obligations de moyens the obligations of the engineer. Similarly, the *Fédération Internationale des Ingenieurs Conseils* (FIDIC) contract model entitled "International General Rules of Agreement between Client and Consulting Engineer for Design and Supervision of Construction of Works," 1979 ed., at clause 2.3.1 provides that "the Consulting Engineer shall exercise all reasonable skill, care and diligence … and shall carry out all his responsibilities in accordance with recognized professional standards. The

Consulting Engineer shall in all professional matters act as faithful adviser to the Client and, in so far as any of his duties are discretionary, act fairly as between the Client and third parties." This wording, and particularly the reference to the "care and diligence," is significant for the qualification of the obligations of the engineer as obligations de moyens.

Purpose of Engineering and Construction Contracts

The purposes of an Engineering Contract may be listed as follows:

1. Revolution in attitude and mind of contractors, clients and construction professionals.
2. Better building at lower cost.
3. Permitting reasonable profit to contractor.
4. Less disputes and litigation.

The ECC documents are written in a style and simple language. The present tense is used almost through out and defined terms are minimal and owe noting to established terminology of other contracts.

Options of Engineering Contracts

The ECC contract actually has six variations on a theme sold as a boxed set with guidance notes, a volume of flow charts and a form of sub-contract. The six contract options all have in common a set of nine core clauses and 15 secondary option clauses.

The (6) six contract options are:

1. Priced contract with activity schedule: It consists of a simple arrangement for a lump sum price for each activity identified on an activity schedule. The schedule is linked to a program showing he start and finish dates for each activity. Payment is earned for each activity only when it is completed.
2. Priced contract with bill of activities: It can operate as lump sum or remeasurement contract, depending on whether or not the quantities in the bills are an accurate statement of the amount or quantity of work actually required. Any difference between the stated and final quantities in the bills is a compensation event. There is no specified method of measurement.
3. Target contract with activity schedule: This is a free and cost reimbursable payment options, coupled with incentives to the contractor to remain within a set cost budget. Compensation is taken into account to adjust the target price. Option C is based on a cost based activity.
4. Target contract with bill of quantities: The only difference between this one and the one above is that this one is based on bills of quantities. The risk that the bills have been under measured rests with the employer.
5. Cost reimbursable contract: It provides for a simple cost reimbursable contract plus a percentage fee.

6. Management Contract: It is an elementary form of management contract based on actual cost plus a fee. The core clauses make no provision for a pre-construction period and the contractor remains as fully liable for the sub-contracted work or design as if th work or design had carried out by the contractor himself.

INTERNATIONAL TRANSFER OF TECHNOLOGY AGREEMENTS

In today's commercialized world, it is more important for anyone who enters in to any kind of business transaction to be familiar in the negotiation of business agreements involving the licensing technology. The U.S government in 1980 enacted the BayhDole Act to encourage the commercial use of technology developed under the federally funded research. Thereafter the development of this underdeveloped technology, it has become an industry which generates hundreds of millions in royalty payments from the sales of products using patented technology. Due to the commercialization and rapid expansion of the technology, where millions of dollars were at stake it became essential to draft this agreement with proper structure in order to protect the objectives and interests of both the parties- unquestionably a formidable task.

Basic Principles of International Technology Transfer Agreements

The following may be treated as the objectives of Technology Transfer and Commercialization of Transactions:

The exploitation of technology in its early stages of development.

Advancing the technology to a stage where it has useful commercial applications

1. Marketing and selling the technology for profit
2. To ensure that the fullest ownership or licensing rights to the technology are conveyed consistent with the intentions of the parties.
3. To ensure that after conveyance the technology is commercially exploited to the fullest extent possible to maximize the possible financial return.
4. To ensure that if the licensee fails to exploit the technology commercially, the conveyed rights will be returned or the license will become non exclusive.

Basic Statements of Technology Transfer Agreements

The International Technology Transfer Agreements shall contain the following basic statements.

Identification of the parties: The opening paragraph should identify the parties to the agreement with their official names, addresses and, when applicable, the location of their governing law of incorporation. Corporations should be identified as patent and subsidiary, patent, or subsidiary alone, and their legal capacity or authority should be given.

Purpose: The purpose of an agreement should be stated in a brief paragraph that captures the essence of why the licence agreement is being executed.

Effective date of the agreement: The data when the agreement comes into full force and effect is often stated in separate paragraphs.

Whereas clauses (recitals, preamble): The whereas clauses give the background and rationale for the agreement. Whereas clauses contain such things as licensor and licensee representation and background of the agreement.

Licensor representations: This clause states that the licensor owns the subject technology of the licence (patents, patent applications, know-how trade secrets, trade marks and / or copyrights), that it has the right to grant the licence and that it has not granted a previous conflicting licence.

Licensee representations: This clause indicates why the licensee wishes to obtain rights to the subject technology. The patent, patent applications, know-how, trade marks and / or copyrights the licensee owns in the field of the licensed technology is also to be incorporated.

Background of the agreement: When warranted, other clauses should include statements about any prior agreements that may relate, dominate or affect in any way the present agreement. Cancelled or suspended agreements should be mentioned as well.

Definition of terms: To preclude misunderstandings between the parties, the subject matter and key words that will have broad impact in the agreement require definition. Most important are the following:

- Licensed patents.
- Licensed know-how/trade secrets.
- Licensed improvements.
- The licensor has obtained the rights to license
- They are patentable or not
- They are developed or acquired during the term of the agreement
- They pertain to the licensed process and licensed apparatus
- They have been put into commercial use by the licensor.
- Major improvements.
- Grant-back.
- Licensed product/licensed process/Licensed apparatus.
- Net sales.
- Territory.
- Subsidiary.

Subject Matter of the licence: The International Technology Transfer agreements shall contain the following subject matter related aspects and clauses in them.

The licence grant: The grant is probably the most important part of the licence. Its provisions, outlined below, require careful thought as to their content. To protect all parties, they should be drafted unambiguously, leaving no doubt or open questions regarding the rights being granted.

Patent rights: The term "licensed patents" should be defined in the agreement in order to identify the patents, applications etc. included in the licence. The grant specifies exclusivity, territory, rights conferred, limitations, maintenance and protection of patents, and patent making.

Exclusivity: The grant can be exclusive, sole (exclusive except for the licensor) or non-exclusive. The licensee seeking an exclusive licence must be prepared to make a strong case for its ability to market the technology in the licensed territory aggressively.

It requires careful assessment of which approach will yield the greatest return. The following questions should be considered:

- Will the licensor use the technology itself?
- If so, will it be only in its own country or in several countries?
- Will the patent protection have a long life?
- Will the licensed product have a broad or narrow market?
- Are there many or few prospects for a licence?
- What is allowed or restricted by the applicable laws?

Territory: As territory is normally defined in the "definitions" section of the licence, as shown earlier, it needs only be denoted by a capital T in the licence grant. This is the preferred technique, as otherwise the licensee grant paragraph will be needlessly encumbered.

Rights conferred: It is proper for the grant to set forth exactly what a licensee is free to do under the patent rights. Depending on the claims in the patents, the licensee can be given the right to manufacture, have manufactured, use and/or sell the subject matter of the licence.

Limitations: Depending on the coverage within the claims of the patents, the licensor may wish to impose limitations beyond the geographical territory on the quantity or volume of products sold and on field-of-use. The licensee and the licensor as well should assess the effect of such restrictions on both the market and its growth potentials.

Maintenance and prosecution of the patents: The licensor, except as noted below, usually bears responsibility for the cost of filing, prosecuting and maintaining licensed patents. This includes future patent applications if improvements are included in the agreement.

Infringement: Licensor and licensee rights concerning infringement suits may vary from country to country owing to differences in the applicable laws.

An award favoring the licensee usually pays the litigation expenses of the parties on a pro-rated basis first. The surplus, if there is one, is then split evenly between the parties. If the licensor does not participate in the litigation, the licensee should insist that no portion of the award be shared.

Patent marking: The licensor often insists on requiring the licensee to mark patented products with the patent number.

Know-how/trade secrets/confidential information: The term know-how will include both confidential information (trade secrets) and non confidential information.

The know-how: It refers to the technical and specialized knowledge that has particular value in making, using and selling the licensed process or product.

The secrecy: The secrecy obligations that permit the usual exceptions should be acceptable, i.e. confidential information that:

The licensee can prove, with written records, is already known to a licensee or is already in the possession of the licensee.

- Was in the public domain prior to disclosure by the licensor.
- Becomes a part of the public domain by publication or by any other means except an unauthorized act or mission by the licensee.
- Is received from third parties who are under no obligation to maintain such information in confidence.
- The licensee can prove, with written records, was developed by licensee independent of disclosures from licensor.
- Licensee's use of the know-how: The agreement may spell out the basis on which disclosures can be made to include a requirement that the licensee execute agreements with the pertinent employees and third parties.

Technical assistance: Technical assistance can greatly reduce the time required by the licensee to move the licensed technology into production. The common elements of the technical assistance include the following:

- Plant visits and training.
- Direct assistance.
- Consultation.

Improvements: If the party decides to include improvements made after the effective date of the agreement, this section must be drafted carefully. Improvements made by the licensee to be granted back to the licensor require a separate clause to specify how they are to be handled.

- Improvements grant
- Timing of the disclosure

- Grant-back of improvements made by licensee

The provisions with respect to definition and timing of disclosure for improvements are commonly reciprocal between the licensor and licensee.

Sub-licence rights: Subject to individual country laws, a licensee does not have sublicensing rights unless the agreement authorizes them. By so doing, it can be certain to include all the pertinent requirements from the primary agreement. This procedure should be acceptable to the primary licensee.

Payments: The payments in technology agreements usually take the form of a lump sum, a royalty or a combination of both.

Initial payment: Technology agreements frequently involve the transfer of valuable know-how. For this reason, the licensor usually requires an initial lump-sum payment when the licensee is executed. This payment should reflect the value of information transferred early in the life of agreement. If the licensee has a good negotiating position, deletion of up-front and minimum royalties should be pursued vigorously.

The amount of up-front payments depends on several factors:

- An assessment of the value of the technology.
- Whether the licence is exclusive or non-exclusive and whether it allows sublicensing or not.
- Whether advance payment of royalties is included.
- The rate of running royalties to be paid
- The amount of minimum royalties.
- The length of the period for which royalties are payable.

Royalties: Most licences require payment of royalties based on a percentage of the net sales of the licensed product, as defined in the definitions section. A reasonable procedure is for the licensor and licensee to try to develop theoretical sales projections, or to use market projections based on the project feasibility study and then to reduce those projections by 20 to 40 percent to arrive at a fair, conservative amount to be used in the agreement.

Separate payments for patents and know-how: A trend exists to separate patent and know-how royalty payments in licence agreements. There are several reasons for this:

- Patent royalties are subject to risk since there is always a chance they can be declared invalid.
- Patent royalties can remain in effect only for the life of the patent, but know-how royalties may continue well after the licensed patents expire (see discussion on know-how licences below).
- The subject matter of the licence with respect to patents is limited to the scope of the claims, whereas the subject matter can be defined more broadly under the scope of the know-how.

Acquisition of machinery: When a licensor sells proprietary machinery to a licensee, the terms for such a transaction can be shown in separate paragraph of the agreement, in a schedule attached to the agreement or in a separate sales agreement.

Technical services: In addition to the above payments, the licensee may have to pay separately for specific technical services the licensor may provide in connection with the licence. Payment method and currency, Interest on overdue payments and Licensee records are to be also taken care of.

Boilerplate Provisions of Technology Transfer Agreements

The following Boilerplate provisions have to be incorporated in the Technology Transfer Agreements to avoid future complications at the time of drafting the Agreements.

Termination of the agreement: Termination provisions vary widely. They can be limited to expiration or invalidity of the patents, to a definite time period for know-how and/or to breach of the agreement by either party. Breach or default is usually determined in arbitration. Often the agreement will include specifically the following conditions as cause for termination: overdue payments; bankruptcy, receivership or insolvency; change of control.

Best efforts: A paragraph stating that the licensee will use its best efforts to exploit the licensed technology is common in both exclusive and non-exclusive licences.

Most favoured licensee: Non-exclusive licensee should insist on this clause. It provides that should the licensor grant another licence to a third party on more favourable terms, the more favourable terms will then apply to the first licensee.

Warranty and identification: Many times a licensor, especially one in a strong position, will make no warranty or representation of any kind, express or implied concerning any matter in the agreement. In effect, no warranty is extended.

If the licensee cannot obtain a warranty of substance in the agreement, it should insist that the warranty section be used to confirm that the licensor:

- Owns or has the rights to the licensed patents.
- Owns or has the rights to disclose the licensed know-how and other technical information.
- Has no ongoing, pending or threatened suit regarding the licensed patents and technology (assuming there is one).
- Has used the know-how to enable him to produce the licensed product. If there is no licensed product, then some statement that attests to the worth of the know-how should be given.

Export control: If the technology or products made under a licence are considered sensitive or if they might be utilized in countries to which the licensing country restricts exports, the licensor will require a clause to assure that such restrictions are not violated.

Arbitration and applicable law: Arbitration is being used more and more frequently as a means to resolve licence agreement disputes because it is usually faster, much less costly and more amicable than lawsuits.

There are many subtle points to consider in writing arbitration and applicable law clauses. Patent laws differ around the world. The use of discovery in arbitration can be limited and the generally accepted procedures for arbitration are changing. The licensee and licensor are advised to have legal counsel study the circumstances for each licence carefully before deciding on the most appropriate provisions for such clauses.

General provisions of Technology Transfer Agreements

The following general provisions will add extra strength to the Technology Transfer Agreements and they have to be also incorporated during the drafting of the Agreements.

Assignment: It is important for the licence agreement to provide for assignment or preclude it. Assignment is commonly precluded for the licensee, although there are exceptions.

Severability: A clause will usually provide that if a significant provision of the agreement is declared void or unenforceable by arbitration or court proceeding, the remaining provision of the agreement will remain in full effect.

Entire agreement: In general, almost all licence agreements contain an entire agreement clause. It is especially important when there are existing agreements or have been prior agreements between the parties related to the current or another subject matter.

Force Majeure, contingencies: This clause provides that neither party to the agreement will be responsible for failure or delay in performing their obligations due to circumstances beyond their reasonable control.

Notices: The parties will designate the principal contacts for the handling of correspondence, fax messages, telephone calls, notices, royalty payments, technical assistance, training, patent administration etc. Generally, each party appoints a technical and/or a licence administrator is appointed to handle the day-to-day business of the licence.

Demographics of Technology Transfer Agreements

Various institutions like colleges and university, business entities, independent development laboratories, non profit organizations, even government are engaged in technology transfer and commercialization. These agencies are performing or sponsoring scientific research and development but cannot exploit their rights for profit except through technology transfer. Individuals who develop technology are typically innovative, but lack all resources required for exploiting technology commercially. They lack financing and even if they receive it somehow they either lack the means for marketing, manufacturing and distribution. Even the early stage technology companies lack the potential to finally put their product for maximum profit. The technology transfer provides them the means to finance their research and development activities from the payments they receive from licensing commercialization right to others. This method provides them the means not only to realize the profit but also to generate funds, which they can later use for their further research.

Importance of Financial clauses in Technology Transfer Agreements

The cost of doing business has risen considerably over the years. The developer usually relinquishes his right for a potential income that may be generated through license fees and royalty payments. The technology transfer provides a significant way to recoup the financial investments, needed to support further research and development activities. These funds further helps in the development of new technology by providing necessary funds required for research and development. It also bridges the gap between those skilled in research and development and those skilled in manufacturing, marketing and distribution.

This method shifts the technical and financial burden of commercial development to the beneficiary, through clauses requiring up-front payments licensing fees and continuing royalty payments. Many times the licensor is also given stock ownership rights in the business entity that is created to exploit the technology commercially.

Some Typical Financial Provisions are as follows:

1. License Issue Fees and Other Up Front Payment Clauses: The first order of a business transaction is to define that what the licensee will pay in advance for the commercialization rights that are being conveyed. It might agree to pay an aggregate sum or a separate license fees for different kind of technology. It may also consist of the provision like to reimburse the licensor any costs incurred in preserving patent or other intellectual property rights in the technology until the transfer takes place.

2. Equity Ownership and Other Secondary Payment Provisions: There can also be a provision in consideration, which could provide for either an equity interest or the creation of a new entity expressly for the purpose of exploiting the technology. This arrangement provides an attractive business deal to the developer because of the potential for capital gains from an increase in the value of the issued stock.

3. Payment Term Provisions: The payment terms could also provide for an over time payment option because it takes a long time for the actual commercialization of the technology. Therefore a middle path is required to be ascertained in order to safeguard the interest of the licensor and the licensee.

4. Royalty Payment Provisions: The final part of the compensation provision might provide for the payment of royalty on the finished products finally sold. It provides for the ultimate

commercialization of the technology and its exploitation in the market place. This clause helps the owner of the technology to earn the maximum profit because it doesn't have the means of financial resources, market penetration or the sales force to explicit the technology itself.

INTERNATIONAL COMMERCIAL AGENCY / FRANCHISE CONTRACTS

Twenty years ago a joint venture most often occurred in domestic construction projects by which two or more companies would join forces for a particular piece of construction, sharing the responsibilities and revenues, with the joint venture ending when the job was completed. Modern day use of the Joint Venture has enlarged its scope so that it is a typical means of engaging in business in a foreign country. A company in the United States which wishes to enlarge its operations abroad or obtain (or share) some intellectual property in a market unfamiliar to it will seek a "partner" in the other jurisdiction to engage in what is often a long term business venture in that locale.

Foreign principals have developed various strategies to address these Middle East dealer protection laws. For example, many principals seek to ameliorate the more onerous aspects of these laws, through certain provisions in their commercial agency agreements. Foreign principals should recognize that such provisions, although perhaps helpful in some instances, may not be entirely effective: Middle East dealer protections are a matter of local public policy, and consequently Middle East courts may disregard contract provisions intended to deny those protections to a local commercial agent . The advantages of having local expertise and personnel without having to directly enter a foreign market is quite appealing to many American companies and the sharing of resources and intellectual property can be an added inducement. What used to be required by certain foreign governments (such as China) has become quite often the preferred methodology of entry into a market by the United States Company. But there are problems and issues that must be confronted before a joint venture is undertaken and this article shall outline some of the most pressing questions that a company must confront and suggest some solutions that can maximize the benefits and minimize the risks of utilization of such joint venture.

The Basic Structure of International Commercial Agency Agreement

Typically, a Joint Venture ("JV") exists so that two parties can combine resources, contacts, skills and assets to better exploit a particular market. The variations are endless. An American company with intellectual property may wish to enter a foreign market and has neither resources, contacts or the skill set necessary so approaches an Indian or Indonesian company to create some sort of relationship to market the product in that country. Or two companies with equal skill sets but without sufficient economic capital combine their capital to engage in entry into a market or to build a production site.

The typical structures are the creation of a partnership or limited liability entity in the foreign locale, which is owned, by both entities. The alternative method is to create a long-term contract between the two entities spelling out duties and division of proceeds and protection of intellectual property.

Sometimes a careful party will wish both…a limited liability entity with a shareholder's agreement is not uncommon.

Tax consideration, both in the United States and abroad (where such oddities as Value Added Tax ("VAT") can have a tremendous effect on structural planning) must be integrated in and a good international CPA is as vital in structural planning as attorneys, both in the United States and in the foreign locale.

The party considering a joint venture must be careful not to let tax or local jurisdictional issues alter the power or monetary arrangements to its disadvantage. The balance between tax planning, operational planning, local legal restrictions, and cost benefit analysis becomes the primary concern of the wise executive.

The following are the examples of clauses dealing with the parties' determination of the law of contract.

- Force Majeure: what events will allow one of the parties to terminate the contract without liability for breach?
- Choice of law: In case of dispute which law will apply? Court to set aside this clause if it is against the pubic policy.
- Merger: What makes up the agreement?
- Modification: Procedure and Method
- Severance: Does the invalidity of one procedure render the whole contract unenforceable.

The Typical Issues of Confrontation in Commercial Agency Agreements

The basic recurring issue involved in Commercial Agency Agreements is sharing resources. There are certain other issues which are to be addressed properly at the time of drafting the agreements.

The recurring problems and questions confronted quite often are:

1. Power. Who makes what decisions and what happens if there is a dispute?
2. Money: Who puts in what and how are the proceeds divided?
3. Responsibilities. Who is to do what and with what priority over other business?
4. Oversight. Who reports to who and what criteria are to be utilized to gauge success? Accounting methods and oversight by whom?
5. Protection of Interests. How is intellectual property, customer lists, contacts, and the business itself to be protected from one or both joint venturers or third parties?
6. Extraordinary events: What happens if one company or owner withdraws or becomes disabled? What happens if the laws change or a new competitor comes in that changes the playing field?
7. Local Issues. Many jurisdictions restrict ownership and power of a foreign national thus the usual fair division of power is made impossible, often putting one of the JV members at risk.

Restrictions on removal of currency can make this an even more difficult question. Taxes come into the picture both in terms of characterization of expenses and treaties between the United States and the particular nation.

8. Business Ethics: Not a minor issue. Not only because what one nation considers appropriate may be considered a major violation of good business practices in another, but because United States law can often prohibit activities that another nation treats as standard business practices. See our article on the Federal Corrupt Practices Act.
9. Competition by the Parties. Quite often the parties remain competitors in other fields. How is that fact to be integrated into the particular venture, both during it and afterwards? How are business advantages to be restricted to the joint venture so that one's competitor does not use the venture to drive one from the market at a later time?
10. Withdrawal from the Venture. Under what terms does one party withdraw or become forced to withdraw from the Venture? What happens to the assets and trade secrets?

These issues are to be addressed properly after systematic negotiations and understanding between the parties.

The Negotiation

A quick review of the above basic issues indicates that creation of a joint venture is not a simple process even if the parties know and trust each other. Knowledge of the law in at least two jurisdictions; knowledge of tax law; realistic and appropriate expectations; and effective means to obtain data about performance are all vital for the negotiation to conclude and the business to prosper. As per the article on International Business Transactions for the United States Business, even the negotiations themselves are subject to different requirements and many a joint venture foundered on perceived insults and slights. There are also predatory entities, particularly in certain parts of Asia, which utilize joint ventures to obtain trade secrets and will cheerfully compete against the very joint venture they are connected with. In some of those nations, there is no effective court system, and such protections as a third nation locale for dispute resolution and utilization of technology to protect technology may be vital.

There are also oddities involved in some locales that only experience or good advice can prepare the businessperson to confront. One ship building company failed in Thailand because they had not budgeted six months for the local workmen to build appropriate shrines to local deities for the ships. Another entity failed to understand that the extended family of their joint ventures would be the hidden vendors for critical materials and that while all in Indonesia knew the extent of that family's holdings, our American client had not. But this writer's favorite story was of the American client who had spent a great deal of money outfitting a state of the art warehouse in South Africa only to have an armored car driven by organized bands of thugs smash through the steel front door and steal literally every stick of furniture on the premises. None of the businesses on that street were surprised and the local warehouseman merely shrugged. A typical event in that locale and solved by hiding one's assets, not "advertising them" by putting them in a modern looking building.

The wise business person will develop a team to assist him or her in not only developing a business plan, but in achieving enough knowledge as to the local taxes, laws, customs and means of enforcement of contracts so that the odds of success are maximized. Local counsel and accountants, a knowledgeable Unites States attorney and CPA, and communications with people already resident in the local are essential. Most attorneys and CPAs who do this kind of work can form the requisite team.

Like riding a bike, if one merely lists the requirements the task appears daunting. But once one has some experience, it goes remarkably smoothly. Understanding the basic requirements and creating the right team of professionals and experts should allow the average business to engage in joint ventures that widen the available markets exponentially.

ICC Model of Commercial Agency Contract

Virtually every company engaged in international trade makes use of agents abroad, and thus faces the problem of drafting an international agency agreement. The lack of uniform rules creates difficulties for parties negotiating agency agreements abroad. There is no internationally agreed uniform legislation for agency agreements, and so parties have to rely on national laws. Not only do these laws differ from country to country, they do not take into account the international nature of the contract. The ICC Model Commercial Agency Contract provides a thought-out and truly flexible alternative solution. To assist business people engaged in international trade and using uniform contractual rules, and not based on any specific national law, the model incorporates prevailing practice in international trade as well as the principles generally recognized by the domestic laws on agency. Commercial agency agreements are the simplest and probably most frequently used means of organizing the distribution of goods in a foreign country. Almost every company engaged in international trade has at least some agents abroad. Most exporters (whether large or small) must therefore face the problem of drafting an international agency contract. To assist business people engaged in international trade (and the lawyers aiding them in drafting and negotiating contracts), ICC drew up the model contract on international commercial agency in 1991. It was the first of a successful series of model contracts that now cover almost all types of agreements relating to distribution. Ten years on, the model contract has been updated, taking account of recent developments in the law of agency and also to ensure that the contract is in harmony with the other ICC model contracts.

ICC Model of International Franchise Contract

International franchising has been seriously hampered by laws and regulations which differ from country to country. In this context, the ICC Model International Franchising Contract provides franchisors and franchisees with a uniform framework for agreement within which their rights and responsibilities can be protected . The ICC Model Contract strikes a fair balance between the interests of the franchisor and franchisee and proposes to candidate franchisors and franchisees flexible drafting solutions that accurately respond to business needs for legal certainty and compliance with common practice.

In doing so, the Contract:

Takes into account the most commonly used clauses in franchise agreements;

- Suggests alternative clauses where no single solution is possible;
- Allows the parties to insert their own requirements on certain points;
- Provides annexes which the parties can modify without changing the basic text of the agreement;
- Provides a system to resolve disputes; and
- Includes a detailed commentary explaining the various provisions

Franchising has proved over many years to be an extremely successful commercial vehicle for the distribution of products and services, making a considerable contribution to growth in business sectors that use this type of distribution channel. However, there have long been doubts about the feasibility of introducing a simple and user-friendly model contract that would reflect the diversity of franchising contracts and would encourage users to choose this type of contractual agreement.

The ICC Model International Franchising Contract clearly demonstrates that a franchising agreement, like agency, distributorship and intermediary agreements can usefully be expressed in a modal contract based on the most common clauses found in international franchise contracts. The ICC Model Franchise Contract proposes to candidate franchisors and franchisees flexible drafting solutions that accurately respond to business needs for legal certainty and compliance with common practice. For the sake of clarity and ease of use an explanatory commentary has been added to the contact, presenting alternative drafting solutions and identifying pitfalls.

This model contract is intended to apply to international direct franchises, which are a new and rapidly expanding franchising instrument. ICC's initiative supplements UNIDROIT's more traditional approach on drafting international franchise contracts, which takes the form of a comprehensive guide on master franchise arrangement. The contract meets a long-felt need, as has been confirmed by ICC's extensive consultation of all business sectors. The ICC Model International Franchise Contract is the result of many months of work carried out under the auspices of the ICC commission on International Commercial Practice.

MODULE III

AIRLINE

CONTRACTS

AVIATION INSURANCE CONTRACT

Aviation Insurance Contracts cover a number of very special risks which are of vital importance for the operation of air services. Generally, airlines especially hold so-called combined single limit insurance policies altogether covered up to

These policies are drawn up as a combination of several risks a certain single limit. In order to reduce the risks for the insurers, there are usually a number of primary insurers underwriting the policy- Since these insurers may be domiciled in a country or even in a number of countries which differ from the domicile or principal place of business of the airline, an aviation insurance contract frequently involves one or more foreign elements. Although none of the underwriters may be domiciled in England[5] and these policies are tailor-made for the individual needs of the respective airlines, it is common to refer to certain standard clauses as have been developed in the leading aviation insurance market of the world, London, and published in the *Handbook of Lloyd's Aviation Underwriters Association* ***(L.A. U.A.).*** These clauses contain e.g. inclusions or exclusions of certain risks.

To choose a rather simple example: **If** an airline in a (continental) European Union state X is insured with insurers domiciled in that same country, the policy is construed in the national language of state X, and the premiums are payable in the national currency, then the law governing the contract is likely to be the law of state X. If, how-ever, the contract refers to certain London standard clauses **by** mentioning only their "official" designation, such as e.g. **AVN-46** B[8], **will** these clauses then also be subject to the law of state X?

Or will the clauses, which are drawn up in English language and apply English legal notions, be subject to English law, which makes it necessary to split the proper law of the contract? This problem would have to be encountered not only if there is no ex-press choice of law in the contract (which is reported to happen unbelievably frequently'), but also in spite of the presence of such clause which might well relate merely to a part of the insurance contract.

As has been pointed out **by** aviation insurance law experts", the standard clauses are referred to because they have been developed and shaped over centuries of maritime and decades of aviation practice **by** insurers, ship and aircraft owners, and the English law courts. Thus even every comma in every single sentence is of significance as to the recognition and interpretation of the clauses. The standardization fosters stability, a vital feature when it comes to extensive risks such as rendering insurance coverage to an airline. Would the application of a continental European legal system to these clauses as shaped **by** English common law be appropriate?

IL. Ascertainment of the Applicable Law

At the outset, the law resolving the conflict of laws has to be ascertained.

At first, one looks at the Rome Convention **1980** on the Law Applicable to Contractual Obligations' as implemented **by** the forum state.

The Convention provides for the possibility of an *express* as well as of an *implied* choice of law **by** the parties (Art. **3).** Otherwise the applicable law will be determined as the law with which the contract has a closest relation (Art. 4). In both cases, sever-ability *(dipevage)* of the contract is possible, i.e. parts of the contract may be governed **by** a law different from the law applicable to the rest of the contract

The Convention in itself expressly excludes contracts of insurance with respect to risks located within European Union states from its scope (contracts of reinsurance, how-ever, are subject to the Convention), because insurance contracts were to be dealt with **by** special European legislation.
The *Second Non-Life (Insurance) Directive* fills this gap in that it provides for some limitations as to the choice of law for the sake of consumer protection. Where there is no social imbalance, i.e. so-called *"large risks"* are insured, however, "virtually unlimited freedom to choose the applicable" exists. Such *"large risks" are inter-alia* aircraft and liability for aircraft. Since the Directive does not contain an exhaustive set of rules governing the latter cases, one has to seek recourse to general provisions, which will usually mean to the *Rome Convention* as enacted in the respective states. English law, e.g., provides for a special reference to the implementing legislation with respect to the *Rome Convention,* preventing courts from accessing the formerly developed principles of common law.

Accordingly, the contract of insurance as to aviation risks in the given example is subject to the ordinary choice of law rules. As there is no express choice of law rule in the contract, the search for hints as to an implied choice, demonstrated with reasonable certainty, begins. In this given case, all circumstances" lead to the conclusion that the law of country X is to govern the policy; at least in general, because there is still the question whether the insurance contract can be **-** or even must be **-** severed with respect to the standard clauses.

III. Intention and Legal Admission with Respect to Depecage

The crucial question whether the contract may **be** severed involves two aspects, the first of which relates to the parties' intentions as to *Depecage* while the second deter-mines the extent as to which *Depecage* is legally admissible.

***1.** Dipegage Intended?*

The first question is one of factual findings, namely, is *Dipegage* intended **by** the parties involved? The concept of such severability of the contract is directly linked to the principle of private autonomy. **If** it is up to the parties to choose the applicable law, they may also choose different legal systems to govern different parts of the contract.
There is, however, a slight difference between an express choice or a choice which is "demonstrated with reasonable certainty **by** the terms of the contract or the circumstances of the case" (as says Art. **3 (1))** on the one hand, and a legal system which is imputed **by** ascertaining the closest connection to it (under Art. 4 **(1))** on the other hand. In the former case, the parties can select a law applicable even to a mere part of the contract if they like. **By** contrast, in the latter case the court may only **by** exception apply a different legal system to a severable part of the contract if that part has a closer connection with it (constituting an objective test).
It has frequently been stated that the distinction between an implied choice and a closest relation test is difficult to define. *Kegel* characterizes inferred implied choices as "caoutchouc", others find it "misleading"· Similarly, the Supreme Court of Canada abandoned the "legal fiction of presumed intention" in favor of an objective closest relation test.
In general, it seems that for the purposes of deciding whether to split the contract at issue or not, three categories are possible: **(1)** explicit choice **by** the parties **-** (2) tacit choice **by** the parties as demonstrated **by** the circumstances **- (3)** otherwise: objective test of the closest relationship. Apparently, the less explicitly the choice is expressed, the more exceptionally the court should have recourse to severance.
In the case given above, the law of state X governs the contract. The reference to the standard clauses is made in order to take advantage of a traditional and reliable practice in the insurance market and its reflections in jurisprudence. In order to avoid unintended mistakes, a policy would usually refer only to the name of the clause (e.g. **AVN-46** B), instead of spelling it out.
Since there exists no translation of the standard clause that is referred to in the con-tract, the parties make the clauses part of their contract in the English wording of the clauses. In addition, in order to benefit from the stability of the legal interpretation of these clauses, the parties would certainly not want a court in state X to attempt an interpretation which would require a translation of the original text and the legal notions. This translation would have to substitute common law notions with terms of continental European civil law, a task whose solution, some may consider, should be kept as Heaven's secret.
Therefore, it appears that the English standard clauses are intended to be governed **by** English law.
2. Dopegage *Admitted?*
The second question addresses to what extent *dipegage* is admissible.
In general, *dipegage* is considered as less desirable because it does not foster oversight.
The *Giuliano-LagardeReport* on the *Rome Convention* suggests that only so called "complex contracts' may be severed as to different types of agreements (e.g. joint venture agreements). *Lando* mentions a contract which is at the same time a sale of goods and a distributor agreement as to *dipefage25* under the *Rome Convention. Dicey and Morris* find that where an issue relating to "the general obligation" of the contract arises, such as e.g. frustration, severance would be "wholly

inappropriate”. In **1961** *Raape* stated more generally: **"A** legal *pot-pourri,* put together **by** the parties *ad libitum* is not tolerable."
*Kahn-Freund*also agrees that "no contractual obligation can exist in more than one system, simultaneously or consecutively".
A well known dictum **by** *Lord MaKDermott* seems to reflect the tendency of the courts in general:

> "Though there is no authority binding your Lordships to the view that there can **be** but one proper law in respect of any given contract, it is doubtless true to say that the courts of this country will not split the contract in this sense readily or without good reason."

Sometimes, however, the **term** *"multiplicity of the proper law"* is mentioned in English jurisprudence. But it usually refers to the phenomenon that the mode of performance is governed **by** a law different from that governing the obligation[30], as pointed out **by** the **C.A.** *Injakobs v. Cridit Lyonnais* **(1884)** and already **by** *Dicey on Conflicts* in the First Edition of **189631.**

Nevertheless, in *Savigny's Treatise on the Conflict of Laws* of 1849, where he promotes his famous *situs theory,* it is submitted that the obligations of the two parties to a con-tract may well be subject to different legal systems, and the leading German commentary on private law observes in its current edition that opinions are split equally as to whether the different obligations arising under a contract can be subject to the government of different legal systems.
In the only case example, the High Court of England at that time still applying common law **-** held that the proper law of **a** reinsurance contract was English law. An ascertainment of the parties' true contractual intentions, however, leads the court to the conclusion that the parties had selected Norwegian law to apply to that part of the contract dealing with the insured's breach of warranty. The decision was subsequently affirmed **by** the House of Lords.
Apparently, there is a tendency, departing from a formerly more strict approach, **by** the courts to *subject* at least parts of tailor-made complex contracts to different **legal** systems, if pertinent to the interests of the parties.
In the light of this perspective, it can be expected that the airline insurance contract given in the example at the beginning will be subject to *dipepage:* The law of state X governs the policy as it is drawn up in the national language, while the English standard clauses can most appropriately only be dealt with under English law.

IV. Additional Requirements

The courts of that given state **X,** however, will apply English law to any extent only if the underlying principle is recognized, that the parties can also choose a legal system to govern their contract, to which the factual circumstances do not have any contact. In English law, this has been recognized since the Privy Council's decision in *Vita Food Products v. Unus Shipping* of **193936.** It is assumed that limitations as to the choice of law in the different systems serve the purpose of consumer protection *(evasion; fraude* a *loi; fraus legis),* which is a purpose that is of no relevance in the case of airline or aircraft manufacturer insurances. In any event, the *Rome Convention* does not prohibit choosing a law that has no relation to the contract, not even in purely domestic cases.

V. Scope of Application of the Applicable Law(s)

It may be worth noting that the *Rome Convention **1980*** also provides a guideline as to the scope of the applicable law governing the obligations. Art. **10** provide that the applicable law extends to the interpretation, the performance, the breach of contract, the extinguishing of obligations and the limitation of actions, and the consequences of nullity of the contract. Therefore, the application of English law as to the standard clauses also and especially embraces the application of English legal interpretation to these clauses.

Thus the conclusion is arrived at, that airline insurance policies, and certainly aviation insurance policies in general, which refer to the standard clauses as developed and used in the London insurance market, are subject to *dipegage:* Even though such policies may be governed **by** a legal system different from the English, English law is likely to be held applicable with respect to the standard clauses in order to maintain the parties' expectations as to the stability in interpretation of these clauses.

AIRLINE LEASE AGREEMENT

Airline leases, as one might imagine, are prevalent at many airports and take on a variety of forms. Lease agreements (also referred to as operating permits, use agreements, or licenses in some circumstances) will reflect the financial policy and rate-setting methodology of the airport. An airport’s rate-setting policy/methodology will consider the various types of spaces that an airline will need to lease, how rental rates are calculated, and the allocation of costs associated with operating those spaces.

Airlines traditionally lease their core operating spaces, such as ticket counters, boarding gates, and office/operations areas, on an exclusive or preferential basis, ensuring that they have the facilities necessary to meet the operational needs of their flight schedule. Other spaces, such as baggage claim and bag-gage make-up areas, are routinely leased on a joint or common use basis. Common use facilities, however, are becoming more widespread. An airline may consider leasing boarding gates and even ticket counter spaces in a shared arrangement, especially in situations where they have a limited number of flights and cannot justify the cost of leasing on an exclusive or preferential basis. Airlines just entering a market with a reduced schedule or international carriers that offer reduced frequency are examples of when common use applications might be desirable.

Aside from passenger terminals, an airline may be one of several tenants in other multitenant facilities such as cargo buildings or ground support equipment buildings. In the passenger terminal scenario, the airline lease should address the allocation of terminal space costs that are not directly leased to the airline, such as mechanical and utility rooms, and public areas such as ticketing lobbies, restrooms, and hallways. In the instance of a multitenant facility other than a passenger terminal, attention should be given to shared interior spaces such as vestibules and access hallways, and shared exterior facilities such as automobile parking and airside access. Allocation of these common area costs should always meet the unique attributes and needs of a given situation and be equitable to the parties affected. Allocation of these costs should be addressed within the rate-setting methodology.

Even within a multitenant facility, such as in the case of a passenger terminal environment, an airline may lease several different areas and/or types of facilities. For example, the airline may rent ticket counter and office space in the ticketing area of the terminal, which likely has a different rental rate associated with it than baggage make-up areas and operational spaces. In the gate area, the airline may have yet another arrangement for gate podiums and/or the use of passenger boarding bridges that have their own unique set of rates and charges.

Two rate-setting philosophies are prevalent within the industry. The compensatory model is an approach that gives the airport sponsor autonomy in setting its fees and charges. Compensatory terminal rents may be calculated on the gross terminal space minus mechanical spaces, or the total rentable space within the terminal, to include airline spaces. It may be based on some other variation, but the compensatory model typically allows the airport to retain revenues that exceed expenses. This model also places the burden of any revenue shortfall on the airport sponsor.

The second model is the residual model (sometimes referred to as the cost approach), which routinely includes a majority-in-interest airline's review of the forecast costs to be considered in the rate-setting exercise and generally places the airport sponsor in a revenue neutral position. Because the residual approach tends to focus on a break-even scenario, with appropriate reserves, both excesses and deficiencies in revenue collection generally carry from one year to the next. The cash position of the airport may, therefore, be limited in this model. Table 1 contrasts the two rate-setting approaches and highlights the attributes of each.

An airport may choose to employ a hybrid of these two approaches, as well. For example, a residual approach might be applied to airfield costs in the calculation of landing fees, while a compensatory approach might be used in setting terminal rents; or a compensatory approach may be chosen for the entire airport, with credits given for certain revenue such as terminal con-cessions to help reduce airline costs. Hybrid approaches are limited only by the imagination; the rate-setting approach, whether it's compensatory, residual, or a hybrid thereof should ultimately meet the needs and goals of a specific airport and its unique mix of airlines and tenants.

Landing fees and fuel flowage fees within an airport's schedule of rates and charges also play a role in airline leases and use agreements. The matrix of fees that an airline pays at any given airport can be quite complex and cover a broad range of real estate types. Ultimately, one of the metrics an airline uses to measure an airport is the total cost, per passenger, that the airline must pay in rents, fees, and charges to do business. This is then compared against other airports of similar size and against the market yield the airline is able to obtain.

An airline may also occupy single-use airport developments that have the same lease attributes as any other single-tenant facility. This is especially true at airports where the airline has the level of activity and presence to support a stand-alone airport development such as a maintenance operation or its own cargo facility

Table 1. Rate-setting models: compensatory versus residual.

	Compensatory Model	**Residual Model**
Typical Application	Airports with positive cash flow and relatively high levels of liquidity/discretionary cash on hand **or** airports that require subsidy from an outside agency	Airports with consistent levels of operations and who are willing to trade cash-on-hand to reduce the fees and charges that airlines must pay
Party That Assumes the Majority of the Financial Risk	Airport—the airport sponsor bears the short-term financial risk and is more exposed to financial and economic downturns.	Airline—the airport sponsor recovers "net costs" of the airport's operations through fees and charges paid by the airlines.
Advantages (from airport sponsor's perspective)	The airport sponsor retains all of the benefits derived from Non-aeronautical revenues and airlines receive no direct benefit from this revenue source (thereby incentivizing the airport to pursue Non aviation revenue). The airlines have limited control over capital projects, and the airport sponsor has the ability to maintain relatively stronger operating and debt coverage ratios.	The airlines guarantee the financial soundness of the airport and share in the risk of financial and economic Down turns.
Disadvantages (from airport sponsor's perspective)	The airline pays only for the facilities it uses and does not take part in sharing all of the airline-related costs of the airport.	Non aeronautical revenues are credited toward the airline's rate base and the airlines pay fees and charges based on net costs after non aeronautical revenues are subtracted. The airport sponsor has less incentive to maximize Non aeronautical revenues, and the airport generally has less liquidity/discretionary cash, which can result in a weaker balance sheet and a higher cost of capital.

While neither airline use agreements nor rate-setting methodologies are the subject of this Guidebook, they both represent a component of the complex issue of airline compensation to the airport sponsor, and correlate directly to the subject of leasing and developing airport property. Ultimately, airline leases represent one small piece of this complex puzzle and contain many of the same elements as any other airport lease. For a more comprehensive discussion of this subject, the reader is encouraged to review ACRP Report 36: Airport/Airline Agreements—Practices and Characteristics.

AIRLINE PURCHASE AND SALES AGREEMENT

Buying an aircraft is an important investment and the many aspects of aircraft ownership should be seriously considered before signing on the dotted line. AOPA is committed to making the purchase and ownership of your aircraft as rewarding as possible. This subject report will present those topics that should be considered when purchasing a used aircraft. For example, the pre-purchase inspection is a very important and often over looked precaution when deciding whether to purchase an aircraft. Many aircraft have underlying flaws that would cost thousands of dollars to correct, which are found by doing a pre-purchase inspection. Prospective buyers can ask the current aircraft owner to correct them, or negotiate new price. Another thing to consider is time between overhaul (TBO). For the sake of example, consider you are purchasing a 1977 C-172N for $40,000. The TBO for this aircraft is typically 2000 hours, and costs roughly $20,000; or half the value of the aircraft. If the aircraft you are considering buying has 1800 hours on the engine, you need to expect to spend an additional $20,000 on the aircraft in your first 200 hours of ownership. Knowing this, it would be in your best interest to negotiate a lower price for the aircraft. This subject report will walk you through the process of buying a used aircraft and focus on the important things to consider before you accept the deal.

The purchase of an aircraft is a major commitment that should be carefully considered. This is especially important when buying a used aircraft. AOPA recommends a buyer take the following steps before seriously considering a purchase. Verification should be done for the aircraft under consideration. This will allow the buyer to see if the aircraft is priced reasonably. In addition, have a pre-purchase inspection completed; this will help avoid any surprises. Verify that parts can be obtained for the aircraft, and that local mechanics can work on it. Always fly the aircraft before you buy; this is the most straightforward way to get a good feel for whether the aircraft is a good fit for you. Thoroughly examine aircraft records and engine logs, looking for unusual entries. If you see an entry for “Replaced sections of fuselage skin” you should be suspicious of a gear-up landing.

One of the most common mistakes in purchasing an aircraft is to buy impulsively without fully considering the effects of your decision. Take the time to analyze your requirements carefully and be realistic. Consider the typical flight loading, trip distance and conditions of flight, then compare aircraft. To avoid the trap of buying more than you need or can use, ask yourself if you really need all the fancy bells and whistles. If possible, rent the type of aircraft you are interested in to get a feel for how well it will meet your requirements.

TECHNICAL INFORMATION

Financing

The amount you borrow will have substantial impact on the total cost of your purchase; therefore, it pays to put some effort into finding the right source of financing. Interest rates on aircraft can vary widely and may reflect a bank's knowledge, or lack of knowledge, about the subject.

Valuation Factors:

Do you know the major factors that affect resale value? Generally speaking they are:

- **Engine hours** — perhaps the most common influence on resale value. The closer an engine is to its recommended time between overhaul (TBO), the less its value. Equally important is a record of consistent use coupled with a good maintenance program. Regular use helps keep seals and other engine components lubricated and in good shape.
- **Installed equipment** — such as avionics, air conditioning, deicing gear and interior equipment. The big item here is usually avionics that can easily double the value of some older aircraft. Also, older equipment is generally more expensive to maintain.
- **Airworthiness Directives** —ADs are issued by the FAA for safety reasons and are a fact of life for most every aircraft. Once issued, owners are required to comply with the AD within the time period allotted. It's important to look at the AD history of an aircraft. Check the nature of the ADs and whether they are recurring or one-time compliance. Make sure the logbooks show compliance with all applicable ADs.
- **Damage history** — major repairs can affect the value of an aircraft significantly, but may be hard to pin down. A damage history will decrease the value of an aircraft, depending on the type of accident, nature of the damage and the degree to which major components have been involved. Any aircraft with a damage history should be closely scrutinized to make sure it has been properly repaired in accordance with the applicable FAA regulations and recommended practices.
- **Paint/interior** — used on occasion to give "tired" aircraft a quick facelift. Check new paint jobs carefully for evidence of corrosion under the surface. Interior items should be checked for proper fit and condition. Done properly, both items enhance the value of the aircraft.

Overhauls

Be careful of the terminology used to describe engine condition. A top overhaul involves the repair of engine components outside of the crankcase. A major overhaul involves the complete disassembly, inspection, repair and reassembly of an engine to specified limits. If an engine has had a top or major overhaul, the logbooks must still show the total time on the engine, if known, and its prior maintenance history.

A "zero-time" engine is one that has been overhauled to factory new limits by the original manufacturer and is issued a new logbook without previous operating history. As a general rule, an aircraft with a "zero-time" engine has more value than the same aircraft with an overhauled engine.

Fly Before You Buy

It is always a good idea to fly the aircraft before you make your final decision. During the flight, carefully check all equipment and systems to determine if they are fully functioning.

Pre-Purchase Inspection

Before buying, have a mechanic you trust give the aircraft a thorough inspection and provide you with a written report of its condition. A pre-purchase inspection should include at least a differential compression check on each cylinder of the engine and any other inspections necessary to determine the condition of the aircraft. In addition to a mechanical inspection, the aircraft logbooks and other records should be carefully reviewed for such things as FAA Form 337 (Report of Major Repair or Alteration), AD compliance, the status of service bulletins and letters, and aircraft/component serial numbers. Ideally, the mechanic you select to do the inspection should have experience and be familiar with the problems that may be encountered on that type of aircraft.

Title/Ownership/Liens

Have an aircraft title search done. Don't make the mistake of finding out about a lien after you've purchased the aircraft. Title searches and related services are available through Aircraft Title and Escrow Service.

Title Protection

Consider the protection afforded to you by the title insurance. For a nominal fee you can protect yourself from surprise claims against your aircraft's title.

Sales Contract

Once you have decided to buy a particular aircraft, put the terms and conditions of the agreement in writing. This is for the protection of both parties since it is often difficult to enforce verbal contracts. The agreement need not be complicated, but it should clearly state the intentions of the parties and cover any warranties made by the seller. Since state laws govern the interpretation of commercial agreements, we recommend that your contract be drafted with the assistance of a local attorney.

Aircraft Records

Make sure the following documents are available and in proper order for the aircraft: Airworthiness certificate, engine and airframe logbooks, aircraft equipment list, weight and balance data, placards, and FAA-approved aircraft flight manual or owner's handbook. Missing documents, pages or entries from aircraft logbooks may cause significant problems for the purchaser and reduce the value of the aircraft.

Unusual/Exotic Aircraft

Generally, the more unique the aircraft, the more unique the problems. Out-of-production aircraft may cause difficulties because of parts shortages or unusual design features. Check on parts availability and product support for any older model you may be considering. In the case of a homebuilt, keep in mind that you are buying an experimental aircraft that has been handcrafted. You may find some mechanics reluctant or unwilling to perform maintenance on such aircraft because of their unfamiliarity with the design and construction, or because of liability concerns.

Insurance

Seek the help of an experienced aviation underwriter when determining what coverage you need. Check on hull rates before you buy so you won't be surprised. Some aircraft are insurable only at very high rates because of age or other factors. Avoid the trap of either over-insuring or under-insuring. Each has its unique problems that can be handled by securing the proper amount of coverage appropriate to the risk. An experienced underwriter or agent will be knowledgeable about any minimum insurance requirements that may be mandatory in your state. When shopping for insurance compare coverage, not just premium cost. Check on the reputation of any insurance company you intend to do business with. Ask for a sample policy and read it carefully so you can compare features.

State Registration

Determine whether you will need to register your aircraft with the state. Some states have registration requirements and impose a fee based on aircraft type, age, value or weight. In some instances this fee is in lieu of personal property taxes. State registries are listed online.

Taxes

Determine what state sales or use tax might apply to your purchase.

Final Inspection

Visually inspect the aircraft prior to taking possession to assure yourself that no damage has occurred since the pre-purchase inspection and that all contract conditions have been fulfilled. Also, make sure the necessary documents as required in FAR 91.419 are transferred with the aircraft at the time of sale.

Bill of Sale

Have the seller execute a Bill of Sale, FAA Form 8050-2 according to the instructions provided. Make sure that the seller signs his or her name, in ink, as it appeared on the previous Bill of Sale.

Aircraft Registration

Execute an Aircraft Registration Application, FAA Form 8050-1, and submit this, along with the Bill of Sale and a $5 recording fee, to the FAA.

The Aircraft Registration Application, AC Form 8050-1, is not available for download. You must use an original Aircraft Registration Application, AC Form 8050-1. FAA will not accept photocopies or computer-generated copies of this form. Aircraft Registration Applications may be obtained from the Aircraft Registration Branch or your local FAA Flight Standards District Office (FSDO). Your application for aircraft registration must include the typed or printed name of each signer in the signature block. FAA will return any applications that do not include the printed or typed name of the signer.

The pink copy of your Registration should be retained and placed in the aircraft as a temporary registration certificate. It is valid for flight within the United States for 90 days. At the same time, submit any necessary state registration forms and fees to the appropriate state office.

Following is a sample **Aircraft Sale and Purchase Agreement**

THIS AGREEMENT, is entered into this _______ day of ________________, _______, by and between ____________________, (the "Buyer"), a(n) __________ (individual(s), corporation, partnership, or LLC) whose principal address is _____________________ ________________________________; and _____________________ (the "Seller"), a(n) _______________ (individual(s), corporation, partnership, or LLC) whose principal address is ____:

IN WITNESS WHEREOF, in consideration of the premises, the mutual covenants contained herein, and other good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties do hereby agree as follows:

1. Sale of Aircraft. Seller agrees to sell to Buyer and Buyer agrees to purchase from Seller the following Aircraft (the "Aircraft"):

Aircraft Make _______________________________________

Aircraft Model ______________________________________

Aircraft Year _______________________

Aircraft Registration Number ___________________

Aircraft Serial Number ________________________________

Aircraft shall be equipped as follows ____

____

____
____

Seller warrants that Seller holds legal title to the Aircraft and that title will be transferred to Buyer free and clear of any liens, claims, charges, or encumbrances. Upon delivery of the Aircraft and payment of the balance of the purchase price, in accordance with this Agreement, Seller shall execute a bill of sale granting good and marketable title to the Aircraft.

2. Consideration. It is agreed that the price of the Aircraft is ________________ Dollars ($____________) and is due on delivery of the Aircraft. All monies paid in accordance with this Agreement will be made by cash, cashier's check, certified check, wire transfer, or equivalent.

3. Escrow. It is agreed that within ________(_____) business days after execution of this agreement an escrow account will be established with escrow agent [*at Buyer's sole discretion*] [*at Seller's sole discretion*] [*agreeable to both parties*]. All funds, including the deposit, and the following documents pertaining to this transaction, shall be transmitted through the escrow account: (a) Bill of sale for the Aircraft from Seller to Buyer; and (b) Application for Registration of the Aircraft to Buyer. The fees for the escrow service shall be [*paid by the Buyer*] [*paid by the Seller*] [*split evenly between Buyer and Seller*].

4. Deposit. The Buyer shall pay a deposit of _________________Dollars ($__________) in to the escrow account immediately upon the establishment of that account. The deposit is [*non-refundable unless otherwise stipulated in this agreement*] [*fully refundable to Buyer except as otherwise stipulated herein*]. The deposit shall be credited to the purchase price of the Aircraft.

5. Pre-purchase Inspection. After the signing of this Agreement and the payment of the deposit into escrow, the Buyer shall have the right to perform a pre-purchase inspection of the Aircraft. Such inspection shall be at the Buyer's expense and may be performed by a individual(s) of Buyer's choice, so long as he/she/they hold current Airframe and Powerplant mechanic certificates issued by the Federal Aviation Administration. The inspection shall be performed at ______________ Airport.

Alternate clauses for this section:

[*If the Buyer does not perform or have this inspection performed within ________ (_____) days of the signing of this Agreement, then Buyer shall be deemed to have waived his/her/its right to such inspection*].

[*Upon completion of this inspection, Buyer shall have ________ (______) days to notify Seller that he/she/they will not purchase the Aircraft. If Buyer elects not to purchase the Aircraft, the Buyer shall notify Seller in writing of this decision. Upon receipt of such notice, Seller shall return, or have returned, within ________ (______) days, to Buyer all payments made by Buyer, except for the deposit*].

[*Upon completion of this inspection, Buyer shall present to the Seller any list of discrepancies* *compiled. The Seller shall have ________ (______) business days to review the list and to notify the Buyer of Seller's decision: (a) to pay to have the [discrepancies] [discrepancies affecting the airworthiness of the Aircraft] repaired at Seller's expense and to complete the sale; or (b) to decline to pay the costs of repairs and to terminate the Agreement. If Seller declines to pay the cost of repairs, Seller shall refund, or have refunded, the Buyer's deposit and shall reimburse the Buyer for the cost of the pre-purchase inspection*].

6. Aircraft Delivery. It is agreed that the Aircraft and its logbooks shall be delivered on ______________(date) at ___________ Airport. Payment in full, as described above, is a condition of delivery. Title and risk of loss or damage to the Aircraft shall pass to Buyer at the time of delivery. The Aircraft will be delivered to Buyer in its present condition, normal wear and tear excepted, with a valid FAA Certificate of Airworthiness.

7. Warranties. *Alternative clauses for this section*:

[*Except as provided otherwise in this agreement, this Aircraft is sold "as is." There are no warranties, either express or implied with respect to merchantability or fitness applicable to the Aircraft or any equipment applicable thereto including warranties as to the accuracy of the Aircraft's logbooks, made by Seller. Buyer agrees that no warranty has been expressed or implied by Seller and that Buyer has inspected the Aircraft and understands that it is being purchased "as is." Buyer hereby expressly waives any claim for incidental or consequential damages, including damages resulting in personal injury against Seller*].

[*Seller warrants that: (a) the Aircraft is in airworthy condition; (b) the Aircraft has a current annual inspection; (c) the Aircraft has a currently effective Standard Category airworthiness certificate issued by the Federal Aviation Administration; (d) all of the Aircraft's logbooks are accurate and current; (e) all applicable Airworthiness Directives have been complied with; (f)* ________________________].

8. Seller's Inability to Perform.

(a) If the Aircraft is destroyed or in Seller's opinion damaged beyond repair, or is seized by the United States Government, Seller shall promptly notify Buyer. On receipt of such notification, this Agreement will be terminated and the Seller shall return to Buyer all payments made in accordance with this Agreement, and Seller will be relieved of any obligation to replace or repair the Aircraft.

(b) Seller will not be responsible or deemed to be in default for delays in performance of this Agreement due to causes beyond Seller's control and not caused by Seller's fault or negligence.

9. Buyer's Inability to Perform. If, for any reason, the Buyer is unable to pay the purchase price of the Aircraft, as specified in this Agreement, the Seller shall return all payments to the Buyer except for the deposit.

10. Taxes. The Buyer shall pay any sales or use tax imposed by a state or local government, which results from the sale of the Aircraft.

11. Assignment. This Agreement may not be transferred or assigned without written authorization signed by Seller and Buyer.

12. Notice. All notices and requests required or authorized under this Agreement shall be given in writing by certified mail, return receipt requested. The date on which any such notice is received by the addressee shall be deemed the date of notice.

13. Governing Law. This Agreement is a contract executed under and to be construed under the laws of the State of ____________________________.

14. Attorney Fees. In the event any action is filed in relation to this Agreement, [*the unsuccessful party in the action shall pay to the successful party a reasonable sum for the successful party's attorney's fees*] [*each party shall be responsible for his/her/its own attorney's fees*].

15. Waiver. Either party's failure to enforce any provision of this Agreement against the other party shall not be construed as a waiver thereof so as to excuse the other party from future performance of that provision or any other provision.

16. Severability. The invalidity of any portion of the Agreement shall not affect the validity of the remaining portions thereof.

17. Paragraph Headings. The headings to the paragraphs to this Agreement are solely for convenience and have no substantive effect on the Agreement nor are they to aid in the interpretation of the Agreement.

18. Entire Agreement. This Agreement constitutes the entire Agreement between the parties. No statements, promises, or inducements made by any party to this Agreement, or any agent or employees of either party, which are not contained in this written contract shall be valid or binding. This Agreement may not be enlarged, modified, or altered except in writing signed by the parties.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement the day and year first above written.

_________________________________ _________________________________

SELLER BUYER

CONTRACT OF CARRIAGE BY AIR

A contract of carriage is a contract between a carrier of goods or passengers and the consignor, consignee or passenger. Contracts of carriage typically define the rights, duties and liabilities of parties to the contract, addressing topics such as acts of God and including clauses such as force majeure. Among common carriers, they are usually evidenced by standard terms and conditions printed on the reverse of a ticket or carriage document.

In the case of passengers or their baggage, the contract is usually evidenced by the ticket issued to the passenger and in the case of air freight; the contract is usually evidenced by the air consignment note. The contract must then be considered to ascertain where, according to the contract, the place of departure and the place of destination are situated.

If the airport of departure and the airport of destination are each situate in the territory of a different country, each of the high contracting party to the Convention of Warsaw or the Convention of Warsaw as amended by The Hague Protocol, then the contract falls within one of the special categories of "international carriage" as defined by the Warsaw Convention or by the Warsaw Convention as amended by the Hague Protocol. According as whether the contract of carriage falls within the definition of "international carriage" as defined by the Convention of Warsaw or as defined by that Convention of Warsaw or as defined by that Convention as amended by the Hague Protocol, the provisions of the Convention of Warsaw or the Hague Protocol will apply to such carriage, provisions of that Convention as amended.

A contract for a round-trip from a place of departure within a country which is a high contracting party to the Convention of Warsaw and back to a place of destination within the same country but without an agreed (i.e. contemplated and pre-arranged) stopping place outside that country does not fall within any of the special categories of "international carriage" but is a contract of domestic carriage. If, however, the contract indicates that there is an agreed (i.e. contemplated and pre-arranged) stopping place outside the territory of that high contracting party, the contract does relate to one of the special categories of "international carriage" as defined (a).

If, according to the contract, the place of departure and the place of destination are both within the territory of the same high contracting party to the Convention of Warsaw as amended by the Hague Protocol and there is an agreed stopping place outside that country, then the contract relates to carriage which falls within the special categories of "international carriage" as defined by that Convention as amended by the Hague Protocol. If, however, there is no agreed stopping place then the contract is one of domestic carriage.

A few examples of some contracts of carriage by air which do and some which do not fall within the special categories of "international carriage" by air may prove of assistance.’

A contract of carriage for a one-way flight: Toronto/New York

The rules of the Warsaw Convention apply because Toronto is in the Dominion of Canada which is a high contracting party to the Convention of Warsaw as amended by the Hague Protocol and New York is in the United States of America which is a high contracting party to the Warsaw Convention and has not yet become a party to the Hague Protocol.

A contract of carriage for a return flight Toronto/New York/Toronto

This contract is subject to the rules of the Warsaw Convention as amended by the Hague Protocol because Toronto which is both the place of departure and the place of destination is situate within the Dominion of Canada which is a high contracting party to the Convention of Warsaw as amended by the Hague Protocol and there is an agreed stopping place outside the Dominion of Canada namely in New York.

A contract of carriage for a return flight-New York/Toronto/New York

This contract is subject to the rules of the Convention of Warsaw because both the place of departure and the place of destination, New York, are within the United States of America which is a high contracting party to the Warsaw Convention and is not a high contracting party to that Convention as amended by the Hague Protocol AND there is an agreed stopping place outside of the U.S.A. namely Toronto.

A contract of carriage for a one-way flight Toronto/Mexico City or Mexico City/Toronto

Either of these contracts of carriage is subject to the rules of the Warsaw Convention as amended by the Hague Protocol as the place of departure, whether Toronto or Mexico City, and the place of destination, whether Mexico City or Toronto, are situate within the territory of Canada or Mexico each of which is a high contracting party to the Warsaw Convention as amended by the Hague Protocol.

A contract of carriage for a one-way flight New York/Mexico City or Mexico City/New York

In either case, the contract of carriage is subject to the rules of the Warsaw Convention because New York is in the territory of the U.S.A. which is a high contracting party to the Warsaw Convention simplifier whereas Mexico City is a high contracting party to the Warsaw Convention as amended by the Hague Protocol.

A contract of carriage for a one-way flight Toronto/Vienna

This contract does not come within any of the special categories of international carriage as the Republic of Austria is not a high contracting party to the Convention of Warsaw and of course, without having become a high contracting party to the Convention of Warsaw, Austria cannot be a party to the Hague Protocol. The law applicable to that carriage will therefore have to be determined in accordance with the ordinary rules of private international law and is unaffected by the Warsaw Convention or the Hague Protocol.

A contract of carriage for a round-trip-Toronto/Vienna/Toronto

As in the case of any round trip, starting from a destination in Canada and having an agreed stopping place outside of Canada, this contract is subject to the rules of the Warsaw Convention as amended by the Hague Protocol since the place of departure and the place of destination, Toronto, are each situate within Canada which is a high contracting party to the Warsaw Convention as amended by the Hague Protocol and Vienna is an agreed stopping place outside of Canada.

A contract of carriage for a round-trip Vienna/Toronto/Vienna

This contract of carriage does not fall within any of the special categories of "international carriage" as defined by the Convention of Warsaw or by the Convention of Warsaw as amended by the Hague Protocol because the place of departure and the place of destination, namely Vienna, is situate in the Republic of Austria which is not a high contracting party to the Warsaw Convention nor of course, is it affected by the Hague Protocol.

A contract of carriage for a one-way trip New York/Honolulu with an agreed stopping place in Chicago and San Francisco, but with no agreed stopping place outside of U.S. territory.

This is a contract of U.S. domestic carriage by air. In determining the place of departure and the place of destination in cases where the services of more than one air carrier are used, the test is whether "the parties"- presumably the parties to the contract - regarded the carriage as "a single operation". If they did so regard it then the whole carriage is "deemed . . . to be one undivided carriage". This is so even if in form there is a series of contracts (e).Following is a **illustration of Contract of Carriage of Air India:**

Article 1 - DEFINITIONS
"AGREED STOPPING PLACES" means those places, except the place of departure and the place of destination, set forth in the ticket or shown in Carrier's timetables as scheduled stopping places on the passenger's route.
"BAGGAGE" means such articles, effects and other personal property of passenger as are necessary or appropriate for wear; use comfort or convenience in connection with the trip and such other items as can be conveniently carried with the passenger on such trip and are accepted by the Carrier for carriage. Unless otherwise specified it includes both checked and unchecked baggage of the passenger.
"BAGGAGE CHECK" means those portions of the Ticket which relate to the carriage of the passenger's checked baggage.
"BAGGAGE IDENTIFICATION TAG" means a document issued by Carrier solely for identification of checked baggage.
"CARRIER" includes the air Carrier issuing the ticket and all air Carriers that carry or undertake to carry the passenger and/or his baggage hereunder.

"CARRIER'S REGULATIONS" means rules, other than these Conditions as may be laid down by the Carrier and for the time being in force, governing carriage of passengers and/or baggage and shall include the Conditions of Contract as incorporated in the ticket and any applicable tariffs in force.
"CHECKED BAGGAGE" means baggage of which Carrier takes sole custody and for which Carrier has issued a

baggage check.
“COMMERCIAL AGREEMENT” means an agreement, other than an agency agreement, made between Carriers and relating to the provision of their joint services for carriage of passengers by air
"CONJUNCTION TICKET" means a ticket issued to a passenger in conjunction with another ticket which together constitute a single contract of carriage.
"CONVENTION" means the Convention for the Unification of certain Rules relating to International Carriage by Air signed at Montreal on May 28,1999 or Warsaw on October 12, 1929, or the said Convention as amended by the Hague Protocol of 1955, whichever may be applicable to the carriage under the Contract of Carriage.
"DAMAGE" means death, injury, delay, loss or other damage arising during the course of carriage by air performed by the Carrier or during the course of any of the operations of embarking or disembarking.
"DAYS" means calendar days, including all seven days of the week, provided that, for the purpose of notification, the day upon which notice is despatched shall not be counted; and that for purposes of determining duration of validity the day upon which the ticket is issued, or flight commenced, shall not be counted.
“ELECTRONIC COUPONS” means an electronic Flight Coupons or other value document held in Carrier’s database.
“ELECTRONIC TICKET” means the itinerary/receipt issued by or on behalf of Carrier, the electronic coupons and, if applicable, a boarding document”
"FLIGHT COUPON" means that portion of the ticket that bears the notation "good for passage" and indicates the particular places between which passenger is entitled to be carried.
“ITINERARY/RECEIPT” means a document or documents forming part of the Electronic Ticket which contains the information and notices required under the Convention as otherwise required.
"PASSENGER" means any person, except members of the crew, carried or to be carried in an aircraft with the consent of Carrier.
"PASSENGER COUPON" or "PASSENGER RECEIPT" means that portion of the ticket issued by or on behalf of Carrier, which is so marked and which ultimately is to be retained by the passenger.
“PRINCIPAL AND PERMANENT RESIDENCE” means the one fixed and permanent abode of the passenger at the time of the accident. The nationality of the passenger shall not be the determining factor in this regard.
"STOPOVER" means a deliberate interruption of a journey by the passenger, at a point between the place of departure and the place of destination, which has been agreed to in advance by Carrier.
"TICKET" means the document entitled "Passenger Ticker and Baggage Check" issued by or on behalf of Carrier and includes the Conditions of Contract and notices and the flight and passenger coupons contained therein.
"UNCHECKED BAGGAGE" means any baggage of the passenger other than checked baggage.
"SPECIAL DRAWING RIGHTS" means Special Drawing Right as defined by the International Monetary Fund, to be converted into the national currency in accordance with the valuation applied by the International Monetary Fund.

Article 2 - APPLICABILITY

2.1 GENERAL

2.1.1 Except as provided in 2.2 to 2.5, these Conditions of Carriage apply to all carriage by air, whether international carriage or carriage which is not international, of passengers and baggage, performed by Carrier for reward.

2.1.2 These Conditions also apply to gratuitous and reduced fare carriage except to the extent that Carrier has provided otherwise in its Regulations or in the relevant contracts, passes or tickets.

2.1.3 In regard to carriage by air in which is international, the rules and limitations relating to liability by the Convention as embodied in the Indian Carriage by Air Act, 1972 as amended vide act No. 28 of 2009, dated 20/03/2009, shall apply.

2.1.4 In regard to carriage by air which is not international, the rules and limitations relating to liability as specified by Notifications issued from time to time under Section 8 of the Indian Carriage by Air Act, 1972, shall apply.

2.2 CARRIAGE TO/ FROM USA AND CANADA

2.2.1 Carriage to/from Canada

These Conditions apply to carriage between places in Canada or between a place in Canada and any place outside thereof, only to the extent they are incorporated in tariffs in force in Canada.

2.2.2 Carriage to/from USA

These Conditions do not apply to air transportation as defined in the U.S. Federal Aviation Act of 1958.

2.3 CHARTERS

If Carriage is performed pursuant to a charter agreement these conditions apply only to the extent they are incorporated by reference by the terms of the charter agreement and the charter ticket.

2.4 OVERRIDING LAW

To the extent that any provision contained or referred herein is contrary to anything contained in the Convention where applicable and any applicable laws, government regulations, orders or requirements that cannot be waived by agreement of the parties, such provision shall not apply. The invalidity of any provision shall not affect the validity of any other provision.

2.5 CONDITIONS PREVAIL OVER REGULATIONS

Except provided herein, in the event of inconsistency between these Conditions and Carrier's regulations, these Conditions shall prevail, except where tariffs in force in the United States or Canada apply, in which case the tariffs shall prevail.

Article 3 - TICKETS

3.1 TICKET PRIMA FACIE EVIDENCE OF CONTRACT

3.1.1 The ticket constitutes prima facie evidence of the contract of carriage between Carrier and the passenger named on the ticket. Carrier will provide carriage only to passenger holding such ticket, or holding, as proof of payment or part payment, any other Carrier document issued by Carrier or its authorised agent. The ticket is and remains at all times the property of the issuing Carrier. The Conditions of Contract contained in the ticket are a summary of some of the provisions of these Conditions of Carriage.

3.1.2 Requirement for Ticket

Except in case of an electronic ticket, a person shall not be entitled to be carried on flight unless that person presents a ticket valid and duly issued in accordance with Carrier's Regulations and containing the flight coupon for that flight and all other unused flight coupons and the passenger coupon. A passenger shall furthermore not be entitled to be carried if the ticket presented is mutilated or if it has been altered otherwise than by Carrier or its authorised Agent. In case of an electronic ticket, a person shall not be entitled to be carried on a flight unless that person provides positive identification and has ticket valid and duly issued in accordance with Carriers's Regulation and contained in Carrier's database.

3.1.3 Loss, etc. of Ticket

In case of loss or mutilation of a ticket, or part thereof, or non-presentation of a ticket containing the passenger coupon and all unused flight coupons, the issuing Carrier may at the passenger's request, replace such ticket or part thereof by issuing a new ticket on receipt of proof satisfactory to Carrier that a ticket valid for the flights in question was duly issued and upon compliance with appropriate conditions as may be required by the Carrier including the payment of a service charge.

3.1.4 Ticket not Transferable

A ticket is not transferable. If someone other than the person entitled to be carried on a ticket travels pursuant to that ticket or is given a refund in connection therewith, Carrier shall not be liable to the person so entitled if, in good faith it provides carriage, or makes a refund. If a ticket is presented by someone other than the person entitled to be carried hereunder or to a refund in connection therewith, Carrier shall not be liable to the person so entitled if in good faith it provides carriage or makes a refund to the person presenting the ticket.

3.2 PERIOD OF VALIDITY

A ticket is valid for carriage for one year from the date of commencement of travel or if no portion of the ticket is used from the date of issue thereof, except as otherwise provided in the ticket, these Conditions or Carrier's Regulations.

3.2.1 Extension of validity

3.2.1.1 If a passenger is prevented from travelling within the period of validity of the ticket because Carrier:

1. cancels the flight on which the passenger holds a reservation; or
2. omits a scheduled stop, being the passenger's place of departure, place of destination or a stopover; or
3. fails to operate a flight reasonably according to schedule; or

4. causes the passenger to miss a connection; or
5. substitutes a different class of service; or
6. is unable to provide previously confirmed space; the validity of such passenger's ticket will be extended until Carrier's first flight on which space is available in the class of service for which the fare has been paid.

3.2.1.2 When a passenger holding a ticket, is prevented from travelling within the period of validity of the ticket because at the time such passenger requests reservations Carrier is unable to provide space on the flight, the validity of such passenger's ticket will be extended in accordance with Carrier's Regulations.

3.2.1.3 When a passenger after having commenced his or her journey is prevented from travelling within the period of validity of the ticket by reason of illness, Carrier may extend (provided such extension is not precluded by Carrier's Regulations applicable to the fare paid by the passenger) the period of validity of such passenger's ticket until the date when the passenger becomes fit to travel according to a medical certificate, or until Carrier's first flight after such date from the point where the journey is resumed on which space is available in the class of service for which the fare has been paid. When the flight coupons remaining in the ticket involve one or more stopovers, the validity of such ticket, subject to Carrier's Regulations, may be extended for not more than three months from the date shown on such certificate. In such circumstances, Carrier may extend similarly the period of validity of tickets of other members of the passenger's immediate family accompanying an incapacitated passenger.

3.2.1.4 In the event of death of a passenger en route, the tickets of the persons accompanying the passenger may be modified by waiving the minimum stay or extending the validity. In the event of a death in the immediate family of a passenger who has commenced travel, the validity of the passenger's tickets and those of his or her immediate family accompanying the passenger may be likewise modified. Any such modification shall be made upon receipt of a proper death certificate and any such extension of validity shall not be for a period longer than forty-five (45) days from the date of the death.

3.3 FLIGHT COUPON SEQUENCE

3.3.1 Carrier will honour flight coupons, or in the case of an electronic ticket, an electronic coupon, only in the sequence from the place of departure as shown on the ticket.

3.3.2 The ticket may not be valid and Carrier may not honour the passenger's ticket if the first flight coupon, or in the case of an electronic ticket, an electronic coupon, for International travel has not been used and the passenger commences his or her journey at any stopover or agreed stopping place.

3.3.3 Each flight coupon, or in the case of an electronic ticket, an electronic coupon, will be accepted for carriage in the class of service specified therein on the date and flight for which accommodation has been reserved. When flight coupons, or in the case of an electronic ticket, an electronic coupon, are issued without a reservation being specified thereon, space will be reserved on application subject to the conditions of the relevant fare and the availability of space on the flight applied for.

3.4 NAME AND ADDRESS OF CARRIER

Carrier's name may be abbreviated in the ticket. Carrier's address shall be deemed to be the airport of departure shown opposite the first abbreviation of Carrier's name in the "Carrier" box in the ticket.

Article 4 - STOPOVERS

Stopovers may be permitted at agreed stopping places subject to government requirements and Carrier's Regulations.

Article 5 - FARES AND CHARGES

5.1 GENERAL

Fares apply only for carriage from the airport at the point of origin to the airport at the point of destination. Fares do not include ground transport service between airports and between airports and town terminals, unless provided by Carrier without additional charge.

5.2 APPLICABLE FARES

Applicable fares are those published by or on behalf of Carrier or, if not so published, constructed in accordance with Carrier's Regulations. Subject to government requirement and Carrier's Regulations, the applicable fare is the fare for the flight or flights in effect on the date of commencement of the carriage covered by the first flight coupon of the ticket. When the amount that has been collected is not the applicable fare the difference shall be paid by the passenger or, as the case may be, refunded by Carrier, in accordance with Carrier's Regulations.

5.3 ROUTING

Unless otherwise provided in Carrier's Regulations, fares apply only to routings published in connection therewith. If there is more than one routing at the same fare, the passenger may specify the routing prior to the issue of the ticket. If no routing is specified, Carrier may determine the routing.

5.4 TAXES AND CHARGES

Any tax or charge imposed by government or other authority, or by the operator of an airport, in respect of a passenger or the use by a passenger of any service of facilities will be in addition to the published fares and charges and shall be payable by the passenger, except as otherwise provided in Carrier's Regulations. The passenger may be required to pay taxes or fees not already collected on the ticket for any reason.

5.5 CURRENCY

Fares and charges are payable in any currency acceptable to Carrier. When payment is made in a currency other than the currency in which the fare is published, such payment will be made at the rate of exchange established in accordance with Carrier's Regulations.

Article 6 - RESERVATIONS

6.1 RESERVATION REQUIREMENTS

6.1.1 Reservations are not confirmed until recorded as accepted by Carrier or its authorised Agent.

6.1.2 As provided in Carrier's Regulations, certain fares may have conditions which limit or exclude the passenger's right to change or cancel reservations.

6.2 TICKETING TIME LIMITS

If a passenger has not paid for the ticket (or made credit arrangements with Carrier) prior to the specified ticketing time limit, Carrier may cancel the reservation.

6.3 PERSONAL DATA

The passenger recognizes that personal data has been given to Carrier for the purposes of making a reservation for carriage and for obtaining ancillary services, facilitating immigration and entry requirements, and making available such data to government agencies who may share such personal data with other government agencies which is beyond the control of the Carriers. For these purposes the passenger authorizes Carrier to retain such data and to transmit it to its own offices, other Carriers or the providers of such services, in whatever country they may be located.

6.4 SEATING

Carrier does not guarantee to provide any particular seat in the aircraft and the passenger agrees to accept any seat that may be allotted on the flight in the class of service for which the ticket has been issued.

6.5 SERVICE CHARGE WHEN SPACE NOT OCCUPIED

A service charge, in accordance with Carrier's Regulations, may be payable by a passenger who fails to use space for which a reservation has been made.

6.6 RECONFIRMATION OF RESERVATIONS

Onward or return reservations may be subject to the requirement to reconfirm the reservation in accordance with and within the time limits specified in Carrier's Regulations. Failure to comply with any such requirement may result in cancellation of any onward or return reservations.

6.7 CANCELLATION OF ONWARD RESERVATIONS MADE BY CARRIER

If a passenger does not use a reservation and fails to advise Carrier, Carrier may cancel or request cancellation of any onward or return reservations.

Article 7 - CHECK-IN

The passenger shall arrive at Carrier's check-in location and boarding gate sufficiently in advance of flight departure to permit completion of any Government formalities and departure procedures and in any event not later than the time that may be indicated by Carrier. If the passenger fails to arrive in time at Carrier's check-in location or boarding gate or appears improperly documented and not ready to travel Carrier may cancel the space reserved for the passenger and will not delay the flight. Carrier is not liable to the passenger for loss or expense due to the passenger's failure to comply with the provisions of this Article.

Article 8 - REFUSAL AND LIMITATION OF CARRIAGE

8.1 RIGHT TO REFUSE CARRIAGE

Carrier may refuse carriage of any passenger or passenger's baggage for reasons of safety or if, in the exercise of

its reasonable discretion, Carrier determines that:
8.1.1 such action is necessary in order to comply with any applicable laws, regulations, or orders of any state or country to be flown from, into or over or
8.1.2 the conduct, age, or mental or physical state of the passenger is such as to:
- 8.1.2.1 require special assistance of Carrier, or
- 8.1.2.2 cause discomfort or make himself or herself objectionable to other passengers; or
- 8.1.2.3 involve any hazard or risk to himself or herself or to other persons or to property; or

8.1.3 such action is necessary because the passenger has failed to observe the instructions of Carrier; or
8.1.4 the passenger has refused to submit to a security check; or
8.1.5 the applicable fare or any charges or taxes payable have not been paid, or credit arrangements agreed between Carrier and the passenger (or the person paying for the ticket) have not been complied with; or
8.1.6 the passenger does not appear to be properly documented; or
8.1.7 the ticket presented by the passenger:
1. has been acquired unlawfully or has been purchased from an entity other than the issuing Carrier or its authorised Agent, or
2. has been reported as being lost or stolen, or
3. is a counterfeit ticket, or
4. any flight coupon has been altered by anyone other than Carrier or its authorised Agent, or has been mutilated, and Carrier reserves the right to retain such ticket, or

8.1.8 the person presenting the ticket cannot prove that he or she is the person named in the "Name of Passenger" box, and Carrier reserves the right to retain such ticket.

8.2 LIMITATION ON CARRIAGE
Acceptance for carriage of unaccompanied children, incapacitated persons, pregnant women or person with illness may be subject to prior arrangement with Carrier, in accordance with Carrier's Regulations.
Article 9 - BAGGAGE
9.1 ITEMS UNACCEPTABLE AS BAGGAGE
9.1.1 The passenger shall not include in his or her baggage:
9.1.1.1 Items which do not constitute baggage as defined in Article 1 thereof;
9.1.1.2 Items which are likely to endanger the aircraft or persons or property n board the aircraft, such as those specified in the Dangerous Goods Regulations of the International Civil Aviation Organisation (ICAO) and the International Air Transport Association (IATA), and in Carrier's Regulations (further information is available from Carrier on request);
9.1.1.3 Items the carriage of which is prohibited by the applicable laws regulations or orders of any state to be flown from, to or over;
9.1.1.4 Items which in the opinion of Carrier are unsuitable for carriage by reason of their weight; size or character, such as fragile or perishable items;
9.1.1.5 Live animals, except as provided for in 9.10
9.1.2 Firearms and ammunition other than for hunting and sporting purposes are prohibited from carriage as baggage. Firearms and ammunition for hunting and sporting purposes may be accepted as checked baggage in accordance with Carrier's Regulations. Firearms must be unloaded with the safety catch on, and suitably packed. Carriage of ammunition is subject to ICAO and IATA Dangerous Goods Regulations.
9.1.3 The passenger shall not include in checked baggage fragile or perishable items, money, jewellery, precious metals, silverware, negotiable papers, securities or other valuables, business documents, passports and other identification documents or samples.
9.1.4 Weapons such as antique firearms, swords, knives and similar items may be accepted as baggage in accordance with Carrier's Regulations.
9.1.5 If any item referred to in 9.1.1 or 9.1.2 are carried, whether or not they are prohibited from carriage as baggage, the carriage thereof shall be subject to the charges, limitations of liability and other provisions of these Conditions applicable to the carriage of baggage.

9.2 RIGHT TO REFUSE CARRIAGE
9.2.1 Carrier may refuse carriage as baggage of such items described in 9.1 as are prohibited from carriage as baggage and may refuse further carriage of any such items on discovery thereof.
9.2.2 Carrier may refuse to carry as baggage any item because of its size, shape, weight or character.
9.2.3 Unless advance arrangements for its carriage have been made with Carrier, Carrier may carry on later

flight baggage, which is in excess of the applicable free allowance.

9.2.4 Carrier may refuse to accept baggage as checked baggage unless it is properly packed in suitcases or other suitable containers to ensure safe carriage with ordinary care in handling.

9.3 RIGHT OF SEARCH

For reasons of safety and security, Carrier may request the passenger to permit a search to be made of his or her person and his or her baggage, and may search or have searched the passenger's baggage in his or her absence if the passenger is not available, for the purpose of determining whether he or she is in possession of or whether his or her baggage contains any item described in 9.1. If the passenger is unwilling to comply with such request, Carrier may refuse to carry the passenger or baggage.

9.4 CHECKED BAGGAGE

9.4.1 Upon delivery to Carrier of baggage to be checked Carrier shall take custody thereof and issue a baggage identification tag for each piece of checked baggage.

9.4.2 If baggage has no name, initials or other personal identification, the passenger shall affix such identification to the baggage prior to acceptance.

9.4.3 Checked baggage will be carried on the same aircraft as the passenger unless Carrier decides that this is impracticable, in which case Carrier will carry checked baggage on the next flight on which space is available.

9.5 FREE BAGGAGE ALLOWANCE

Passenger may carry free of charge baggage as specified and subject to the conditions and limitations in Carrier's Regulations.

9.6 EXCESS BAGGAGE

A passenger shall pay charge for the carriage of baggage in excess of the free baggage allowance at the rate and in the manner provided in Carrier's Regulations.

9.7 EXCESS VALUE DECLARATION AND CHARGE

9.7.1 If, in accordance with Carrier's Regulations Carrier offers an excess valuation facility, a passenger may declare a value for checked baggage in excess of the applicable liability limits. If the passenger makes such a declaration the passenger shall pay any applicable charges.

9.7.2 Carrier will refuse to accept an excess value declaration on checked baggage when a portion of the carriage is to be provided by another Carrier which does not offer the facility.

9.8 UNCHECKED BAGGAGE

9.8.1 Baggage which the passenger carries on to the aircraft must fit under the seat in front of the passenger or in an enclosed storage compartment in the cabin. Items determined by Carrier to be of excessive weight or size will not be permitted in the cabin.

9.8.2 Objects not suitable for transport in the cargo compartment (such as delicate musical instruments and the like) will only be accepted for transportation in the cabin compartment if due notice has been given in advance and permission granted by Carrier. The transport of such objects may be charged for separately.

9.9 COLLECTION AND DELIVERY OF BAGGAGE

9.9.1 The passenger shall collect his or her baggage as soon as it is available for collection at place of destination or stopover.

9.9.2 Only the bearer of the baggage check and identification tag, delivered to the passenger at the time the baggage was checked, is entitled to delivery of baggage. Failure to exhibit the baggage identification tag shall not prevent delivery provided the baggage check is produced and the baggage is identified by other means.

9.9.3 If a person claiming the baggage is unable to produce the baggage check and identify the baggage by means of a baggage (identification) tag, Carrier will deliver the baggage to such person only on condition that he or she establishes to Carrier's satisfaction his or her right thereto, and if required by Carrier, such person shall furnish adequate security to indemnify Carrier for any loss, damage or expense which may be incurred by Carrier as a result of such delivery.

9.9.4 Acceptance of baggage by the bearer of the baggage check without complaint at the time of delivery is prime facie evidence that the baggage has been delivered in good condition and in accordance with the contract of carriage.

9.10 ANIMALS

9.10.1 Animals such as dogs, cats, household birds and other pets, when properly crated and accompanied by valid health and vaccination certificates, entry permits, and other documents required by countries of entry or transit will, with the advance agreement of Carrier, be accepted for carriage, subject to Carrier's Regulations.
9.10.2 If accepted as baggage, the animal, together with its container and food carried, shall not be included in the free baggage allowance of the passenger but constitute excess baggage, for which the passenger shall pay the applicable rate.
9.10.3 Guide dogs accompanying sight/hearing impaired and physically handicapped passengers together with containers and food, will be carried free of charge in addition to the normal free baggage allowance, subject to Carrier's Regulations.
9.10.4 Acceptance for carriage of animals is subject to the condition that the passenger assumes full responsibility for such animal. Carrier shall not be liable for injury to or loss, delay, sickness or death of such animal in the event that it is refused entry into or passage through any country, state or territory.

Article 10 - SCHEDULES, CANCELLATION OF FLIGHTS
10.1 SCHEDULES
Carrier undertakes to use its best efforts to carry the passenger and his or her baggage with reasonable despatch and to adhere to published schedules in effect on the date of travel.
10.2 CANCELLATION, CHANGES OF SCHEDULE, ETC.
If due circumstances beyond its control Carrier cancels or delays a flight, is unable to provide previously confirmed space, fails to stop at passenger's stopover or destination point, or causes the passenger to miss a connection flight on which the passenger holds a reservation, Carrier shall either:
10.2.1 Carry the passenger on another of its scheduled passenger services on which space is available or
10.2.2 Reroute the passenger to the destination indicated on the ticket or applicable portion thereof by its own scheduled services or the scheduled services of another Carrier, or by means of surface transportation. If the sum of the fare, excess baggage charge and any applicable service charge for the revised routing is higher than the refund value of the ticket or applicable portion thereof, Carrier shall require no additional fare or charge from the passenger, and shall refund the difference if the fare and charges for the revised routing are lower; or
10.2.3 Make a refund in accordance with the provisions of Article 11; and shall be under no further liability to the passenger.
Except in the case of its acts or omissions done with intent to cause damage or recklessly and with knowledge that damage would probably result, Carrier shall not be liable for errors or omissions in timetables or other published schedules, or for representations made by employees, agent or representative or Carrier as to the dates or times of departure or arrival or as to the operation of any flight.

Article 11- REFUNDS
11.1 GENERAL
On failure by Carrier to provide carriage in accordance with the Contract of carriage, or where the passenger requests a voluntary change of his or her arrangements, refund for an unused ticket or portion thereof shall be made by Carrier in accordance with this Article and with Carrier's Regulations.

11.2 PERSON TO WHOM REFUND WILL BE MADE
11.2.1 Except as herein after provided in this Article, Carrier shall be entitled to make refund either to the person named in the ticket, or to the person who has paid for the ticket upon presentation of satisfactory proof. In the even payment for the ticket is made through a travel agent, refund shall normally be made through such travel agent.
11.2.2 If a ticket has been paid for by a person other than the passenger named in the ticket, and Carrier has indicated on the ticket that there is a restriction on refund, Carrier shall make a refund only to the person paying for the ticket or to that person's order.
11.2.3 Except in the case of lost tickets, refunds will only be made on surrender to Carrier of the passenger coupon or passenger receipt and surrender of all unused flight coupons.
11.2.4 A refund made to anyone presenting the passenger coupon on passenger receipt and all unused flight coupons and holding himself or herself out as a person to whom refund may be made in terms of 11.2.2 shall be deemed a proper refund and shall discharge Carrier from liability and any further claim for refund.

11.3 INVOLUNTARY REFUNDS
If Carrier cancels a flight, fails to operate a flight reasonable according to schedule, fails to stop at a point to

which the passenger is destined or ticketed to stop over, is unable to provide previously confirmed space or causes the passenger to miss a connecting flight on which the passenger holds a reservation, the amount of the refunds shall be:

11.3.1 If no portion of the ticket has been used, an amount equal to the fare paid;

11.3.2 If a portion of the ticket has been used, the refund will be the higher of;

11.3.3 The one way fare (less applicable discounts and charges) from point of interruption to destination or point of next stopover, or

11.3.4 The difference between the fare paid and the fare for the transportation used.

11.4 VOLUNTARY REFUNDS

If the passenger wishes a refund of his or her ticket for reasons other than those set out in Paragraphs of this Article the amount of the refund shall be:

11.4.1 If a portion of the ticket has been used, the refund will be an amount equal to the difference between the fare paid and the applicable fare for travel between the points for which the ticket has been used, less any applicable service charges or cancellation fees.

11.5 REFUND ON LOST TICKET

11.5.1 If a ticket or portion thereof is lost, refund will be made on proof of loss satisfactory to Carrier and upon payment of any applicable service charge, on condition.

11.5.2 That the person to whom the refund is made undertakes, in such form as may be prescribed by Carrier, to repay to Carrier the amount refunded in the even and to the extent that the lost ticket or portion thereof is used by any person or that refund thereof is made to any person in possession of the ticket.

11.6 RIGHT TO REFUSE REFUND

11.6.1 After the expiry of the validity of the ticket, Carrier may refuse refund when application therefore is made later than the time prescribed in Carrier's Regulations

11.6.2 Carrier may refuse refund on a ticket which has been presented to Carrier or to Government officials of country as evidence of intention to depart there from, unless the passenger establishes to the Carrier's satisfaction that he or she has permission to remain in the country and that he or she will depart there from by another carrier or another means of transport

11.7 CURRENCY

All refunds will be subject to Government, laws, rules and regulations or orders of the country in which the ticket was originally purchased and of the country in which the refund is being made. Subject to the foregoing provision, refunds will normally be made in the currency and in the country in which the ticket was paid for.

11.8 BY WHOM TICKET REFUNDABLE

Voluntary refunds will be made only by the Carrier which originally issued the ticket or by its Agent if so authorised.

Article 12 - CONDUCT ABOARD AIRCRAFT

12.1.1 If the passenger conducts himself or herself aboard the aircraft so as to the endanger the aircraft or any person on property on board, or obstructs the crew in the performance of their duties, or fails to comply with any instruction of the crew, or behaves in a manner to which other passengers may reasonably object, Carrier may take such measure as it deems necessary to prevent continuation of such conduct including restraint of the passenger.

12.1.2 The passenger may not operate aboard the aircraft portable radios, electronic games or transmitting devices including radio controlled toys and walkie-talkies. The passenger shall not operate any other electronic devices on board without Carrier's permission, except that portable recorders, hearing aids and hear pacemakers may be used.

12.1.3 The Carrier may prohibit the taking of photograph where Government Regulations so require.

Article 13 - ARRANGEMENTS BY CARRIER

If in the course of concluding the contract of carriage by air, Carrier also agrees to make arrangements for the provision of additional service, Carrier shall have no liability to the passenger except for wilful negligence on its part in making such arrangements.

Article 14 - ADMINISTRATIVE FORMALITIES
14.1 GENERAL
The passenger shall be solely responsible for complying with all laws, regulations, orders, demands and travel requirements of countries to be flown from, into or over and with Carrier's Regulations and instructions. Carrier shall not be liable for any aid or information given by any agent or employee of Carrier to any passenger in connection with obtaining necessary documents or visas or complying with such laws, regulations, orders, demands, and requirements, whether given in writing or otherwise or for the consequences to any passenger resulting from his or her failure to obtain such documents or visas or to comply with such laws, regulations, orders, demands, requirements, rules or instructions.

14.2 TRAVEL DOCUMENTS
The passenger shall present all exit, entry, health and other documents required by laws, regulations, orders, demands or requirements of the countries concerned. Carrier reserves the right to refuse carriage of any passenger who has not complied with applicable laws, regulations, orders, demands or requirements or whose documents do not appear to be in order.

14.3 REFUSAL OF ENTRY
The passenger agrees to pay the applicable fare whenever Carrier, on Government order, is required to return a passenger to his or her point of origin or elsewhere, owing to the passenger's inadmissibility into a country, whether of transit or of destination. Carrier may apply to the payment of such fare any funds paid to Carrier for unused carriage, or any funds of the passenger in the possession of Carrier. The fare collected for carriage to the point of refusal of entry or deportation will not be refunded by Carrier.

14.4 PASSENGER RESPONSIBLE FOR FINES, DETENTION COSTS, ETC.
If Carrier is required to pay or deposit any fine or penalty or to incur any expenditure by reason of the passenger's failure to comply with laws, regulations, orders, demands and travel requirements of the countries concerned or to produce the required documents, the passenger shall on demand reimburse to Carrier any amount so paid or deposited and any expenditure so incurred. Carrier may use towards such expenditure any funds paid to Carrier for unused carriage, or any funds of the passenger in the possession of Carrier.

14.5 CUSTOMS INSPECTION
If required, the passenger shall attend inspection of his or her baggage, checked or unchecked, by customs or other Government officials. Carrier is not liable to the passenger for any loss or damage suffered by the passenger through failure to comply with this requirement.

14.6 SECURITY INSPECTION
The passenger shall submit to any security checks by Government or airport officials or by Carrier.

Article 15 - SUCCESSIVE CARRIERS
Carriage to be performed by several successive Carrier under one ticket, or under a ticket and any conjunction ticket issued in connection therewith, is regarded as a single operation.

Article 16 - LIABILITY FOR DAMAGE
16.1. The carrier shall be liable for damages sustained in case of death or bodily injury of a passenger upon condition only that the accident which caused the death or injury took place on board the aircraft or in the course of any of the operations of embarking or disembarking.

16.2 The carrier shall be liable for damages sustained in case of destruction or loss of, or of damage to checked baggage upon condition only that the event which caused the destruction, loss or damage took place on board the aircraft or during any period within which the checked baggage was in the charge of the Carrier. However the Carrier shall not be liable if and to the extent that the damage resulted from inherent defect, quality or vice of the baggage. In the case of unchecked baggage including personal items, the Carrier is liable if the damage has resulted from its fault or that of its servant or agents.

16.3 The Carrier shall be liable for damages occasioned by delay in the carriage by air of passengers, baggage or cargo. Nevertheless, The Carrier shall not be liable for damage occasioned by delay if it proves that it and its servants and agents took all measures that could reasonably be required to avoid the damage or that it was impossible for it or them to take such measures.

16.4 If the Carrier proves that the damages was caused or contributed to by the negligence or other wrongful act or omission of the person claiming compensation, or the person from whom he or she derives his or her rights, the Carrier shall be wholly or partly exonerated from its liability to the claimant to the extent that such negligence or wrongful act or omission caused or contributed to the damage. When by reason of death or injury of a passenger, compensation is claimed by a person other than the passenger, the Carrier shall likewise be wholly or partly exonerated from its liability to the extent that it proves that the damage was caused or contributed to by the negligence or other wrongful act or omission of that passenger.

16.5 All the compensation shall be subject to limits on compensation as provided under these conditions.

Article 17 - LIMITS OF COMPENSATION

17.1 International Carriage hereunder is subject to the rules and limitations relating to liability established by the Convention as embodied in the Indian Carriage by Air Act 1972 as amended vide Act No. 28 of 2009, dated 20/03/2009 unless otherwise specified in 17.5.

(1)Pursuant to Notification No S.O. 1283(e) issued by the Government of India notifying The Carriage by Air Amendment Act, 2009, Carrier hereby agrees that its liability for damages in international carriage would extend up to:

(a) Liability for death or bodily injury to passengers shall be in accordance with Air India's conditions of carriage, but is limited as per the Montreal Convention 1999. In case of death or injury of passengers the liability of the Carrier for each passenger is limited to the sum of 1,00,000 SDR.

Provided that the carrier shall not be liable beyond this limit if it proves that:

(a) Such damage is not due to negligence or other wrongful act or omission of the carrier or its servants or agents.

(b) Such damage was solely due to the negligence or other wrongful act or omission of a third party.

(b) The liability for loss, delay or damage to baggage is limited by the Montreal Convention 1999 such liability is limited to a maximum of 1,131 SDRs per passenger unless the passenger has made, at the time of when checked baggage was handed over to the carrier, a special declaration of interest in delivery at destination and has paid a supplementary sum, if so required and in that case, the carrier shall be liable to pay a sum not exceeding the declared sum, unless it proves that the sum is greater than the passenger's actual interest in delivery at destination

(c) The liability for damage occasioned by delay in the carriage of air is limited by Montreal Convention 1999 such liability is limited to 4,694 SDR unless certain defenses specified by that convention apply.

(d) The liability for destruction, loss, damage or delay with respect to cargo is limited by Montreal Convention 1999. Such liability is limited to 17 SDR per kilogram of cargo.

17.2 Carriage hereunder which is not international subject to the rules and limitations relating to liability as specified by Notifications issued from time to time under Section 8 of the Indian Carriage by air Act, 1972.

(1) Pursuant to Notification No S.O. 142(E), dated January 17, 2014, issued by the Ministry of Civil Aviation, Government of India, Carrier hereby agrees that its liability shall be as under:

(a) For damages arising under article 16.1 not exceeding Rupees Twenty Lakhs for each passenger, Carrier shall not be able to exclude or limit its liability.

(b)Carrier shall not be liable for damages arising under article 16.1, to the extent that they exceed for each passenger, Rupees Twenty Lakhs if Carrier proves that -

(i) such damage was not due to the negligence or other wrongful act or omission of Carrier or its servants or agents; or

(ii) such damage was solely due to the negligence or other wrongful act or omission of a third party.

(c)In the case of damage caused by delay in carriage of persons as specified in article 16.3 in the carriage by air of passengers by Carrier, the liability Carrier for each passenger is limited to Rupees Eighty Thousand per passenger. Nevertheless, Carrier shall not be liable for damage occasioned by delay if it proves that it and its servants and agents took all measures that could reasonably be required to avoid the damage or that it was impossible for it or them to take such measures.

(d) In the carriage of baggage, the liability of Carrier in the case of destruction, loss, damage or delay shall be limited to Rupees Twenty Thousand for each passenger unless the passenger has made, at the time when the checked baggage was handed over to Carrier, a special declaration of interest in delivery at destination and has paid a supplementary sum, if so required. In that case, Carrier shall be liable to pay a sum not exceeding the declared sum, unless it proves that the declared sum is greater than the passenger’s actual interest.

(e) In the carriage of cargo, the liability of Carrier in case of destruction, loss, damage or delay is limited to a sum of Rupees Three Hundred and Fifty per kilogram, unless the consignor has made, at the time when the package was handed over to Carrier, a special declaration of interest in delivery at destination and has paid a supplementary sum, if so required. In that case, Carrier shall be liable to pay a sum not exceeding the declared sum, unless it proves that the sum is greater than the consignor's actual interest in delivery at destination.

17.3 To the extent not in conflict with the foregoing and whether or not the convention applies:

1. Carrier is liable only for damage occurring on its own line. A Carrier issuing a ticket or checking baggage over the lines of another Carrier does so only as agent for such other Carrier. Nevertheless, with respect of checked baggage the passenger shall also have a right of action against the first or last Carrier:
2. Carrier is not liable for damage to unchecked baggage unless such damage is caused by the negligence of Carrier. If there has been contributory negligence on the part of the passenger, Carrier’s liability shall be subject to the applicable law relating to contributory negligence;
3. Carrier is not liable for any damage arising from its compliance with any laws or Government regulations, orders or requirements, or from failure of the passenger to comply with the same;
4. If the weight of the baggage is not recorded on the baggage check, it is presumed that the total weight of the checked baggage does not exceed the applicable free baggage allowance for the class of service concerned as provided in Carrier’s Regulations. If in the case of checked baggage a higher value is declared pursuant to 9.7, the liability of Carrier shall be limited to such higher declared value
5. Carrier’s liability shall not exceed the amount of proven damages. Carrier shall furthermore not be liable for indirect or consequential damage;
6. Carrier is not liable for injury to a passenger or for damage to a passenger’s baggage caused by property contained in such passenger’s baggage. Any passenger whose property cause injury to another person or damage to another person’s property or to the property of Carrier shall indemnify Carrier for all losses and expenses incurred by Carrier as a result thereof
7. Carrier is not liable for damage to fragile or perishable items, money, jewellery, precious metals, silverware, negotiable papers, securities, or other valuables, business documents, passports and other identification documents, or samples, which are included in the passenger’s checked baggage.
8. If a passenger is carried whose age or mental or physical condition is such as to involve any hazard or risk to himself or herself, Carrier shall not be liable for any illness, injury or disability, including death, attributable to such condition or for the aggravation of such condition.
9. Any exclusion or limitation of liability of Carrier shall apply to and be for the benefit of agents, employees and representatives of Carrier and any person whose aircraft is used by Carrier and such person’s agents, employees and representatives. The aggregate amount recoverable from Carrier and from such agents, employees, representative and person shall not exceed the amount of Carrier’s limit of liability.

17.4 Unless so expressly provided nothing herein contained shall waive any exclusion or limitation of liability of Carrier under the Convention or applicable laws.

17.5 Special Provision

SPECIAL AGREEMENT

Special Agreement applicable to carriage to, from or with an agreed stopping place in the United States of America (see applicable US Tariffs) .

Carrier shall avail itself of the limitation of liability provided in the Convention. However, in accordance with Article 22(1) of the Convention, Carrier and certain other Carriers agree that as to all international carriage by such carriers to which the Convention applies and which according to the contract of Carriage includes a point in the United States of America as a point of origin, a point of destination or agreed stopping place:

a. the limit of liability for each passenger for death, wounding or other bodily injury shall be the sum of

US$75,000 inclusive of legal fees and costs except that, in the case of a claim brought in a State where provision is made for separate award of legal fees and costs, the limit shall be the sum of US$ 58,000 exclusive of legal fees and costs;

b. Such Carriers shall not, with respect to any claim arising out of the death, wounding or other bodily injury of a passenger, avail themselves of any defence under Article 20(I) of the Convention.

Nothing herein shall be deemed to affect the rights and liabilities of such Carriers with regard to any claim brought by, on behalf of, or in respect of, any person who has willfully caused damage which resulted in death, wounding or other bodily injury of a passenger.

The names of Carriers party to the Agreement referred to in this paragraph are available at all ticket offices of such Carriers and may be examined on request. Each of such Carriers has entered into the said agreement solely on its own behalf and with respect to Carriage performed by it and has not thereby imposed any liability on any other Carrier with respect to the portion of the Carriage performed by such other Carrier or assumed any liability with respect to the portion of the Carriage performed by such other Carrier.

Article 18 - TIME LIMITATION ON CLAIMS AND ACTIONS

18.1 NOTICE OF CLAIMS

No action shall lie in the case of damage to checked baggage unless the person entitled to delivery complains to Carrier forthwith after the discovery of the damage, and, at the latest, within seven (7) days from the date of receipt and in the case of delay unless the complaint is made at the latest within twenty-one (21) days from the date on which the baggage has been placed at his or her disposal. Every complaint must be made in writing and dispatched within the times aforesaid. If no complaint is made within the time period specified above, no action shall lie against the Carrier, except in the case of fraud committed by the Carrier.

18.2 LIMITATION OF ACTIONS

Any right to damages shall be extinguished if an action is not brought within two years reckoned from the date of arrival at the destination, or from the date on which the aircraft ought to have arrived, or from the date on which the carriage stopped. The method of calculating the period of limitation shall be determined by the law of the court seized of the case.

18.3 JURISDICTION

An action for damages in respect of baggage shall be brought, at the option of the claimant of damages, in the territory of one of the state parties, either before the court of domicile of the Carrier or of its principal place of business, or where it has a place of business, or where it has a place of business through which the contract has been made or before the court at the place of destination.

An action for damages in case of death may be brought in the above mentioned courts or in the territory of a state party in which at the time of accident, the passenger has his or her principal place and permanent residence and to or from which the Carrier operates services for the carriage of passenger by air, either on its own aircraft, or on another Carrier's aircraft pursuant to a commercial agreement, and in which the Carrier conducts its business of carriage of passengers by air from premises leased or owned by the Carrier itself or by another Carrier with which it has a commercial agreement.

In case of carriage of air performed by a Carrier (i.e. actual Carrier) other than the contracting Carrier, an action for damages must be brought, at the option of the complainant, in the territory of one of the state parties, either before a court in which an action may be brought against the contracting Carrier, or before the court having jurisdiction at the place where the actual Carrier has its domicile or its principle place of business.

Article 19 - MODIFICATION AND WAIVER

No Agent, employee or representative of Carrier has authority to alter, modify or waive any provision of these Conditions of Carriage.

AIRCRAFT MAINTENANCE, REPAIR AND OVERHAUL AGREEMENT

The maintenance, repair and overhaul (MRO) of aircraft and aircraft systems and components is very essential for the aviation industry. Thousands of organizations in India and abroad are certified in Aircraft Maintenance, repair and overhauling with a comprehensive range of capabilities. Collectively, these firms generate more than $3 billion in annual revenues and employ some 17,000 highly skilled workers in India.

Key Segments of MRO

The key segments of maintenance, repair and over-haul (MRO) activity are as follows:

- Line Maintenance
- Airframe Heavy Maintenance
- Engine Overhaul
- Components Overhaul
- Modifications

Line Maintenance:

This is the activity associated with routine turning round and servicing aircraft up to and including A Checks. It is an activity very largely done in-house by the legacy airlines (flag carriers and full-service airlines) either for themselves or for their partners. They frequently club together their needs especially for common aircraft types and one airline provides the engineering service for all the participating air-lines. Many new entrant airlines, especially where they have low frequencies to particular cities, sub-contract out this work. This situation is particularly common at outstations.

Most of the cost of routine line maintenance is labour costs. Typically it now accounts for about 85% of the total costs. However, over recent years there has been a significant reduction in the labour con-tent and hence cost savings in selected areas by possibly up to 30%. Examples include the routine ground turnaround of aircraft without an engineer and contracting the supervision of aircraft fuelling operations out to the oil companies supplying the airline at the individual airports where it operates.

Airframe Heavy Maintenance:

In airframe heavy maintenance, approximately 85% of the total cost is for labour with only a small element for materials.

The introduction of the latest generation of aircraft is having a very significant affect on overall work-loads. Service intervals and types of maintenance change as new aircraft types are introduced into service. Generally the newer aircraft types have in-creasing longer time and/or cycles before overhaul is required. The manufacturers are also extending the service intervals as they build up experience of the reliability profiles of the different aircraft types.

Appendix 1 shows an example of the maintenance requirements of the B737 new generation and of the predecessor “classic” type.

Engine Overhaul:

This is essentially a material intensive process with labour only accounting for 15-20% of total cost. The OEMs control about 45% of the work with the air-lines doing around 35% in-house. This then leaves the remainder (20%) split fairly evenly between air-line third party contracts and independent sources. The engine manufacturers have increasing sought to raise their share of the engine overhaul market as it is a valuable source of substantial additional revenue and profit.

Engine overhaul work is of a highly technical nature and large elements of it call for highly specialised equipment and tooling. Since materials make up such a large element of the total cost, and because there is considerable effort put into the restoration of items through sophisticated technical processes such as plasma spray, it gives a natural advantage for the engine manufacturers to carry out the work.

While some airlines’ MRO divisions, for example Lufthansa Technik, carry out a substantial amount of engine overhaul, it is doubtful whether this is as profitable for them as it would be for the engine manufacturers to carry out the work.

The engine repair OEMs are also able to offer the smaller airlines the benefit of purchasing engines on a pay-as-you-go basis per flying hour. This is called Power by the Hour. Some low-cost airlines operate on this basis but at discounted rates from the OEMs.

Performance retention is a key part of jet engine engineering. Over the past 15 years there has been a massive improvement jet engine performance retention that has had an effect of reducing the average level of engine maintenance per operating hour. At the same time the number of engines has grown significantly as the aircraft fleet has increased.

Components:

The largest share of this activity is carried out by the original equipment manufacturer (OEM). They have an advantage with technical knowledge of new products. Techniques and tools developed for the manufacturing process can readily be adapted for maintenance tasks. In addition, it is becoming increasingly beneficial for an airline operator to leave all the work to the OEM, who has the advantage of much larger scale of activity. Contracting-out this work to OEMs also saves the costs associated with procuring spare parts and tooling for a smaller number of items by the airline.

Additionally, for reasons of simplicity there is tendency to transfer the ownership of inventory to the OEM or other repair agency and base charges on a per flight hour basis.

Modifications:

Modification work is so varied that no single factor accounts for a predominant amount. Some modifications such as conversion work of passenger air-craft to cargo involves complexity and is expensive. The aircraft manufacturers have approved conversion processes, parts and procedures and tend to limit the number of MROs that they will licence to carry out this work. This tight control also maintains profitability of this process for the OEMs. Carrying out of passenger product modifications (interiors and in-flight entertainment systems IFE) is also expensive and quite labour intensive.

Additionally, there is an element associated with mandatory changes to service bulletins. Increasingly, some of the more established MROs are expanding to take on large amounts of this work in purpose-built facilities

Contracts in Use

There are a number of differing types of contractual arrangement that operators make with MRO suppliers. These are described below:

- One-off contracts for the defined work package
  Normally this would be done on a fixed price for the scheduled work with additional work being at an agreed man-hour rate per item. Difficulties invariably arise when the final bill comes in with frequent major disputes over the level of booked hours! In addition, the customer usually has to provide a number of engineers to be on site in order to agree what the scope of the additional work is to be and to act as a technical monitor of the work as it progresses.
- Long-term contracts to cover a whole fleet over a fixed time period
  Often this will be for a number of years. As a result of the certainty of an income stream for the supplier, the overall price will fall and a better relationship will develop.
- Power by the Hour
  This is a concept whereby the supplier is effectively selling a total service to the customer. Often used in the engine market, it guarantees the availability of serviceable engines in exchange for a fixed price per actual flying hour achieved. Airline finance directors particularly support this type of arrangement, as it gives fixed and predictable costs over the life of the contract. Additionally, it encourages the improvement of quality, since the longer the engine stays in service the lower the cost to the supplier. This type of contract is now being used increasingly for the component industry.
  A variation of this type of support is where the sup-plier takes ownership of the entire inventory of the customer and manages it on his behalf. A typical inventory might be 7 -10 % of the initial aircraft pur-chase price so the savings for the customer can be very great.

- Total Maintenance

This is an increasingly popular contract for the emerging airlines. The MRO supplier contacts to support the total operation from the departure phase all the way through to major maintenance including parts. Contracts of this type are necessarily long so giving both the customer and the supplier some stability in revenues and costs.

Work Loads

All maintenance tasks are generated as a result of the aircraft operation. The manufacturer, in conjunction with the regulator (CAA in the UK and the FAA in the USA), produces a Maintenance Planning Document (MPD) for the particular aircraft type. This spells out the required task and the frequency – or interval – at which individual maintenance checks have to be undertaken. This is normally a function of flying hours; landings; cycles and calendar time. In some cases several of these parameters may simultaneously apply and the first hurdle in any category triggers the requirement for a maintenance check or overhaul requirement.

The operator may vary these intervals, in conjunction with the regulator and manufacturer, to suit his particular type of operation. For example an operator with a predominantly summer operation may wish to confine his maintenance to the winter months.

Engine maintenance is defined by the number of hours of operation and by the operating cycles – this being necessary since the number of take-offs affects the stress and thus the wear on the engine. The scope of work actually needed at engine removal is not fixed and will depend to a large degree on the engine condition at removal and the requirements of the operator in terms of its next planned removal. Component maintenance is increasingly dictated by failure rather than by a fixed life, except where any failure could adversely affect safety.

It is clear from the above that the projected growth in fleets and traffic will generate additional work for the maintainers. However, there are already significant technology improvements in place and more undoubtedly planned. Evidence shows that the traffic growth will not produce a similarly sized growth in work load. Indeed, due to technological change our forecast shows a possible reduction overall.

Technology changes have been accompanied with improvements in productivity. The traditional way in which work was divided up between trades has changed in a major way. It is now quite common for a single trade group to carry out all the functions and indeed for most individuals to certify their own work. Previously, certification was carried out by specialist staff or by a limited number of skilled tradesmen.

Finally, in this area, the role of the Trades Unions has also changed. Traditionally they were opposed to any transfer of work out of the operators' own facilities. Now transfers and sub contracting are commonplace with changes being negotiated.

In all the above the key is costs. Not only is the direct cost of the work important, but also the over-all cost of the maintenance task as a percentage of total cost for the operator is a determinant. Since the major success factor for any airline is the amount of flying they can get out of an aircraft, it follows that the maintenance needs to be done in such a way that downtime is minimized. It is perfectly legitimate for actual maintenance costs to rise if there is a trade-off in terms of reduced downtime.

The chart in Appendix 1 shows the typical intervals and man-hours planned for B737 by one of the European maintainers. Variations between new and older generation aircraft are clearly evident.

Capacity

This is normally measured – for airframe maintenance – in terms of available man-hours. The calculations needed are relatively simple but have a profound affect on both costs and productivity. While costs are driven directly by paid man-hours the efficiency of a unit is driven by available man-hours and by the rate of utilization of those hours. So, while all the employees contracted hours are paid, he –or she – is only useful when actually at work and actually working.

These issues have significantly affected the planning and execution of tasks with heavy emphasis placed on production planning and computer aided task allocation. He challenge for maintainers is to have just enough capacity for the contracted tasks but not too much which stands around unused. Our clear impression of the UK market at present is one of some excess capacity although this appears to be localized and may be a feature of only some MRO facilities. There are definitely excess physical facilities but these are in the main on valuable land.

BASIC ORDERING AGREEMENT FOR MAINTENANCE SERVICES
Between
COLUMBIA HELICOPTERS, INC.
An Oregon Corporation
and
CUSTOMER

Customer operates a diverse fleet of helicopters and other aircraft.
CHI is willing to supply, and Customer is willing to purchase, helicopter engine repair and overhaul services and/or spare parts and components.

CHI operates an FAA-approved aircraft maintenance, repair and overhaul facility capable of maintaining, repairing and/or overhauling certain helicopter engines, parts, and components.
AGREEMENT

The Parties (individually, each a “Party” and, collectively, the “Parties”):

This Basic Ordering Agreement (the “Agreement”) has been entered into as of the date last signed below by COLUMBIA HELICOPTERS, INC, (“CHI”) and [insert customer name] (“Customer”).

RECITALS

R1.
R2.
R3.

Now Therefore, the Parties agree as follows:

1. Definitions

1.1. "Aircraft" means those aircraft or types of aircraft, as the case may be, designated in Exhibit 1.

1.2. "Airworthiness Tag" means FAA Form 8130-3 Authorized Release Certificate, Airworthiness Approval Tag, signifying an item has been repaired and checked by an FAA repair station certificate holder.

1.3. "Approved Vendors List" means the list of vendors approved by CHI according to its quality system requirements.

1.4. "Certificate of Conformity" means the certificate issued by the manufacturer of a part built to published industry specifications and criteria of the appropriate maintenance organization for work performed. An example Certificate of Conformity is attached hereto as Exhibit 2.

1.5. "CHI's Facility" means CHI's main maintenance facility located at 14452 Arndt Road NE, Aurora, Oregon, 97002.

1.6. "Confidential Information" means any information marked by a Party as being of a confidential or proprietary nature including, but not limited to, information related to marketing plans, customer identification, personnel, pricing, contracts, procedures, Aircraft/Part design, drawings/tooling, and other intellectual property.

1.7. "Customer Parts" means any Parts provided to CHI by Customer, including those delivered to CHI for Service, for use as Replacement Parts, or for any other purpose. The types of Customer Parts provided to CHI for Service are listed in Exhibit 1.

1.8. "DDP" means Delivered Duty Paid as that term is defined by the International Chamber of Commerce's International Commercial Terms (INCOTERMS) in effect at the time any order to which such term applies.

1.9. "End-User" means the person or entity that owns or operates the Aircraft as designated in Exhibit 1.

1.10. "EXWORKS" has the same meaning as defined in the International Chamber of Commerce's International Commercial Terms (INCOTERMS) in effect at the time any order to which such term applies.

1.11. "FAA" means the U.S. Federal Aviation Administration.

1.12. "FAA-DER" means an FAA approved Designated Engineering Representative.

1.13. "FAR" means the U.S. Federal Aviation Regulations, 14 C.F.R. 1.1 et seq.

1.14. "Invoice" means an itemized list of Spare Parts, Parts, or Services provided by CHI and the price to be paid for each by Customer.

1.15. "Maintenance" means the activity involved in maintaining an aircraft, part, component or equipment in airworthy condition and good working order.

1.16. "MRO" means Maintenance Repair Organization, as defined in the FARs.

1.17. "OEM" means Original Equipment Manufacturer, as defined in the FARs.

1.18. "Overhaul" means the process whereby methods, techniques, and practices acceptable to the FAA are employed to restore an aircraft, part, or component to a completely serviceable condition as prescribed by maintenance serviceability standards, and includes disassembly, cleaning, inspecting, repairing as necessary, reassembling, and testing in accordance with applicable specifications and criteria.

1.19. “Parts” means all Aircraft parts, components and related materials and equipment, including Replacement Parts, Spare Parts, Serviced Parts and Customer Parts.

1.20. “PMA” means Parts Manufacturing Approval, as defined in the FARs.

1.21. “Purchase Order” means a purchase order issued by Customer to CHI pursuant to this Agreement listing the Spare Parts and Services to be provided.

1.22. “Quote” means the list issued by CHI, pursuant to this Agreement, of Parts and Services to be provided and the price of each, along with any special terms and conditions.

1.23. “Repair” means elimination of damage and/or restoration to an airworthy condition following initial release into service by the manufacturer of any product, Part or component.

1.24. “Replacement Part(s)” means Parts used to replace damaged, worn-out, beyond economic repair, or defective Parts removed by CHI during the course of maintenance Service.

1.25. “RFQ” means a Request for Quote or a Request for Proposal from Customer.

1.26. “Service(s)(d)” means Aircraft Maintenance, Repair, Overhaul, and training services.

1.27. “Serviced Parts” means a Part that has been partially or completely Serviced under this Agreement.

1.28. “Spare Part(s)” means Parts purchased from CHI by Customer (not including Replacement Parts).

1.29. “Teardown and Evaluation” means the process of inspecting individual Customer Parts in order to identify any problems with the Part and estimate the price of Services.

1.30. “Turn Around Times” (TAT) has the meaning provided in Paragraph 8 of this Agreement.

2. Scope of the Agreement

2.1. CHI agrees to supply to Customer, and Customer agrees to purchase from CHI:

2.1.1. Services performed on Aircraft and related Parts; and/or

2.1.2. Replacement and Spare Parts.

2.2. This Agreement, together with its Exhibits and the Purchase Orders accepted hereunder, contains the exclusive terms and conditions governing all transactions between CHI and Customer that relate to CHI’s provision of any Parts or Services to Customer.

3. Term

This Agreement shall become effective on the date of the last signature hereto and shall remain in effect for a period of two (2) years or until the completion of Purchase Orders accepted hereunder, whichever is later. This Agreement shall automatically renew for additional one (1) year terms unless terminated by either party with written notice to the other at least thirty (30) days prior to the renewal date.

4. Ordering Procedures

4.1. Customer shall provide CHI with a RFQ when Customer seeks to purchase Parts or Services from

CHI. The RFQ shall state the Parts or Services that Customer is seeking, and shall identify:

4.1.1. The Parts or Services requested, including the part, component, or equipment by nomenclature, part number, and serial number (if applicable);

4.1.2. The type of Aircraft the Parts or Services are to be used on (when known to Customer); and

4.1.3. The End-User of the Parts or Services (when applicable).

4.2. As soon as practicable after receiving the RFQ, CHI shall either: (a) issue Customer a Quote; (b) notify Customer that CHI shall not issue a Quote or that CHI needs further information to issue a Quote; or (c) notify Customer that Teardown and Evaluation is required prior to CHI issuing a Quote.

4.3. CHI shall exercise commercially-reasonable efforts to provide accurate terms in its initial Quote and shall promptly notify Customer of any material changes to the terms of a Quote. However, unless specifically stated otherwise in the Quote, Quotes are not binding upon CHI and CHI remains free to change the terms of the Quote up until the date that CHI receives Customer's Purchase Order. A Quote shall be valid for forty-five (45) days from its most recent issuance or change by CHI. A Quote shall not be deemed to be an offer to form a contract; offers shall be made only via a Purchase Order as provided below.

4.4. Customer shall move forward on a Quote by issuing a Purchase Order to CHI. The Purchase Order shall be deemed an offer by Customer to form a contract embodying the terms of the Quote. CHI may accept Purchase Orders on a case-by-case basis. CHI has ten (10) days from the date of the Purchase Order to accept or reject it. The Purchase Order shall be deemed accepted and shall be binding on both Parties when CHI: (a) provides Customer with written acceptance of the Purchase Order; (b) begins performing Services; or (c) after notice to Customer, Delivers Spare Parts. The Purchase Order shall be deemed rejected when CHI: (a) provides Customer with written notice of rejection; or (b) fails to accept the Purchase Order within the above-described thirty-day period. In accepting a Purchase Order, CHI may, with Customer's prior written consent, make immaterial changes, correct typographical or other palpable errors, or supply missing information without such changes constituting a rejection of the offer and issuance of a counter-offer.

4.5. Any terms in the Purchase Order that are in addition to, or different from, those of the Quote shall be disregarded and of no force or effect, unless the Purchase Order specifically and prominently notes such additional or different terms and CHI explicitly accepts the additional or differing terms in writing.

4.6. Customer Parts shipped to CHI for Service prior to final acceptance of the Purchase Order may be returned by CHI at Customer's expense in the event that CHI rejects the Purchase Order.

5. Teardown and Evaluation

5.1. It may be necessary for CHI to perform a Teardown and Evaluation prior to issuing a Quote for Services. If CHI determines that a Teardown and Evaluation is necessary, CHI shall provide a Quote for Teardown and Evaluation and the process provided in this Agreement shall apply to acceptance of a Purchase Order issued by Customer following that Quote.

5.2. Upon completion of the Teardown and Evaluation, CHI shall issue a Quote for Services. Unless specifically stated otherwise in the Quote, Quotes are not binding upon CHI and CHI remains free to change the terms of the Quote up until the date that CHI receives Customer's Purchase Order. A Quote shall be valid for forty-five (45) days from its most recent issuance or change by CHI. Customer may then either: (a) issue a Purchase Order for the Services; or (b) decline to issue a Purchase Order and provide CHI with instructions as to how to dispose of or return the Customer Part.

5.3. If, after receiving CHI's Quote for Services, Customer does not issue a Purchase Order, Customer shall be responsible for costs and expenses according to the Teardown and Evaluation Purchase Order, together with all costs (on a Time and Materials basis) associated with CHI's packing, reassembly, or disposal of Customer Parts, such packing, reassembly, or disposal costs not to exceed $500.00, absent Customer's written prior authorization.

6. Standard of Service

6.1. Services performed on Customer Parts from Aircraft having a U.S. airworthiness certificate shall be performed in accordance with the following (and, in the event of any contradiction, in the following order of precedence): (a) applicable FARs and FAA-established standards; (b) the OEM's maintenance, repair, and overhaul instructions; and (c) CHI's maintenance policy and shop practices/procedures approved by an FAA-DER. Such Services shall receive an Airworthiness Tag upon their completion.

6.2. All Services performed by CHI shall be performed by qualified CHI personnel.

6.3. CHI may (as it deems advisable in its sole discretion) subcontract out Services to third party vendors that are on CHI's Approved Vendors List.

7. Materials and Replacement Parts

7.1. CHI shall provide all Replacement Parts (other than any Customer Parts provided by Customer) necessary to complete the Services. Customer Parts shall be subject to a handling fee, which shall be itemized in CHI's Quote.

7.2. In conducting Repair or Overhaul services, CHI shall, at its discretion, install OEM, FAA-approved (such as PMA or TSO) parts, repaired parts or serviceable parts. Given the scarcity of certain parts in the market, CHI may obtain repaired or otherwise serviceable parts from other CHI-approved sources. All repaired or serviceable parts will be appropriately inspected, maintained, or altered under the FARs to establish airworthiness.

8. Turn Around Times

The Turn Around Times provided in the Quote will represent CHI's reasonable estimate as to the length of time it will take CHI to complete the Services or supply the Parts. CHI shall use its commercially-reasonable efforts to comply with the Turn Around Times stated in the Quote. Turn Around Times shall begin to run on the later of the date that CHI accepts the Purchase Order or the date that all Customer Parts are Delivered to CHI, and shall cease to run on the date that CHI notifies Customer that the Services have been completed and/or the Serviced Parts are ready for Delivery. CHI shall notify Customer as soon as practicable if the Turn Around Time must be extended and the reasons therefor.

9. Pricing

9.1. The type of pricing shall be specified in the Quote. If the Quote does not specify the pricing used, the price shall be a Best Estimate Price.

9.2. The types of pricing are:

9.2.1. Best Estimate Price – The price quoted is CHI's best estimate as to the cost of the Services and/or Parts. The actual amount due will be determined by the actual Time and Materials required to complete the Services or supply the Parts. Accordingly, the invoiced amount may be less or more than the Best Estimate Price. In no event shall the invoiced price exceed the quoted price by 10%.

9.2.2. Flat Rate Price – The price quoted is the flat rate for the type of routine Service requested. Invoiced amounts will be equal to the Flat Rate Price quoted, except that CHI may ask Customer for permission to charge an additional amount on a Time and Materials basis for labor and materials/Replacement Parts that the Parties expressly agree are not routine for the type of Service quoted. For the sake of clarity, incorporation

of a service bulletin, part upgrades, and the repair of corrosion or excessive damage shall not be considered to be routine Services. CHI may not commence any Service or order any Replacement Part that was not included in the Flat Rate Price, or invoice Customer therefor, unless with Customer's prior written consent. In no event shall Customer be liable for payment of any expenses incurred without its prior consent.

9.2.3. Not-to-Exceed Price – The price quoted is the maximum price. The actual amount due will be the lower of the cost of the actual Time and Materials required to complete the Services or supply the Parts, or the Not-to-Exceed

Price.

9.2.4. Firm Fixed Price – The price quoted is the final price.

9.3. The prices for Time and Materials are determined by CHI in accordance with CHI's standard rates in effect at the time of CHI's acceptance of the Purchase Order. Rate changes that occur after CHI's acceptance of the Purchase Order shall not affect the prices for Time and Materials with respect to the Services covered by the accepted Purchase Order.

9.4. CHI shall notify Customer as soon as practicable if: (a) CHI determines that the cost of the Service will exceed the Best Estimate Price in the Purchase Order by more than twenty five percent (25%); or (b) if CHI determines that the cost of materials or Replacement Parts required to complete the Services will exceed 65% of the new list price for the Part. Such notification shall include the new estimated price and a request for Customer to determine whether to continue with the Service. If Customer decides to cease the Services, Customer shall pay CHI on a Time and Materials basis for the Services already completed.

10. Packing

10.1. Customer shall be responsible for packing Customer Parts prior to Delivery to CHI, and shall, wherever commercially reasonable, provide reasonably adequate packing materials capable of reuse by CHI.

10.2. When possible, CHI shall reuse packing materials provided by Customer. If Customer-provided packing materials are deemed insufficient by CHI, or if Customer has not provided any packing materials, CHI shall notify Customer of the estimated price of packing materials. Customer shall be responsible for any additional costs of packing materials on a Time and Materials basis. Such costs shall be in addition to the project price noted in the Quote.

10.3. CHI shall be responsible for packing all Serviced Parts prior to Delivery to Customer. The cost of CHI's labor required for packing shall be included in the Quote.

11. Delivery and Acceptance

11.1. CHI shall Deliver all Parts EXWORKS (INCOTERMS) at CHI's Facility. Delivery shall be deemed effective upon receipt of the Parts by Customer or its nominated freight agent.

11.2. Delivery of Customer Parts to CHI shall take place only upon receipt at CHI's Facility.

11.3. Customer shall be deemed to have inspected and accepted any Services or Parts upon the earlier of: (a) the date that Customer notifies CHI that it has accepted such; (b) five (5) days after Customer inspects such, provided Customer does not notify CHI to the contrary; or (c) thirty (30) days from the date Customer is in receipt of such, provided Customer does not notify CHI to the contrary.

12. Shipping and Transportation

12.1. All Customer Parts shall be transported to CHI's Facility DDP, unless specifically agreed to the contrary.

12.2. All Parts shall be transported from CHI's Facility to the designated destination by Customer, EXWORKS.

13. Title and Risk of Loss

13.1. Title to Customer Parts shall remain with Customer (or the End-User, if applicable) at all times.

13.2. For Replacement Parts and Spare Parts, title shall transfer to Customer in accordance with the INCOTERM applicable to the transaction.

13.3. The risk of loss for all Parts shall transfer in accordance with the INCOTERM applicable to the Transaction.

14. Failure to Take Delivery, Storage and Disposal of Customer Parts

14.1. All items that are removed from Customer Parts and unrelated to the Services shall be reinstalled prior to Delivery. Unless agreed otherwise by Customer, all repairable items removed from Customer Parts but not reinstalled shall be returned to Customer at the time of Delivery. All non-repairable items, including life-limited parts without remaining life status (in accordance with FAR § 43.10) and expendable items removed from Customer Parts, shall be disposed of by CHI at CHI's expense.

14.2. If Customer requests CHI to store Parts, or if Customer fails to take Delivery of Parts within ten (10) business days of notification by CHI that such Parts are ready and available for Delivery, CHI may charge additional storage fees. CHI will determine the amount of such storage fees at the time of storage, but shall not exceed any applicable statutory maximum.

15. Invoicing and Payment

15.1. CHI shall provide open credit up to [insert amount as approved by CHI Finance] (the "Credit Limit") with Invoices provided upon Delivery, and payment due within thirty (30) days (net thirty) of the Invoice date. Any amount due that exceeds the Credit Limit shall be paid by Customer prior to the commencement of CHI's performance under the Purchase Order.

15.2. Payment shall be made by Customer via wire transfer direct to CHI's bank account:
Columbia Helicopters, Inc. [insert banking information]

16. Delays in Payment

Interest owed on delayed payments to CHI shall accrue at the lesser of: (a) a monthly rate of 1%; or (b) the maximum amount allowed by applicable law.

17. Taxes and Duties

17.1 In addition to the Invoice price, Customer shall pay any and all taxes (not including any income taxes paid by CHI), fees, duties, or other charges which may be imposed by any government authority arising from the sale, Delivery, or use of any Part or Service provided hereunder, for which CHI may be held responsible for collection or payment, either on its own behalf or that of Customer. Customer shall defend and indemnify CHI against any such taxes, fees, duties, or charges.

17.2 Customer shall provide to CHI an appropriate exemption certificate with respect to all sales, and CHI shall not charge sales taxes on any invoices to Customer.

18. Limited Warranties

18.1. CHI warrants that: (1) the Services shall be performed in a workmanlike manner and in compliance with applicable FAA rules and regulations; and (2) the Parts provided to Customer shall be airworthy at the time of their Delivery. CHI's sole and exclusive obligation under this warranty is to repeat any Services that do not comply with this standard and to repair damage to Customer's Parts caused directly by such non-compliant Services. For Services related to Parts other than avionics and electrical instrument components, this warranty shall be valid for a period of: (a) one (1) year from the Delivery to Customer or; (b) six (6) months from the installation of the Parts onto an Aircraft or; (c) two hundred-fifty (250) hours of operation, whichever is shortest. For Services related to avionics and electrical instrument components, this warranty shall be valid for a period of ninety (90) days for Repairs and six (6) months for Overhauls. The warranty period for warranty Services provided hereunder shall be the unexpired portion of the original warranty, if any, on the original Service.

18.2. The warranty provided herein shall not apply:

18.2.1. To defects, nonconformities, failures, or abnormal wear and tear, which are attributable in whole or in part to: (a) Customer's (or a third party's) non-conformance or non-compliance with CHI's (or the OEM's) operation or maintenance manuals, or other instructions or recommendations on storage, handling, installation, maintenance, or operation; (b) other misuse, accident, or negligence on the part of Customer or any third party; or (c) foreign object damage, internal object damage, or damage by the elements including, but not limited to, corrosion and erosion;

18.2.2. If Customer fails to notify CHI in writing within thirty (30) days following discovery of the defect (but not later than the warranty notice period set forth above). Such written notification shall contain a description of the defects observed and give the reasons, conditions, and circumstances of the defects; or

18.2.3. If Customer or any third party undertakes any action, other than installation and routine maintenance (not including Repair or Overhaul), on Serviced Parts.

18.3. CHI does not provide any warranty for materials or Parts. The warranties associated with materials and Parts shall pass directly from the manufacturer/supplier to Customer.

18.4. Upon receipt of written notification of a warranty claim, CHI, using its sole discretion, shall determine whether the warranty applies or further inspection is necessary. If further inspection is necessary, CHI shall notify Customer whether CHI will send a technician to inspect the Serviced Parts on location or require the Serviced Parts be transported to CHI's Facility. After inspection, if CHI, in its sole discretion, determines that this warranty does not apply, Customer shall pay all costs of inspection and shipping on a Time and Materials basis. CHI shall reimburse Customer for the shipping costs of any Serviced Parts which are repaired or replaced pursuant to this warranty.

19. Limited Liabilities/Waiver

19.1. In no event shall either Party be liable to the other Party (or any third party) for any incidental damages, consequential damages, special damages, indirect damages, diminution of value, loss of profits, loss of revenues, or loss of use, even if the other party is informed of the possibility of such damages. CHI's liability for damages arising out of or related to this Agreement is limited to the price paid for the specific Services or Parts that give rise to the claim. To the extent permitted by applicable law, these limitations and exclusions shall apply regardless of whether liability arises from breach of contract, warranty, tort (including, but not limited to, negligence), by operation of law, or otherwise.

19.2. The warranties and liabilities of CHI set forth in this Agreement are expressly in lieu of, and Customer hereby waives and releases CHI from, any and all other warranties; agreements; guarantees; conditions; duties; obligations; remedies; any direct, indirect or incidental or consequential damages whether in contract or in tort; loss such as (but not limited to) diminution of value or loss of operation, profit or use; liabilities (whether express or implied) arising by law, custom, or otherwise as to the title, airworthiness, value, quality, durability, description, condition, design, operation, or merchantability; claims related to the infringement of any patent, copyright, design, or other proprietary right; or to fitness for use for a particular purpose; or to the quality of the material or workmanship of Services, the absence therefrom of latent defects, or as to any other representation or warranty whatsoever, express or implied (INCLUDING, BUT NOT LIMITED TO, ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, OR ANY IMPLIED WARRANTY IN THE COURSE OF TRADE OR THE COURSE OF DEALING) with respect to the Parts or Services. Customer hereby waives, releases, renounces and disclaims expectation of, or reliance upon, any such representation or warranties, it being understood that all conditions, warranties, and representations (or obligations or liabilities in contract or in tort) in relation to any of those matters, express or implied, statutory or otherwise, are expressly excluded. No agreement or understanding altering or extending CHI's liability shall be binding upon CHI except if in writing and signed by a duly authorized representative of CHI.

19.3. The Parties agree that this paragraph entitled "Limited Liabilities/Waiver" and the paragraphs entitled "Indemnification" and "Limited Warranties" have been the subject of discussion and negotiation and are fully understood by the Parties, and that the terms and conditions of this Agreement were arrived at in consideration of the provisions of these paragraphs.

20. Indemnification and Defense

20.1. Each party (as "Indemnitor') shall defend and indemnify the other Party (including that other Party's corporate parents, employees, officers, and directors; collectively, "Indemnitee") against any and all claims, lawsuits, causes of action, damages, liabilities, costs, fines, and penalties (including associated attorneys' fees and court costs; collectively, "Claims") arising out of this Agreement (or the Parts and/or Services provided by CHI hereunder) and to the extent caused by the Indemnitor's negligence, gross negligence, recklessness, and/or wilful or intentional misconduct.

20.2. The Parties' obligations under this Section 20 shall survive the termination of this Agreement and/or the sale of the Parts by Customer.

21. Insurance

21.1. Customer shall obtain and maintain during the term of this Agreement, at Customer's expense, policies of insurance, issued in a form and with aviation insurers of recognized responsibilities. Customer shall be solely responsible for payment of any and all deductibles or self-insured retentions under its insurance policies. The coverage afforded under any insurance policy obtained by Customer pursuant to this paragraph shall be primary to, and non-contributory with, any CHI coverage.

21.2. Minimum Limits Do Not Limit Liability or Represent Coverage Adequacy: The minimum limits of coverage required by this Agreement may be satisfied by a combination of primary and/or excess or shared insurance policies. Customer's maintenance of this insurance shall not in any way operate to limit the liability of Customer under this Agreement. By requiring insurance herein, CHI does not represent that coverage and limits will necessarily be adequate to protect Customer.

21.3. Minimum coverage requirements shall be as follows:
21.3.1. Customer shall maintain Aviation Liability Insurance with a per-occurrence limit of at least [insert amount as approved by CHI Finance] combined single limit bodily injury and property damage.
21.3.2. CHI will provide evidence of Aviation Liability including Products/Completed Operations, Premises Liability and Hangarkeepers Legal Liability of [insert amount as approved by CHI Finance] each occurrence and in the annual aggregate combined single limit bodily injury and property damage and, with respect to Hangarkeepers Legal Liability, per aircraft/per location.
21.4. Customer shall ensure that its aviation liability policy, required by Article 21.3.1 hereof, shall: a) name CHI (and CHI's employees, officers, and directors) as additional insureds with respect to the operations of the Customer, b) provide a Breach of Warranty clause with respect to the operations of the Customer, c) be primary without right of contribution by any insurance carried by CHI with respect to the operations of the Customer, and d) contain a cross liability clause.
21.5. Customer and CHI shall, prior to any service hereunder, provide certificates of insurance evidencing the required insurance and providing 30 days prior written notice of cancellation to Customer or CHI in the event of cancellation or adverse material change.

22. Compliance with U.S. Export Control Laws
22.1. To the extent that any of the Parts, Services, or related Technical Data provided by CHI hereunder are subject to U.S. Export Control Laws, including the U.S. Export Administration Regulations ("EAR") and the International Traffic in Arms Regulations ("ITAR") and if fulfilling the terms of the Purchase Order requires an "export", as that term is defined in EAR/ITAR, and if EAR/ITAR requires prior approval for such an export, then CHI will not Deliver any Part, Service, or Technical Data until such approval has been obtained. Customer agrees to assist CHI with obtaining such approval.
22.2. The Parties agree that each shall fully comply with EAR and ITAR. Such compliance with EAR and ITAR shall include, but shall not be limited to, refraining from exporting any Part, Service or technical data outside of the U.S. prior to ensuring that all necessary approvals/export licenses have been applied for and obtained by the shipper of record; and refraining from exporting any Part, Service or Technical Data to any country without first obtaining any required approvals/export licenses. Customer must provide CHI with the country of end-use and the name of the end-user for each Part, if known at the time of sale by CHI to Customer (e.g., the Part is included in Customer's inventory for sale to as-yet-unknown third parties).
22.3. Customer shall grant CHI reasonable access to documents, materials, or information that CHI may reasonably request in furtherance of any compliance efforts under this section. Customer shall also assist CHI in obtaining any required U.S. Government approvals.
22.4. Either party may immediately terminate this Agreement and any Purchase Order if the terminating Party reasonably believes that the other has, is, or is about to violate any U.S. Export Control law or regulation. The Parties also understand and acknowledge that this Agreement and any Purchase Order may be terminated or restricted due to the actions of the U.S. Government or other applicable government(s). Neither Party shall be liable in any way to the other in the event of a termination pursuant to this section or any action or inaction by the U.S. or any other government(s).

23. Intellectual Property Rights
CHI's provision of Services or Parts hereunder shall not constitute in any way a transfer to Customer, or any right of use by Customer, of all or part of the intellectual property rights owned by CHI or licensed to CHI by any third party. CHI shall remain the exclusive owner of any intellectual property rights related to the Services or Parts supplied by CHI including, but not limited to, industrial processes.

24. Confidentiality
24.1. The Parties shall keep in strict confidence all Confidential Information obtained from each other. Confidential Information shall only be used to perform this Agreement, and shall not be disclosed to a third party unless that third party: (a) has a need to know the Confidential Information; and (b) has agreed in writing to maintain the strict secrecy of the Confidential Information.
24.2. If a Party is compelled by law to disclose any Confidential Information, that Party will: (a) provide prompt written notice to the other Party; and (b) cooperate with the other Party in obtaining protection for the Confidential Information (or avoiding disclosure entirely).
24.3. The Parties' obligations under this Paragraph shall survive for a period of five (5) years after the termination or expiration of this Agreement.

25. Excusable Delay

25.1. CHI shall not be liable for, nor be deemed to be in default or be liable on account of, delays in performance hereunder or under any Purchase Order due to any of the following causes: natural disasters; wars, warlike operations, armed aggression, insurrections or riots; fires, floods, explosions; accidents; epidemics or quarantine restrictions; any act of government or governmental priorities, allocation regulations, or approvals; any unforeseen act of any government or binding court authority; any change in applicable law or regulations that affect CHI's ability to perform the Services; strikes or labor troubles causing cessation, slow-down or interruption of work; failure of or delay in transportation; inability after due and timely diligence to procure Spare Parts, Replacement Parts, tools, materials or accessories; or due to any other cause to the extent that it is beyond CHI's control or not occasioned by CHI's fault or negligence.

25.2. CHI shall notify Customer within five (5) days of any event causing an excusable delay. The time for performance by both Parties shall be extended by the length of the excusable delay, unless Customer elects to terminate the remainder of the Purchase Order. If Customer so elects, Customer shall pay CHI for all work completed on a Time and Materials basis, or the original price quoted by CHI for the completed scope of work, whichever is lower.

26. Termination

26.1. Either Party may immediately terminate this Agreement without any notice of default or intervention of a court or other governmental entity being required if the other Party: (a) breaches its obligations under the Nondisclosure Agreement; or (b) transfers control of its business in whole or in part to a third party or third parties without the non-assigning Party's prior written consent.

26.2. In the event of a material breach of this Agreement or of any Purchase Order, the party not in default may terminate this Agreement and/or any outstanding Purchase Orders by providing thirty (30) days written notice to the breaching party. In the event that the breach is not cured within the thirty (30) day period, the non-breaching party may terminate this Agreement and any outstanding Purchase Orders, effective at the end of the thirty (30) day notice period.

26.3. Either party may terminate this Agreement for convenience upon thirty (30) days written notice.

26.4. Notwithstanding termination, both Parties agree to fulfill all pre-termination obligations that accrued under this Agreement and related Purchase Orders.

27. Notices and Language

27.1. Any notice or communication under this Agreement shall be sent to the authorized address of the party to whom the notice is to be given via postal service, recognized courier service, fax, or e-mail. The authorized address for the purpose of this Agreement shall be the addresses given below, or any subsequent address as noticed by a party in accordance with this Agreement:

CHI Customer

[insert CHI & Customer contact information]

27.2. All communications, notices, and/or documents exchanged between Customer and CHI shall be in the English language.

27.3. Notices shall be deemed received on the earlier of the date they are actually received by the receiving party or five (5) days after being sent by the sending party, provided they were sent to the correct address via express delivery.

28. Precedence

In case of conflict between the terms of this Agreement and any Exhibit, RFQ, Quote, Purchase Order, Purchase Order acceptance, Invoice, or any other document or agreement between the Parties, the terms of this Agreement shall prevail, unless the conflicting term makes specific reference to the terms of this Agreement and is signed by duly authorized representatives from both Parties.

29. Miscellaneous

29.1. This Agreement replaces any previous written or oral understanding or agreement between CHI and Customer and, together with Exhibits, Quotes, and Purchase Orders accepted hereunder, is the only arrangement between the Parties currently in effect, except for the Nondisclosure Agreement between the Parties. No change in or addition to the terms and conditions contained herein shall be valid unless set forth in writing and duly signed by both Parties.

29.2. If any provision of this Agreement is held to be invalid or unenforceable, said provision shall be deemed to be non-existent, and such invalidity or unenforceability shall not affect any other provision of this Agreement or the Agreement as such. The provision found to be invalid or unenforceable shall be replaced by a provision mutually agreed upon, expressing the original intent of the invalid and unenforceable provision to the maximum extent possible under applicable law.

29.3. The possible failure by a Party to exercise, or decision of a Party not to exercise, any right hereunder in a particular event shall not constitute or imply a waiver or release by such Party of the continuing obligation of the other Party to comply with the provisions hereof or of the right to require full performance of such obligations later or in any subsequent event.

29.4. Customer may not assign or transfer its rights or obligations under this Agreement to any other individual or business entity without the prior written consent of CHI, and any such transfer without written consent from CHI shall be grounds for immediate termination of this Agreement and all Purchase Orders accepted hereunder.

29.5. This Agreement may be executed in counterparts and delivered via fax or other electronic means.

30. Applicable Law And Dispute Resolution

30.1. This Agreement is governed by and construed pursuant to the laws of the State of New York, U.S.A. (without regard to conflict of laws principles).

30.2. The Parties agree to resolve all disputes under this Agreement in the state or federal courts located in New York County, New York, to the exclusion of all other forums. Both Parties expressly agree that they are subject to personal jurisdiction in New York County, New York, and waive any right that they may have to assert the doctrine of forum non conveniens (or seek a transfer to another forum) with respect to any lawsuit venued in New York County, New York.

30.3. The Parties agree that monetary damages would be inadequate to compensate a Party in the event of a breach by the other Party of Paragraph 24 of this Agreement. Accordingly, and because of the potential for irreparable harm in the event of such a breach, a Party may, in addition to its other remedies, seek equitable or injunctive relief to address an actual or threatened breach of Paragraph 24 of this Agreement, without having to prove specific damages.

31. Survival

If this Agreement terminates or expires, the following Sections shall continue to bind the Parties: 1, Definitions; 14, Failure to Take Delivery, Storage and Disposal of Customer Parts; 15, Invoicing and Payment; 16, Delays in Payment; 17, Taxes and Duties; 18, Limited Warranties; 19, Limited Liabilities/Waiver; 20, Indemnification and Defense; 21, Insurance, 22, Compliance with U.S. Export Control Laws; 23, Intellectual Property Rights; 24, Confidentiality; 27, Notices and Language; 28, Precedence; 29, Miscellaneous; 30, Applicable Law and Dispute Settlement; and, 31, Survival.

THIS AGREEMENT HAS BEEN DULY SIGNED BY THE PARTIES’ AUTHORIZED REPRESENTATIVES AS OF THE DATE(S) WRITTEN BELOW.

For and on behalf of For and on behalf of
COLUMBIA HELICOPTERS, INC. CUSTOMER
By: By:
Signature Signature

Printed Name Printed Name
Title: Title:
Date: Date:

GROUND HANDLING AGREEMENT

Many airlines subcontract ground handling to airports, handling agents or even to another airline. According to the International Air Transport Association (IATA), conservative estimates indicate airlines outsource more than 50 per cent of the ground handling that takes place at the world's airports. Ground handling addresses the many service requirements of an airliner between the time it arrives at a terminal gate and the time it departs on its next flight. Speed, efficiency, and accuracy are important in ground handling services in order to minimize the turnaround time (the time during which the aircraft must remain parked at the gate). Airlines with less-frequent service or fewer resources at a particular location sometimes subcontract ground handling or on-call aircraft maintenance to another airline, as it is a short-term cheaper alternative to setting up its own ground handling or maintenance capabilities.

Airlines may participate in an industry-standard Mutual Assistance Ground Service Agreement (MAGSA). The MAGSA is published by the Air Transport Association (the current version is from 1981) and is used by airlines to assess prices for maintenance and support to aircraft at so-called MAGSA Rates, which are updated annually based on changes in the U.S. Producer Price Index.[citation needed] Airlines may choose to contract for ground handling services under the terms of a Standard Ground Handling Agreement (SGHA) published in the International Air Transport Association (IATA) Airport Handling Manual. Airlines may also contract for ground handling services under non-standard terms.

Ground handling compromises the many services to an aircraft between the time it arrives at a terminal gate and the time it departs from the gate for its next flight. Speed, efficiency and accuracy are important in ground handling operations in order to minimize turnaround time and ground handling costs. Airlines are interested to look at a reduction of Direct Operating Costs (DOC), because DOC include not only ground handling costs, but also depreciation, interest, insurance, fuel costs, maintenance costs, crew costs, landing fees and navigation fees.

Improvements to ground handling operation always aim at reducing turnaround time and ground handling costs, however it needs a close look to find out, if improvements to ground handling operations also reduce Direct Operating Costs. This has to be done because in some cases a reduction in ground handling increases the aircraft weight and delivery price, which lead to snowball effects, indirectly increasing other DOC cost items.

Most ground services are not directly related to the actual flying of the aircraft, and instead involve other tasks. The major categories of ground handling services are described below:

Cabin service

These services ensure passenger comfort. The cabin cleaning is the main job in the cabin service. They include such tasks as cleaning the passenger cabin and replenishment of on-board consumables or washable items such as soap, pillows, tissues and blankets.

Catering

Catering includes the unloading of unused food and drinks from the aircraft, and the loading of fresh food and drink for passengers and crew. Airline meals are typically delivered in Airline service trolleys. Empty or trash-filled trolley from the previous flight is replaced with fresh ones. Meals are prepared mostly on the ground in order to minimize the amount of preparation (apart from chilling or reheating) required in the air.

Ramp service

- Luggage being unloaded from a Northwest Airlines Boeing 757-200 at Amsterdam Airport Schiphol
- A British Airways aircraft being refueled
- Pushback tractor and a ground power unit
- Lavatory drainage

STANDARD GROUND HANDLING AGREEMENT (SGHA)
between: ULTRA AVIATION SERVICES, INC. and:
The agreement consists of:
MAIN AGREEMENT, and, as required, ANNEX A (description of services)
ANNEX(ES) B (location(s), agreed services and charges)

DEFINITIONS AND TERMINOLOGY
For the sake of clarity, the following definitions and terminology apply to the SGHA;
AIRPORT TERMINAL means all buildings used for arrival and departure handling of aircraft.
ARRANGE (or MAKE ARRANGEMENTS FOR) implies that the Handling Company may request an outside agency to perform the service in question. The charge of the outside agency shall be paid by the Carrier. The Handling Company assumes no liability toward the Carrier for such arrangements.
AS MUTUALLY AGREED or BY MUTUAL AGREEMENT or BY THE CARRIER'S REQUEST, it is recommended that, whenever this terminology is used, such items be supported by specific documentation or reference.
CARGO includes the Carrier's service cargo and company mail.
THE CARRIER'S AIRCRAFT means any aircraft owned, leased, chartered, hired or operated or otherwise utilized by or on behalf of the Carrier and in respect of which the Carrier has either expressly or implicitly contracted, instructed or otherwise requested the Handling Company to perform or carry out any ground handling service(s).
DEPARTURE CONTROL SYSTEM (DCS) means an automated method of performing check-in, capacity and load control and dispatch of flights.
DIRECT LOSS means a loss arising naturally or directly from an occurrence and which excludes remote, indirect, consequential, or special losses or damages, such as loss of revenue or loss of profit.
ELECTRONIC DATA INTERCHANGE (EDI) means the computer-to-computer (application-to-application program processing) transmission of business data in a standard format.
LOADS means baggage, cargo, mail and any aircraft supplies including ballast. OWNING CARRIER means a carrier who is the owner or lessee of a Unit Load Device. PASSENGERS includes the Carrier's service and free passengers.
PROVIDE implies that the Handling Company itself assumes responsibility for the provision of the service in question.
RECEIVING CARRIER means a carrier who receives a Unit Load Device from a transferring carrier at a transfer point.

SPECIAL SHIPMENTS means, for example, perishables, live animals, valuables, vulnerable cargo, news material, dangerous goods etc.
SPECIALISED CARGO PRODUCTS means, for example, express cargo, courier shipments, same day delivery.
STATION MANAGEMENT means management of Carriers administrative and/or operational functions(s) within scope defined in the Annex B.
SUPERVISION means oversight of services performed by third parties, i.e. companies who have a separate Annex B (or similar contact with the carrier). The term Supervision shall not apply to the Handling Company self-management of own services or oversight of Handling Company's subcontractors (as referenced to in Article 5 of the Main Agreement.
TECHNICAL LANDING is a landing for other than commercial reasons where no physical change of load occurs.
TICKET means either the document entitled “Passenger Ticket and Baggage Check” or any electronic ticket data held in the Carrier's data base.
TRANSFERRING CARRIER means a carrier who transfers a Unit Load Device to a receiving carrier at a transfer point.
TRANSIT FLIGHT is an aircraft making an intermediate landing for commercial reasons where a change of load occurs.
TRUCK HANDLING means loading and/or unloading a truck operating as a Truck Service.
TRUCK SERVICE means a service operated by truck on behalf of an airline carrying loads documented in accordance with the applicable IATA and/or ICAO rules, regulations and procedures. In the Main Agreement and in Annex A, the word “aircraft” will read “truck” and “flight” will read “truck service” when it concerns the handling of a truck as meant under the above definitions. In Section 5, Item 5.5.5 of Annex A, the word “vehicle” means a conveyance of any kind to be used within the ramp area for transport of cargo between warehouse and truck or between two trucks or between two warehouses.
TURNROUND FLIGHT is an aircraft terminating a flight and subsequently originating another flight following a complete change of load.
UNIT LOAD DEVICES (ULDs) means devices which interface directly with an aircraft restraint system and are registered by the IATA ULD Technical Board.

An Agreement made between: having its principal office at:
hereinafter referred to as ‘the Carrier’ or ‘the Handling Company’ as the case may be, and:
having its principal office at:
hereinafter referred to as ‘the Handling Company’ or ‘the Carrier’, as the case may be,
the Carrier and/or the Handling Company may hereinafter be referred to as “the Party(ies)”

WHEREBY THE PARTIES AGREE AS FOLLOWS:

ARTICLE 1. PROVISION OF SERVICES

1.1 General

The services will be made available within the limits of possibilities of the Handling Company and in accordance with the applicable IATA and/or ICAO and/or other governing rules, regulations and procedures.
It is not considered necessary or possible to specify every detail of the services it being generally understood what such services comprise and the standards to be attained in their performance.

1.2 Documents for Ground Handling

Documents used for ground handling will be the Handling Company's own documents, where applicable, provided these documents comply with standardized formats that may apply under IATA and/or ICAO and/or other governing rules, regulations and procedures.

1.3 Scheduled Flights

The Handling Company agrees to provide for the Carrier's Aircraft for flights operating on an agreed schedule at the location(s) mentioned in the Annex(es) B, those services of Annex A as are listed in the Annex B for the respective locations. The Carrier, in turn, agrees to inform the Handling Company as soon as possible about any changes of schedule and/or frequencies and/or types of aircraft.

1.4 Extra Flights

The Handling Company will also provide the services to the Carrier's Aircraft for flights in addition to the agreed schedule at the same locations, provided that reasonable prior notice is given and the provision of such additional services will not prejudice commitments already undertaken.

1.5 Priority

In case of multiple handling, priority shall, as far as possible, be given to aircraft operating on schedule.

1.6 Emergency Assistance

It is the responsibility of the Handling Company to participate in local emergency response plan(s) in order to provide support to the Carrier in the event of an emergency including but not limited to, forced landings, accidents or acts of violence.

Carrier will contact the Handling Company to establish the carrier's needs in an emergency and provide the Handling Company its current emergency procedures.

In the absence of Carrier instructions, in part or whole, the Handling Company shall follow its own emergency response plan(s)

In case of an emergency, the Handling Company shall without delay activate its local emergency plan(s) which includes the immediate notification to the Carrier and establish open-line communications with the Carrier.

The Handling Company shall take all reasonable measures to assist passengers, crew and family members and to safeguard and protect baggage, cargo and mail carried in the aircraft from loss or damage in co-operation with the relevant local authorities.

All documentation and information pertaining to the emergency is the property of the Carrier and shall be held confidential by the Handling Company, unless such documentation and information is specifically required by applicable law or by governmental or local authorities regulations.

The Carrier shall reimburse the Handling Company for expenses and disbursements incurred in rendering such assistance.

1.7 Additional Services

As far as possible, the Handling Company will, upon request, provide to the Carrier any additional services. Such services may be governed by special conditions to be agreed between the Parties.

1.8 Other Locations

In case of occasional flights of the Carrier's Aircraft at locations which are not designated in the present Agreement, where the Handling Company maintains a ground handling organization, the Handling Company shall, on request, make every effort, subject to the means locally available, to furnish necessary services.

ARTICLE 2. FAIR PRACTICES

2.1 The Handling Company will take all practicable measures to ensure that sales information contained in the Carrier's flight documents is made available for the purposes of the Carrier only.

2.2 Neither Party to this Agreement shall disclose any information contained in Annex(es) B to outside parties without the prior consent of the other Party, unless such information is specifically required by applicable law or by governmental or authorities' regulations, in which case the other Party will be notified accordingly.

ARTICLE 3. SUBCONTRACTING OF SERVICES

3.1 The Handling Company is entitled to delegate any of the agreed services to subcontractors with the Carrier's consent, which consent shall not be unreasonably withheld. It is understood that, in this case, the Handling Company shall nevertheless be responsible to the Carrier for the proper rendering of such services as if they had been performed by the Handling Company itself. Any subcontracting of services and the provider(s) thereof, will be recorded in the Annex(es) B.

3.2 The Carrier shall not appoint any other person, company or organization to provide the services which the Handling Company has agreed to provide by virtue of this Agreement, except in such special cases as shall be mutually agreed between the Parties.

ARTICLE 4. CARRIER'S REPRESENTATION

4.1 The Carrier may maintain at its own cost, its own representative(s) at the location(s) designated in the Annex(es) B. Such representative(s) and representative(s) of the Carrier's Head Office may inspect the services furnished to the Carrier by the Handling Company pursuant to this Agreement, advise and assist the Handling Company and render to the Carrier's clients such assistance as shall not interfere with the furnishing of services by the Handling Company.

4.2 The Carrier may, by prior written notice to the Handling Company and at its own cost, engage an organization (hereinafter referred to as ‘the Supervisor’) to supervise the services of the Handling Company at the location(s) designated in Annex(es) B. Such notice shall contain a description of the services to be supervised.

The Supervisor shall have the same authority as defined above in Sub-Article 4.1 for the Carrier's own representative.

4.3 Such assistance, when performed by the Carrier's representative(s) and/or Supervisor(s) will be the sole responsibility of the Carrier, unless requested by the Handling Company.

ARTICLE 5. STANDARD OF WORK

5.1 The Handling Company shall carry out all technical and flight operations services as well as other services also having a safety aspect, for example, load control, loading of aircraft and handling of dangerous goods, in accordance with the Carrier's instructions, receipt of which must be confirmed in writing to the Carrier by the Handling Company. In the case of absence of instructions by the Carrier, the Handling Company shall follow its own standard practices and procedures provided they comply with the applicable IATA and/or ICAO and/or other governing rules, regulations and procedures.

5.2 The Handling Company will carry out all other services in accordance with the Carrier's procedures and instructions, or as mutually agreed. In the case of absence of instructions by the Carrier, the Handling Company shall follow its own standard practices and procedures.

5.3. The Handling Company agrees to take all possible steps to ensure that, with regard to contracted services, the Carrier's Aircraft, crews, passengers and load receive treatment not less favorable than that given by the Handling Company to other Carriers or its own comparable operation at the same location.

5.4 The Handling Company agrees to ensure that authorizations of specialized personnel performing services for the Carrier are kept up-to-date. If at any time the Handling Company is unable to provide authorized personnel as requested by the Carrier, the Handling Company shall inform the Carrier immediately.

5.5 The Carrier shall supply the Handling Company with sufficient information and instructions to enable the Handling Company to perform its handling properly.

5.6 In the provision of the services as a whole, due regard shall be paid to safety, security, local and international regulations, applicable IATA and/or ICAO and/or other governing rules, regulations and procedures and the aforementioned request(s) of the Carrier in such a manner that delays and damage to the Carrier's Aircraft and load are avoided and the general public is given the best impression of air transport.

5.7 The Handling Company must report to the Carrier's representative immediately all loss of or damage, threatened or actual, to aircraft and loads noticed in the course of the handling or which in any other way comes to the knowledge of the Handling Company.

5.8 The Parties shall reach mutual agreement on the quality standards for any services, not excluding those covered by Sub-Article 5.1 above. Such quality standards for a specific location may form part of the applicable Annex B. The Handling Company agrees to take all possible steps to ensure that, with regard to contracted services, the agreed upon quality standards will be met.

5.9 The Carrier may at its own cost, by prior written notice, audit the designated services in the applicable Annex(es) B. Such notice shall contain a description of the area(s) to be audited. The Handling Company shall cooperate with the Carrier and will undertake any corrective action(s) required.

5.10 In the provision of the Services, the Parties agree to comply with any applicable data protection laws.

5.11 The Handling Company will supervise and manage its own activities and/or those subcontracted as agreed/covered scope of services with Annex B.

5.12 The Handling Company Shall be able to demonstrate a Safety management System in use following IATA AHM610 and/or ICAO, local and international regulations, or other governing rules.

ARTICLE 6. REMUNERATION

6.1 In consideration of the Handling Company providing the services, the Carrier agrees to pay to the Handling Company the charges set out in the respective Annex(es) B. The Carrier further agrees to pay the proper charges of the Handling Company and to discharge all additional expenditure incurred for providing the services referred to in Sub-Articles 1.4, 1.6, 1.7 and 1.8.

6.2 The charges set out in Annex(es) B do not include:

— any charges, fees or taxes imposed or levied by the Airport, Customs or other authorities against the Carrier or the Handling Company in connection with the provision of services herein by the Handling Company or in connection with the Carrier's flights.

— expenses incurred in connection with stopover and transfer passengers and with the handling of passengers for interrupted, delayed or cancelled flights.

Such charges, fees, taxes or other expenses as outlined above shall be borne ultimately by the Carrier;

ARTICLE 7. ACCOUNTING AND SETTLEMENT

7.1 The Handling Company shall invoice the Carrier monthly with the charges arising from the provision of the

handling services of Annex A as listed in Annex(es) B at the rates of charges set out in Annex(es) B.
7.2 Settlement shall be effected through the IATA Clearing House unless otherwise agreed in Annex(es) B.

ARTICLE 8. LIABILITY AND INDEMNITY

In this Article, all references to:

(a) “the Carrier” or “the Handling Company” shall include their employees, servants, agents and subcontractors;

(b) “ground support equipment” shall mean all equipment used in the performance of ground handling services included in Annex A, whether fixed or mobile, and

(c) “act or omission” shall include negligence.

8.1 Except as stated in Sub-Article 8.5, the Carrier shall not make any claim against the Handling Company and shall indemnify it (subject as hereinafter provided) against any legal liability for claims or suits, including costs and expenses incidental thereto, in respect of:

(a) delay, injury or death of persons carried or to be carried by the Carrier;

(b) injury or death of any employee of the Carrier;

(c) damage to or delay or loss of baggage, cargo or mail carried or to be carried by the Carrier, and

(d) damage to or loss of property owned or operated by, or on behalf of, the Carrier and any consequential loss or damage;

arising from an act or omission of the Handling Company in the performance of this Agreement unless done with intent to cause damage, death, delay, injury or loss or recklessly and with the knowledge that damage, death, delay, injury or loss would probably result.

PROVIDED THAT all claims or suits arising hereunder shall be dealt with by the Carrier; and

PROVIDED ALSO THAT the Handling Company shall notify the Carrier of any claims or suits without undue delay and shall furnish such assistance as the Carrier may reasonably require.

PROVIDED ALSO THAT where any of the services performed by the Handling Company hereunder relate to the carriage by the Carrier of passengers, baggage or cargo, then if the limitations of liability imposed by the Warsaw Convention and/or the Montreal Convention (1999) as applicable and as amended from time to time would have applied if any such act or omission had been committed by the Carrier but are held by a Court not to be applicable to such act or omission committed by the Handling Company in performing this Agreement then upon such decision of the Court the indemnity of the Carrier to the Handling Company hereunder shall be limited to an amount not exceeding the amount for which the Carrier would have been liable if it had committed such act or omission.

8.2 The Carrier shall not make any claim against the Handling Company in respect of damage, death, delay, injury or loss to third parties caused by the operation of the Carrier's aircraft arising from an act or omission of the Handling Company in the performance of this Agreement unless done with intent to cause damage, death, delay, injury or loss or recklessly and with knowledge that damage, death, delay, injury or loss would probably result.

8.3

(a) Notwithstanding the provisions of Sub-Article 8.1, in the case of claims arising out of surface transportation which is provided on behalf of the Carrier and is part of the operation of loading/embarking or unloading/disembarking and/or is covered by the Carrier's Contract of Carriage the indemnity shall not exceed the limits specified in the said Contract of Carriage.

(b) In the case of claims arising out of surface transportation which is not provided on behalf of the Carrier and/or is not part of the operation of loading/embarking or unloading/disembarking and/or is not covered by the Carrier's Contract of Carriage the waiver and indemnity herein contained shall not apply.

8.4 The Handling Company shall not make any claim against the Carrier and shall indemnify it (subject as hereinafter provided) against any legal liability for claims or suits, including costs and expenses incidental thereto, in respect of:

(a) injury to or death of any employees of the Handling Company, its servants, agents or subcontractors; and

(b) damage to or loss of property owned or operated by, or on behalf of, the Handling Company and any consequential loss or damage;

arising from an act or omission of the Carrier in the performance of this Agreement unless done with intent to cause damage, death, delay, injury or loss or recklessly and with knowledge that damage, death, delay, injury or loss would probably result.

8.5 Notwithstanding Sub-Article 8.1(d), the Handling Company shall indemnify the Carrier against any physical loss of or damage to the Carrier's Aircraft caused by the Handling

Company's negligent act or omission PROVIDED ALWAYS THAT the Handling Company's liability shall be limited to any such loss of or damage to the Carrier's Aircraft in an amount not exceeding the level of deductible under the Carrier's Hull All Risk Policy which shall not, in any event, exceed USD 1,500,000 except that loss or damage in respect of any incident below USD 3,000 shall not be indemnified. For the avoidance of doubt, save as expressly stated, this Sub-Article 8.5 does not affect or prejudice the generality of the provisions of Sub-Article 8.1 including the principle that the Carrier shall not make any claim against the Handling Company and shall indemnify it against any liability in respect of any and all consequential loss or damage howsoever arising.

8.6. Furthermore, notwithstanding Sub-Article 8.1.(c), the Handling Company shall indemnify the Carrier against direct loss of or damage to the Carrier's cargo (excluding Mail) caused by the negligent act or omission by or on behalf of the Handling Company in the provision of the services and/or the supply of goods under this Agreement PROVIDED ALWAYS THAT the Handling Company's liability shall be limited to 17 SDR per kilo or to the actual compensation paid out by the Carrier, whichever is less. In any event, the total amount of the claim shall not exceed USD 1,000,000, except that loss or damage in respect of any claim below USD 500 shall not be indemnified. Any claim shall be submitted within the time limits of the Warsaw convention. For the avoidance of doubt, the liability of the Handling Company shall never exceed the liability of the Carrier.

ARTICLE 9. ARBITRATION

In the event of any dispute or claim concerning the scope, meaning, construction or effect of this Agreement, the parties shall make all reasonable efforts to resolve disputes amongst themselves. Failing mutual resolution of the dispute, the parties may elect to resolve the dispute through arbitration (either by a single arbitrator or a panel of arbitrators). In the event that the parties fail to agree to an arbitration process, the dispute shall be settled in accordance with the laws of the state or jurisdiction set out in Annex(es)B, by the courts set out in Annex(es) B without regard to principles of conflict of laws.

ARTICLE 10. STAMP DUTIES, REGISTRATION FEES

10.1 All stamp duties and registration fees in connection with this Agreement, which may be prescribed under the national law of either Party to this Agreement, are payable by that Party.

10.2 All stamp duties and registration fees in connection with this Agreement, which may be prescribed under the national law of the location(s), as mentioned in the Annex(es) B and not being a location situated in the country of either Party to this Agreement will be shared equally between the Parties.

ARTICLE 11. DURATION, MODIFICATION AND TERMINATION

11.1 This Agreement shall be effective from .... the date specified in the respective Annex(es) B. It shall supersede any previous arrangements between the Parties governing the provision of services at locations for which there are valid Annex(es) B to this Agreement.

11.2 Modification of, or additions to this Agreement shall be recorded in Annex(es) B.

11.3 Any notice referred to under this Article 11 given by one Party under this Agreement shall be deemed properly given if sent by registered letter, or by other means where proof of receipt or acknowledgement is obtained, to the respective office of the other Party as recorded in the Annex(es) B. In the case of a registered letter notice shall be considered to be served on the date of receipt.

11.4 This Main Agreement shall continue in force until terminated by either Party giving sixty days prior notice to the other Party.

11.5 Termination by either Party of all or any part of the services to be furnished at a specific location requires sixty days prior notice to the other Party. In the event of part termination of services, consideration shall be given to an adjustment of charges.

11.6 Any Annex(es) B to this Agreement exceeding a defined period of validity, shall continue in effect until terminated by either party providing sixty days prior notice to the other Party.

11.7 In the event of the Carrier's or the Handling Company's permit(s) or other authorization(s) to conduct its air transportation services, or to furnish the services provided for in the Annex(es) B, wholly or in part, being revoked, cancelled, or suspended, that Party shall notify the other Party without delay and either Party may terminate the Agreement or the relevant Annex(es) B at the effective date of such revocation, cancellation or suspension by giving to the other Party notice thereof within twenty-four hours after such event.

11.8 Either Party may terminate this Agreement and its Annexes at any time if the other Party becomes insolvent, makes a general assignment for the benefit of creditors, or commits an act of bankruptcy or if a petition in bankruptcy or for its reorganization or the readjustment of its indebtedness be filed by or against it, provided the petition is found justified by the appropriate authority, or if a receiver, trustee or liquidator of all or substantially all of its property be appointed or applied for.

11.9 Both Parties shall be exempt from obligation if prompt notification is given by either Party in respect of any failure to perform its obligations under this Agreement arising from any of the following causes;—
— labor disputes involving complete or partial stoppage of work or delay in the performance of work;
— force majeure or any other cause beyond the control of either Party.

11.10 In the event of the Agreement or part thereof being terminated by notice or otherwise, such termination shall be without prejudice to the accrued rights and liabilities of either Party prior to termination.
11.11 The Handling Company shall have the right at any time to vary the charges set out in the Annex(es) B provided, however, that the Handling Company has given notice in writing to the Carrier not less than sixty days prior to the revised charges becoming effective. The notice shall specify the revised charges which the Handling Company proposes to introduce, together with the date on which they are to be brought into effect.
11.12 Notwithstanding Article 11.11, when changes occur in the schedule, and/or frequencies and/or types of aircraft, other than those set out in Annex(es) B, which affect the handling costs, either Party shall have the right to request an adjustment to the handling charges as from the date of the change provided that the Party concerned does inform the other Party within thirty days of the change.

Signed the Signed the

at at

for and on behalf of for and on behalf of

by by

CODE SHARING AND INTERLINE AGREEMENT

Code-sharing amongst air carriers became popular within the United States following the deregulation of the domestic air travel market at the end of the 1970s, from there spreading into international markets. In Europe, code-sharing similarly became more popular following EU deregulation in 1993. T he scale and importance of code-sharing is demonstrated by the fact that in the latest annual airline alliance survey of the largest 200 airlines published by Airline Business magazine (in September 2006), virtually all of the over 100 airlines that res ponded had code-shares, usually with several partner airlines.

Although most airline alliance partners code-share on flights (whenever permitted by regulators), not all code-share agreements are between alliance partners. While code-share agreements therefore represent a lower level of co -operation than full membership of the airline alliances, they nevertheless involve significant levels of co - ordination between the airlines involved. In addition to the use of an airline’s code on a flight operated by a different airline, code-share agreements always involve an underpinning set of operational and commercial agreements concerning at least access to, and prices for , seat inventory, and in many cases additional features such as changes to separate agreements allocating revenue and s hared frequent flyer programmes.

In its most basic form, a code -share agreement simply allows for a flight operated by one carrier (which will offer the flight for sale under its own code or designator and associated flight number, such as ‘ XY1234’), also to be marketed by another carrier, under that other carrier ’s code and flight number (e.g. ‘PQ5678’). The carrier operating the flight (in this case, carrier with code ‘ XY’) is known as the “operating carrier”, while the carrier marketing the flight under its own code (in this case ‘PQ’) is known as the “marketing carrier”.

In principle the re is no limit to the number of marketing carriers on any one flight, although Global Distribution System (GDS) system limitations restrict the number to However, it should be noted that GDS rules, which govern the systems that are used to market and sell airline tickets, prevent more than one marketing carrier being displayed for any proposed journey be tween a given pair of origin and destination (“O&D”) airports. Thus, for example, at least seven airlines market code – share flights on BMI-operated flights between London Heathrow and Edinburgh; however, of these, only Lufthansa is able to market the London-Edinburgh O&D journey. The other carriers that put their code on the London-Edinburgh route do so as p art of journeys originating from behind London.

The carrier that issues tickets to the passenger for a journey involving a code-share flight is known as the “ticketing carrier”. Where the complete journey does not involve a third carrier, the ticketing carrier will generally be the same as the marketing carrier (unless the ticket is issued by the operating carrier itself, in which case no code-sharing is involved). Where a third carrier is involved in a passenger’s journey, the carrier is suing the ticket may , in some cases, be neither the operating nor the marketing carrier, but part of the journey may, nevertheless, be booked under the marketing carrier’s code for a flight operated by the operating carrier. This can cause problems in revenue settlement if t he operating carrier, which in general accepts the ticket coupon for carriage on the flights that it operates (or equivalent electronic ticketing procedure), has no interline relationship with the ticketing carrier.

The under lying geography of the routes covered by code-share agreements can be classified into three major types, namely:

- Parallel operation on a trunk route - two carriers both operate the same sector (flown airport pair), and each gives its code to the other’s operated flights. An example of this is flights between Paris and Milan, operated by Air France and Alitalia, which have each others’ codes as well as their own. These are sometimes known as “online code-shares” (although this term may be misleading and we have avoided it in this Report).

- Unilateral operation on a trunk route - a carrier puts its code on a sector operated by another carrier, but not by itself, and not (necessarily) connecting to one of it s own operated flights (for example, British Airways puts its code on Manchester-Chicago, operated by American Airlines; Delta puts its code on Paris-Boston, operated by Air France). These are sometimes known as “network extension code-shares”.

- Behind and beyond rout e (connecting to a trunk route service) – a carrier puts its code on sectors, opera ted by another carrier, to pro vide connections with it s own operated services. Connecting code-shares generally require the marketing carrier to sell an interline journey, i.e. one involving travel on its own service and then on the service of the partner carrier (and this kind of code -share is therefore sometimes known as an “interline code-share”). The classic example of this sort of code-share is, for example, when British Airways sells a journey from London Heathrow to, say, Albuquerque, via Dallas, with the US domestic sector operated by American Airlines. However, because of the existence of a code -share agreement, they can nevertheless be distinguished from a tr additional inter line journey, on which passengers simply take connecting flights designated only by the code of the operating carrier.

Space sharing arrangements within Code Share Agreements

Free-sale code share

Free-sale or "free flow" code-share arrangements give the marketing carrier access to the operating carrier’s inventory and allow it to market seats independently of the operating carrier. The risk is completely on the operating carrier since the marketing carrier functions almost as an agent. Moreover, seats availability is determined solely by the operating carrier that can decide whether or not to close seats availability at the prices set by the marketing carrier.

Blocked space code share

Blocked space (blocked seat) agreements allocate the marketing carrier a certain number or percentage of reserved seats on flights provided by the operating carrier. Under a ‘hard’ blocked space code-sharing the revenue risk is borne by both, as operating and marketing carrier are responsible for the sale of their allocated number of seats. The marketing carrier has to pay to the operating carrier the agreed financial contribution for the reserved seats independent of whether or not he succeeds in selling the blocked seats. However, in the context of a ‘soft’ blocked space agreement the marketing carrier can return seats to the operating carrier according to the terms concluded on a bilateral basis.

Two agreements shared benefits

Code-sharing allows airlines to offer their passengers a range of travel options that extend beyond their own network. This type of airline partnership offers air passengers the convenience and confidence of making a booking with a single airline for the entire journey. When agreed upon between airlines, code-sharing can also allow air passengers to earn and redeem frequent flyer rewards on journeys involving one or both airlines. With both interline and code-share agreements, airlines can offer passengers more destination choices with the convenience of a single reservation and the confidence in appropriate connection times.

INTERLINE AGREEMENT

Interline agreements between airlines facilitate travel for passengers who require flights with more than one airline to reach their final destination. The term relates to the ability of one carrier to sell a journey, or part of a journey, on the services of another carrier, together with the procedures for settlement of the revenue owed to the carrying airline. Interline agreements allow air passengers to travel across the networks of multiple airlines with the convenience of a single reservation and the confidence that their itinerary includes appropriate connection times. The agreement allows each airline to accept the other's ticket and covers baggage transfers and liability.

Advantages for the Airline

The main advantage of interlining from an airlines' perspective is revenue increase. The two interlining airlines have the opportunity to offer a highly competitive joint fare that attracts customers to their particular route. Cash flow also benefits the airline that issues the ticket since ticket revenue for both airlines is collected by the issuing carrier. Internal airline accounting procedures process tickets via industry clearing houses, and the issuing carrier then pays other airlines for travel over their routes based on the interline prorate agreement. Interline agreements also simplify customer claims for baggage irregularities and provide a system for settling claims internally after final customer settlement.

Benefits for the Passenger

Air travellers benefit from interline agreements from a cost and convenience standpoint. Many small and medium-sized cities feature air service but often only offer flights to a larger hub airport where a connecting flight takes the passengers to their final destination. Fares between the regional airport and the hub airport are often high, but an interline ticket to the final destination is normally considerably cheaper than the sum of the two local fares. Another added benefit for passengers is that airlines automatically transfer baggage at the connecting airport. Interline agreements also cover irregular operations where customers may be transferred to other airlines at no cost. Other irregularities include baggage damage, delay or loss where the customer deals only with the final delivering carrier regardless of which airline was responsible for the irregularity.

MODULE IV

AIRPORT

CONTRACTS

AIRPORT LEASE AGREEMENTS

While a lease is often considered a complex and daunting document by the legal and real estate neophyte, it can be easily understood and digested if the individual components that comprise the whole are broken down and examined in detail. Every lease, regardless of type, is comprised of essentially the same core elements; understanding the individual components of a lease will provide the necessary building blocks needed to construct and execute a successful airport lease agreement.

The first section will address the basic types of leases at an airport and the core elements included in each. The type of airport lease applicable to each agreement will vary based upon the tenant and anticipated use of the land or facility (i.e., private versus commercial venture). These general lease types can be broken down into the following broad categories:

- Aeronautical versus non-aeronautical leases,
- Land leases,
- Fixed-base operator (FBO) leases,
- Specialized aeronautical service operator (SASO) leases,
- Hangar rental leases,
- Subleases, and
- Airline leases.

Subsequent sections in this chapter will list and detail the core and optional lease elements that comprise a complete lease agreement. How these elements fit into the overall lease, the key considerations of each, and their potential impact on the airport sponsor and tenant are examined.

AIRPORT LEASE TYPES

There are various lease agreements, each with unique characteristics, which are in effect at any given airport. The variance between lease structures is dependent upon the type of tenant (i.e., commercial versus private individual), the location of the leasehold (i.e., airside versus landside), and the type of activity to take place within the leasehold. The structure of the lease, as indicated by the lease elements included in the agreement (discussed later in this chapter), should always reflect the activity, tenant type, and location of the leasehold in order to protect the financial, development, and regulatory needs of the airport. The following sections will present an overview of the characteristics of differing lease types, and the considerations an airport sponsor should take into account before executing a lease agreement.

Aeronautical Versus Non-aeronautical

Many airports have aeronautical, or aviation-related tenants, users, and lessees, and non-aeronautical tenants who lease property from the airport but do not necessarily depend on, nor require, the airport itself for the fulfillment of their business activities. This Guidebook focuses primarily on aeronautical activity, which is most consistent with the core mission of the airport sponsor. However, non-aeronautical airport development is often an important component of the business mix, providing non-aeronautical or nontraditional revenue streams that can help sustain the operating requirements of the public airport.

The airport sponsor often welcomes non-aeronautical uses (e.g., cases where the airport has excess property as the result of buffers put in place to ensure compatible development; the acquisition of property under a noise mitigation program; or public benefit transfer of former military air bases that required a larger land footprint than the public airport). In such instances where the airport sponsor has excess property that is not required for aeronautical use, the FAA is generally supportive of non-aeronautical uses on airport property. Such support typically requires that the airport sponsor receives fair market value for the land, and the non-aeronautical use does not preclude or retard the aeronautical development of airport lands as demand for aeronautical property occurs.

To achieve this balance of aeronautical and non-aeronautical uses, it is important to put quality planning tools in place. The central consideration is to determine when the property will be needed for aeronautical purposes. If good forecasting and planning tools are employed and property is not foreseen to be needed for aeronautical purposes for an extended period of time (e.g., 50 years), the airport sponsor may justifiably pursue non-aeronautical development on that property. Property furthest from airfield infrastructure may have greater potential for non-aeronautical development than property closer to aeronautical surfaces that may have forecasted aeronautical needs in the next 10 to 20 years. In this example, the airport sponsor would be wise to refrain from considering new non-aeronautical development on the property that is forecast to be needed for aeronautical development in as soon as 10 years; new development is likely to require a land lease that would extend beyond 20 years. For this reason, the property furthest from airfield infrastructure may actually have a higher value for non-aeronautical development and should be considered first.

The key is that non-aeronautical development is an important tool for the airport sponsor to employ, but it should be carefully balanced with the core mission of the airport sponsor in developing airport land for aeronautical purposes.

Land Lease

With the possible exception of terminal leases at commercial service airports, land leases are the most common type of airport lease. A land lease is simply an agreement whereby the airport sponsor leases a parcel of land for a stated period of time (term) and the tenant, or the tenant's developer, is responsible for making improvements on that land. Long-term leases of land are most commonly used for the purpose of erecting buildings and/or making improvements. At the end of the lease term, the land and all structures and enhancements will typically revert to the owner.

Land leases should follow the basic format of facility leases and include all of the same references to the Airport Rules and Regulations, and Airport Minimum Standards discussed in Chapter 3. The land lease price per square foot (rent) may vary by location on the airport and possibly by the length of the term. The value of a land lease is also dependent on permitted uses. The site for an FBO, for example, will likely have a greater value than the site for privately-owned aircraft storage hangars because the revenue generation potential is typically much higher on the site where FBO activities are permitted.

Depending upon the type of tenant, facility, and anticipated activity that will take place on the leased land, differing elements and stipulations may need to be included in the lease agreement. Leases for commercial operations may include elements beyond typical core lease elements that are addressed in a standard airport lease policy. These considerations may include stringent insurance requirements, limitations on the types of activity that can take place, revenue sharing agreements, and minimum levels of service that must be offered.

FBO Lease

At most airports, FBO leases represent an area of significant interest and reasonable complexity involving the assembly of exclusive and nonexclusive as well as public and private attributes. The majority of general aviation airports require an FBO to provide a variety of services that are identified in advance by the airport sponsor, typically through a Minimum Standards document. In return for providing this full complement of identified services, the FBO is granted the ability to sell fuel. Fuel sales are typically a significant component of an FBO's business model and income. Additional services an FBO might provide include, but are not limited to, aircraft storage, ground handling, maintenance and repair, flight instruction, aircraft rental, and aircraft sales.

Because the FBO serves as a quasi-public portal to the community, often adjacent to a public ramp, and often tasked with collecting fees on behalf of the airport, FBO leases typically contain as much airport-use agreement terminology as commercial real estate language. The added complexity of an FBO lease dictates that FBO leases be negotiated individually based upon the FBO service levels desired by the airport sponsor and the ability of the FBO to profitably provide said services.

Despite the additional complexity, FBO leases should still follow the basic format of a standard airport facility lease and include all of the same references to the Airport Rules and Regulations and Minimum Standards documents.

SASO Lease

While an FBO provides fueling service and engages in one or more aviation-related services, a SASO provides specialized products and services in one or more of the aviation-related service areas such as flight training or maintenance, excluding the retail sale of fuel. A SASO may operate under a direct lease agreement with the airport or as subtenant of an FBO.

A corporate hangar lease may constitute a SASO lease since its underlying purpose is a commercial enterprise whereby in-house maintenance and fueling activity may be taking place. The lease agreement may allow for these functions taking place in-house but limit these operations to based aircraft only (i.e., no servicing of transient or third-party aircraft) in order to financially protect other on-airport FBO and SASO operators.

Hangar Rental Agreement

A hangar lease is typically flexible enough to accommodate all hangar types, sizes, and tenants, from small T-hangars to large conventional hangars. The variable in these leases is usually the rental price. The rental price of the building may vary based on size, amenities, location, access, and condition or type of door-operating mechanism. It is not uncommon for the same size hangar to have different prices based on amenities. This type of lease generally specifies that hangars are for aircraft storage only. Hangars leased for a business purpose should be covered under an FBO or SASO lease. Storage hangar leases generally prevent a tenant from using the property for conducting a business or for storing other items because aircraft storage hangars typically do not have safety or public amenity attributes required for a proper business venture. The lease should require compliance with Airport Rules and Regulations and Minimum Standards and is generally short in term length to allow for market adjustments in rent.

Sublease (Subletting)

Many agreements include language governing the tenant's ability to sublease (sublet) all, or a portion of, the leased property at the airport sponsor's discretion. Typically, the sublease is for a defined portion of the improvements: space in a conventional hangar, office space in an FBO building, or warehouse space and truck docks in a cargo building, for example. The ability and extent to which an airport tenant can sublease a facility must be clearly stated in the primary lease document between the airport sponsor and tenant. Depending on the type and function of the facility, the airport may require a formal approval process for any potential subtenants, a process that mandates the primary tenant submit written notification of the lessee's intent to sublease a portion of a facility. The submission should provide the following information to the airport:

- Location and size of the proposed sublease,
- Description of proposed use,
- Sub-lessee organization and authorized users, and
- Terms of the proposed sublease agreement.

It is the responsibility of both the airport and primary tenant to ensure that any sublease agreements conform to Airport Minimum Standards policy. The airport has the role of ensuring compliance with policy in its dealing with the primary tenant, as specified in the lease agreement. However, the oversight of sublease compliance can fall equally to both the airport and primary lessee. Since real estate values typically appreciate over time, it is not uncommon for the lessee to have a net profit when subletting space. In cases where the ten-ant pays a known amount for space and sublets for a greater amount, it's not uncommon for the airport sponsor in a commercial leasing scenario to receive a percentage of the profit. Detailed provisions should be spelled out in the lease and any operating agreement to avoid future conflict between the parties in a long-term lease agreement.

EXISTING AIRPORT LEASE AGREEMENTS

Existing airport lease agreements have the potential of affecting future agreements in multiple ways, thus, it becomes important to account for any tenants and agreements that may be impacted by planned development. Several factors may influence lease agreements between the airport and a potential tenant, including existing airport lease policy and non-compete agreements.

Existing airport leasing policy, if applied equitably to existing tenants, will limit the flexibility of the airport to offer discounts, incentives, and other benefits to new tenants without negatively affecting the goodwill of existing tenants. It is the goal of an airport leasing policy to assure that each tenant is treated equitably, so it becomes necessary that the airport consider potential conflict and confusion that might arise when granting lease policy waivers and exemptions to new tenants.

It is the duty of the airport to assure that new agreements are not in conflict with existing leases and airport leasing policy. A cohesive and accessible leasing policy can be a key tool in mitigating any confusion and conflicts that may arise later. Non-compete agreements are generally in conflict with federal grant assurances and difficult to apply to commercial ventures such as an FBO or MRO operation. When seeking to execute a lease for commercial activity, the airport must be aware of current tenants in the same industry and be cognizant that grant assurances require access to new entrants at public airports. If non-compete clauses are prevalent in existing documents, changes may be required.

Airport marketing can be instrumental in developing land and leasing airport property. The marketing targets will differ, depending on whether there is an existing facility or if the airport plans on constructing a new facility. If a facility exists on airport property, the airport will likely market that facility to potential tenants. If the airport is planning to build a new facility, it may need to market to the community and local, state, and federal agencies to garner support for the project. In either case, a good relationship with the community's economic development entity and/or chamber of commerce is always beneficial. In fact, these entities may be able to help the airport secure funding for the project. With an existing facility, the economic development entity may be able to help attract tenants, and, in some cases, even build a workforce. An example of this can be found in the PEMCO project in Tampa, FL (see Appendix A). Characteristics such as the airport's location, possible niches, history, and area demographics should be taken into account as well.

Funding
The ability to enter into a lease agreement is often dependent upon the availability of funding or the ability to obtain project financing. Whether or not the airport sponsor is responsible for financing the development project, either in part or in total, is dependent on the type of project and the financial resources the developer/tenant brings to the table. In addition to airport-specific resources (e.g., revenue derived from existing airport leases, fees, and charges), potential funding sources for an airport development project can be found from a variety of local, federal, and state agencies. These sources may include

- AIP,
- Passenger Facility Charge (PFC) Program,
- Local or state economic development grants,
- Federal economic development agency grants,
- American Recovery and Reinvestment Act (ARRA) bonds,
- Airport issued bonds,
- General obligation bonds, and
- Private financing.

While an airport's operating revenue is generally derived from lease agreements and fees, most airports rely on capital improvement project funding from the FAA through the AIP. Many commercial service airports also levy passenger fees through the PFC Program. Other sources of project funding come in the form of economic development grants should the project meet eligibility requirements, while additional financing options are in the form of subsidized bonds.

Land and Facility Development
Airports and potential tenants have a wide variety of leasing options and examples at their disposal. The land will more often than not require certain improvements such as utilities, access, and preconstruction development. These improvements are usually negotiated in the early stages of project development, to ensure the required elements are available when needed. As development coordinator, the airport's first priority is fostering and supporting aviation. Portions of air-port land may be occupied by entities that have little to no involvement with aviation when airports offer a competitive strategy for stimulating economic activity by preparing excess land for compatible non-aeronautical development. While some airports turn away from leasing or developing land for non-aeronautical use, non-aeronautical development can diversify an airport's revenue stream.

Shovel-ready is a popular term for sites that have utilities, roads, and, in some cases, initial permitting completed before ever talking to potential developers, which only maximizes the desirability of the site. Offering shovel-ready sites that include competitive rates, land entitlements, utilities, facilities, and incentives will support the development of airport property and set the stage for a sustainable revenue base.

In this regard, many airports develop their land before marketing ever begins. Out-of-the-box thinking can be extremely valuable because land/facility development can be a costly prospect. In cases of non-aeronautical development in particular, developers may have many options, most of them on property that can be purchased fee simple, so preparation on the part of the airport can pay big dividends. Aspects of land/facility development include, but are not limited to, the following:

- Utilities such as water, electricity, and sewer;
- Civil site work and soil stabilization;
- Airfield access;
- Roadways and public access;
- Development planning; and
- Maintenance and upkeep of common areas.

The scale of the project, its intended use, the impact on the community, a balance of commercial enterprise versus private use, potential job creation, and public resources needed will all deter-mine the mix of stakeholders that need to be involved. While private-party leases tend to be straightforward, requiring limited stakeholder involvement (e.g., renting a hangar to the owner of a single-engine Cessna), commercial enterprise projects are typically more complex. Commercial enterprises require greater resources and produce a corresponding greater positive impact on the community in terms of job creation and tax revenue. Commercial enterprises are often sought by competing communities, and, through competitive site selection processes, the commercial enterprise may consider incentives offered when choosing its ultimate location. These projects often involve the inclusion of multiple local, state, and federal entities that are needed to provide funding, tax incentives, and other applicable financial incentives, as well as regulatory oversight.

Valuation

Valuation of airport property can vary widely from one airport to the next and is often influenced by both the valuations that are placed on property at other airports and by local influence of the aviation community. In cases where airport development has not been done at the subject airport for some time, the risk of undervaluation can come into play if the airport sponsor did not negotiate appropriate escalation language in the existing leases. In those cases, applying a contemporary method of valuation may be met with resistance if the new valuation is significantly higher than the lease rates already in place. Similarly, airport sponsors that take control of improvements after they revert back to the airport at the end of the lease term may inadvertently undervalue the improved property if they don't seek the assistance of an appropriate valuation methodology.

Airport sponsors that are systematic in their approach to updating rates and charges, and that routinely update the value of both unimproved and improved property, are best prepared when a prospective airport development does present itself. As in most real estate transactions, facility and property valuation should not be too low or the airport sponsor misses a revenue opportunity, but not too high or the airport sponsor misses a development opportunity by not being competitive in the marketplace. The marketplace, in the context of airport development, can sometimes be a large geographic area, because prospective development may have the luxury of considering airports of comparable size within a region of the country, as opposed to more site-specific, non-airport development such as distribution parks, hotels, and restaurants.

LEASE EXECUTION

A lease agreement may take on various forms and include differing stipulations based upon the function, location, and tenants involved (land lease versus facility lease, or aeronautical versus non-aeronautical leases, for example). Many leases will be unique in their development and execution while others will adhere to a standard airport lease policy that can be uniformly applied to multiple tenants, such as in the case of T-hangar leases. The airport sponsor must determine whether the circumstances of a specific lease negotiation are unique enough to deviate from standard terms and contract language, whether deviation from leasing policy in order to accommodate a tenant is appropriate, and/or whether similarity prevails and consistency is more important than accommodating one tenant.

Regardless of whether the anticipated lease agreement is for existing facilities or new development, or for aeronautical versus non-aeronautical use, the best practices of project development discussed below should be applied.

- While ensuring reasonable rates, leasing policies should also state the need to comply with all state, local, and federal building codes.
- Lease terms should be as consistent as possible and clearly understood by all parties.
- An airport may decide to pursue a solicitation process, but in some cases airport property may be leased without seeking competitive proposals when it is in the best interest of the airport or community and described/offered through a visioning document such as an Airport Master Plan. If a solicitation process is required, the process and criteria for approval should be stated clearly in the policy.
- The leasing policy should state whether the transfer of a lease or subletting will be permitted.
- Finally, the airport should establish policy for rent increases. For example, an airport may decide to increase rents on some periodic basis, assuming rents are at fair market value, to keep pace with inflation.

Airport Leasing Policy

A recommended best practice is that airport sponsors develop a standard Airport Leasing Policy that applies to both facility and land leases. The Leasing Policy must be flexible enough to allow for unanticipated development opportunities while being comprehensive enough to account for multiple tenant types and operations. A standard, comprehensive Leasing Policy provides for the equitable treatment of all airport tenants and will minimize questions, concerns, and potential conflict between the airport and its tenants. The Leasing Policy should include, at a minimum, the following provisions:

- Land lease rates (per square foot), differentiated by area. Aeronautical versus non-aeronautical, for example, and consideration of the land's proximity to infrastructure.
- Hangar lease rates (per square foot), with consideration to the gauge of aircraft that the hangar will accommodate in terms of hangar doors size, height, and clear span distance.
- Building and facility lease rates (per square foot).
- Standard lease terms that are compliant with state and local law.
- FBO/SASO lease requirements, which are consistent with an airport's Minimum Standards.
- Process for adjusting rents and fees (living clause).
- Insurance requirements, preferably in one document and adopted by official action, of the governing body. Consolidation of all insurance requirements applicable to the airport allows an air-port to review, update, and have them reconsidered by the governing body from time to time.
- Obligations of lessee, covered in a Rules and Regulations document.
- Routine inspection provisions for safety and compliance of airport tenants and users.
- Construction and improvement standards that outline pre-approval by the landlord and the airport sponsor, local permitting agency requirements, and FAA notification of proposed construction once all other approvals are secured.
- Subletting policy.

Minimum Standards

As with the Airport Leasing Policy document, the airport sponsor should have Minimum Standards that apply to all lessees. This document is necessary to ensure that lessee improvements conform to the operational standards set forth by the airport, and that the level of services provided to the aviation community is appropriate. Minimum Standards are especially relevant to leasing and developing airport property because they speak to what facilities are required for a specific activity. For example, if a parcel of land is less than one acre in size and surrounded by other development, and the Minimum Standards require more than an acre of land for FBO and other commercially-intense business activities, the value of that property, and any improvements on the property, may be affected by the fact that only certain activities will be allowed on a parcel of that size. Therefore, comparable used to value the property and improvements should only include examples with uses that would be allowed on the airport where the subject land resides.

Lease Rate Determination

It should always be the goal of the airport sponsor, in line with FAA guidance, to maximize revenue for the airport. An appraisal of airport property should be conducted in order to determine the base value of airport assets. Land leases for commercial non-aeronautical uses should be based on current market rate comparable. Airside land, aeronautical facilities, and hangar rates should be based on comparable facilities at surrounding airports with similar attributes. In order to accurately value land and facilities, benchmarking of airports of similar size and with similar infrastructure (runway length, instrument approaches, security, and air traffic control for example), should be used in a consistent manner. The same benchmarked airports are tracked over time for comparative purposes. The appraisals and benchmark rates should be used as guidelines for the airport to determine baseline rates that can be subsequently adjusted as new information becomes available.

The airport may vary its lease rates depending upon size, function, location, and level of improvements to the land and the facilities being leased. For example, the rental price of a building or hangar may vary based on size, amenities, location, access, condition, construction, and allowable use by the airport. Likewise, the airport may want to vary land lease rates based upon factors such as the magnitude of the project, the synergistic effect the project may have on other tenants and/or future development, airside versus landside location, availability of utilities, and access (from both the airside and the landside).

The airport may also adjust lease rates below established baseline rates if the tenant provides additional airport revenue through other sources, such as fuel sales or percentage of gross revenue. The airport should consider modifications to rental rates that include a percentage of gross sales, depending on the type of business being conducted. Similarly, the airport might consider land leases that require a percentage of any profit be paid to the airport on the sale of leasehold improvements or equity. Regardless of the rate-setting methodology used, the airport sponsor should create a transparent process for all stakeholders to see and understand. Once transparency is established, the airport sponsor can clearly outline the rationale and justification for its rates and charges, placing itself in a defensible posture that will either hold up to stakeholder criticism or that can be adjusted for broad acceptance by the aviation community.

Lease Term Determination

The Airport Leasing Policy document should consider appropriate lease lengths. Land leases are routinely set at 20- to 30-year terms; lease terms beyond this length may be limited by local or state statutes. Provisions for the extension of a land lease should be included in the lease agreement and outline the requirements that must be met before the lessee is allowed to extend the lease, preferably contingent upon the lessor’s concurrence and approval, by periods of 5 to 10 years. These extensions of the lease are considered addendums to the original lease document with all covenants and provisions of the original remaining in effect. The length of a lease and the ability to extend the lease term is an important consideration for potential tenants who will be making substantial investment in improvements that will need to be amortized over a number of years. It is important to consider the useful life of the improvements and the size of the tenant’s investment when negotiating length of term.

Risk and reward should also be given due consideration. If improvements are very specialized, the developer may need a longer lease term than normal. Without knowing the exact functional life of the improvements, or how the niche industry might change and make the improvements functionally obsolete, the developer may require a buffer of term length to ensure that sufficient time exists to repay the debt and make a reasonable profit.

Reversion

Best practices for leasing and developing airport property include reversion of improvements back to the airport sponsor at the termination of the lease. Therefore, the lease must be long enough for the developer to be able to amortize the investment the company makes in improvements, but not so long as to unnecessarily restrict the options available to the sponsor to develop and improve the airport in the future. The savvy airport sponsor will be prepared to balance these sometimes competing goals so as to attract development without impeding future options, all the while securing market-rate fees that will support the operational costs of the airport in a sustainable fashion.

Regulatory Compliance in Leasing

The airport sponsor must be careful when crafting the lease agreement that federal grant assurances are not violated. Within the lease document, there are four common issues that the sponsor must be aware of: lease term length, economic nondiscrimination, airport sustainability, and the granting of exclusive rights. The following addresses these points in greater detail:

- The lease term should not be longer than 50 years for land that has actual or potential aeronautical uses. The FAA may consider lease terms greater than 50 years as a disposal of land and require fair market value payment from the airport sponsor.
- The lease must ensure economic nondiscrimination; all tenants must be treated equitably when assessing rates, charges, and terms, and, to the extent possible, any provisions and rights afforded to one must be available to all.
- The airport sponsor must maintain a fee and rate structure that will make the airport as self-sustainable as possible. This requires the airport sponsor to know and negotiate market-value rate for airport property.

PPP CONTRACTS AND PRIVATIZATION OF AIRPORTS

PUBLIC-PRIVATE PARTNERSHIPS IN AIRPORTS

Emerging Legal Issues

Aviation industry in India has a chequered history. Pre-1953 aviation Industry was in the private hands. In 1953 the aviation industry was nationalized through Air Corporation Act, 1953.From 1953 to 1980’s, the aviation industry was completely dominated/by the public sector both in airlines and airport sectors. However the Liberalisation, Privatisation, Globalization (LPG) process happened all over the world and India is not an exception. Liberalisation Process in Aviation sector in India

started in mid-1980's through open sky policy first in cargo and later in passenger sector. In the process many airlines started their operations from early 1990's.
In the aviation sector, the liberalization /open skies policy started in India in the late 1980s. A strong consumer demand and constraints on the rapid expansion of national carriers and tourism potential have favoured this policy. India first introduced the open skies policy in cargo services and chartered flights for domestic and foreign carriers. The open skies policy in cargo has facilitated the emergence of all-cargo airlines in India. India's new economic policies in the early 1990s have triggered far-reaching fiscal, trade, industrial and economic reforms, aimed at accelerating growth, employment, productivity and technical innovations. In civil aviation sector, the government repealed the Air Corporations Act 1953 and passed the Air Corporations (Transfer of Undertakings and Repeal) Act in 1994. This Act ended 40 years of state monopoly and a large number of private domestic airlines are now operating in the Indian skies.

The Indian aviation industry has been rapidly expanding in the last few years with the entry of several new airlines especially low cost operators such as Deccan Airlines and Spice Jet, the opening up of international routes for private domestic carriers, the introduction of open skies regimes with several countries like the United States of America, the substantial increase in flight entitlements under bilateral agreements and initiation of private sector participation in the development and management of airports. However as the industry moves away from the state-centric model of the nationalization era where the government was the only significant player in the entire industry (the government controlled both the carriers i.e. the Indian Airlines and Air India and the airport operators) to the multi-player model of the post-liberalization era where there is large scale participation from private players, there is an urgent need to establish an independent regulator that has the mandate to regulate technical and economical aspects in the sector to replace the present obsolete regulatory framework .
At present, the Ministry of Civil of Aviation is the apex civil aviation regulatory institution in India. It is responsible for formulating and implementing the national aviation policy, taking key decisions on all issues related to aviation, initiating major initiatives in aviations and other regulatory bodies like the Directorate General of Civil Aviation (DGCA) and the Bureau of Civil Aviation Security (BCAS) are under its purview. The Directorate General of Civil Aviation (DGCA), created during the British time, is responsible for regulation of air transport services to/from/within India and for enforcement of civil air regulations. The DGCA primarily deals with technical issues related to safety of civil air operations, licensing, maintenance, training and airworthiness standards. It is also responsible for coordination with the International Civil Aviation Organization (ICAO) on various regulatory issues related to international civil aviation. This setup as whole is antiquated and not designed or equipped to meet the regulatory challenges of a highly competitive multi-player industry that has replaced the earlier state monopoly.

The need for a regulatory authority to deal with the important economic issues in the sector is acutely felt as the current decision making authority i.e. the Ministry of Civil Aviation has substantial interest in major industry players like Indian Airlines, Air India, Pawan Hans Corporation and the Airports Authority of India. There is a clear potential for conflict of interest in this case and therefore regulatory functions of the Ministry need to be transferred to an independent regulator.

Secondly, an independent regulator with integrated regulatory functions can address all technical, economic, management, operational, environmental, licensing, liability, safety and security related issues in an holistic manner and creates standards in line with global best practices unlike the current 'piece – meal' approach where a regulator's mandate restricted to just one aspect leading to an overall ineffective regulatory framework and several key issues being not properly addressed at all.

Independent 'super' regulators have been created for other sectors like the telecom (the Telecom Regulatory Authority of India) and insurance sectors (the Insurance Regulatory and Development Authority), which also underwent a similar transition from a state-monopoly model. The TRAI and IRDA have been effective in dealing with key issues in the sector and providing a viable regulatory framework for their respective industries. In the context of civil aviation, several countries like the United States and United Kingdom have successfully followed the independent regulator approach for decades.

The Naresh Chandra Committee has recommended the creation of a regulatory mechanism consisting of an independent regulatory authority with a mandate to deal only with economic functions while the DGCA would retain its technical regulatory functions. However, regulatory experiences in the civil aviation sector from other countries indicate that divorcing economic and technical issues in modern aviation leads to several regulatory problems and hinder the growth of the sector. Therefore, the proposed civil aviation regulatory authority needs to cover both economic and technical issues so that it can effectively deal with the complexities of modern civil aviation in India..

The pioneers of civil aviation in India like J.R. D Tata had dreamt of creating a competitive aviation industry that would be counted among the best in the world. However in the first five decades after independence, despite our territorial advantage and technical expertise, we failed to capitalize on the global aviation boom. With the advent of privatization, India can emerge as an Asian powerhouse in commercial civil aviation and then challenge the western hegemony on the global aviation order. But, for this to dream to turn into reality, a growth oriented and viable regulatory framework by establishing an independent integrated super regulator that can ensure Indian civil aviation industry's smooth flight into the global aviation big league.
With the turn of the century, India started getting noticed as a major player on the global stage. This was the time of economic growth and the growth of the great middle-class. With an all-round economic growth and growing disposable income, there was increased demand for greater mobility by Indians. Government responded very well – aviation sector was taken up on priority and reforms were put in place to make air travel more realizable, safe and comfortable for the burgeoning

middle-class. The airline industry witnessed the influx of many new players thus squashing the duopoly of Air India and Jet Airways. The Government also provided ample impetus to the industry by modernizing and restructuring several airports. Starting with creating The Policy of Airport Infrastructure in 1997 to the actual concessions for the Metro airports, the Government showed great foresight and boldness. Thus, buoyed by an overall positive market sentiment, the 2005-2008 were the golden years of the aviation sectorwhere it very clearly moved on from being a luxury and became a common man's need.Passengers got excellent service from airlines at very competitive fares and improved connectivity across the board. The government received increased revenue from various taxes and surcharge levied on airlines, airports and passengers. The story seemed set for success.

All the infrastructure sectors in India such as Electricity, Oil, Gas, Coal, Telecommunications, Ports, Airports, Inland water ways, Water and Sanitation, Railways and Highways are priority sectors where the Government is actively involving private participation to meet the funding gap. Indian investment needs are enormous, the aspirations of the people are very high, and opportunities the sector presents to investors are enormous. PPPs gives an opportunity to meet India's investment needs that can be translated into a win-win situation for all. The need for such an initiative has arisen because Economic liberalization has distanced the relationship between the state ownership and funding and development of infrastructure in the country. The responsibility of providing infrastructure facilities has now been shared with private investors. The development of infrastructure is in the top priority of the Government. The importance of this can be gauged from the fact that Government of India while presenting the Union Budget for the year 2010-11 has set the platform for infrastructure development by allocating 46% of the total plan expenditure towards infrastructure development while recognizing that Indian infrastructure has the potential to absorb more than US $ 150 billion in FDI over the next five years. PPP presents most attractive option of meeting the targets not only in a timely and lost efficient manner but also in upgrading the standard of delivery through greater efficiency. There are many critical issues and concerns surrounding the design of policies and institutions to promote service delivery such as the Legal prerequisites to attract investment and a balanced Regulatory framework to ensure viability and a level playing field between the Government and the private participants etc.

Regulatory Uncertainty

There are several issues like high fuel costs, high and varying taxes, rupee depreciation, excess competition etc. which has resulted in severe financial distress among Airlines. However, another angle which is more worrisome is the struggle by the private sector – especially those who have invested in regulated sectors – to keep fending off the bureaucratic and red-tape challenges. This is because the laws and governing bodies are too many in number and too scattered in the civil aviation sector. This means regular scrutiny, compliance issues, delay in clearances etc. for all players in the sector.

Let’s rewind our clocks a bit to 2004-5 when the need for world-class airport infrastructure was paramount for India to continue its growth story. The impetus for airports was provided in form of private participation through the much vaunted PPP route. The Government followed an international, competitive, transparent and fair bidding process to select the private players with whom they joined hands to create specialized companies to control the major airports. The structure of this process, the details of the transaction and the selection of the final bidders were decided after several rounds of discussion between various committees formed specially formed for this purpose – 4 in total plus the involved party – the Airports Authority of India. The entire process was also reviewed and approved by an Empowered Group of Ministers and the Cabinet. To top it off, the entire bidding process was scrutinized and deemed transparent and fair by both the Hon’ble High Court of Delhi and the Hon’ble Supreme Court of India.

In their turn, the privatecompanies brought in significant private investment, development and management expertise, operating efficiency and became beacons for “Modern India”. In spite of all the bureaucracies and red-tapes, the projects were completed in time and provided hope for increased encouragement of private investment in the aviation industry – after all these became marquee projects.

That was until an august Constitutional authority like the Comptroller and Auditor General (CAG) of India tabled a damning report in the Parliament – effectively concluding that the privatization of the Delhi International Airport was a black spot on the resume of the aviation sector. Having gone through the C&AG report in detail, I feel disheartened and sad at the lack of objectivity and what might be an effort to sensationalize the issues. While there are many issues with the report (including major factual errors – how can CA&G commit factual errors in its report is beyond my comprehension), I would like to focus on three major concerns

The report mainly talks about the largess that was supposedly doled out to the private players while privatizing the airports. However, as stated above, there were significant checks and balances involved in the entire process – which included scrutiny of all major aspects by as many as 9 different bodies. The supposed freebies being referred to were part of the transaction structure based on the recommendations of reputed international consultants and vetted by various committees. Moreover, the audit conveniently ignores that the final realized bids had a direct correlation with the transaction structure. They would have varied considerably if the conditions would have changed. Hence,either the CAG has ignored the logic or reasoning behind the decisions or else it means to say that these various committees and reviewers were highly incompetent!

On a detailed reading, the report appears to be completely one-sided representation of a majority of facts. The key allegation made by the Authority is around Commercial usage of land. The Authority claims that the private operator can earn Rs. 1.6 Lakh Crore from the land while providing the Government with a paltry Rs. 100 per year. However, the concession of airports by AAI needs to be seen as a whole and not be divided into parts – i.e. usage of land cannot be seen separately from operation of the airport. It is unfair to see the potential earnings from land without considering the revenues being provided to AAI as revenue share. Indeed, as per the Government's own admission, it has received more than Rs. 6,000 Crore from the Delhi and Mumbai airports as revenue share in last 6 years. These funds have been subsequently deployed in up-gradation works of other airports across the country – thus benefiting the aviation sector at large. As the CAG expands its purview to Performance Audits, it becomes even more imperative for the Audit be cognizant of the larger picture while making sweeping statements.

But perhaps, the most disheartening fact about the CAG report is that it completely ignores any and all rulings made by the judiciary and legislative system of the country. Amongst the key allegations made by the C&AG is the one regarding the levy of Development Fee on passengers to fund the shortfall in investment required for development and up-gradation works. However, it fails to take notice of the fact that the levy of this fee was enabled by the Government prior to the process of privatization of the airports – in 2003. Moreover, this matter has been brought by several appellants in front of both the Hon'ble Delhi High Court and the Hon'ble Supreme Court of India. Both these courts have ruled that the levy of Development Fee is completely in accordance with the laws of the land.

When a report is published by an august institution like the C&AG, the entire country takes notice. However, if the private players involved in PPPs with government are forced to deal with such one-sided, inaccurate and vitiating reports – over and above the Business As Usual challenges – it will sound the death knell of the efforts of the government to invite private participation for rapid infrastructure investment. Moreover, it will restrict any progressive law and policy making on the part of current and all future Governments.

As amply showcased globally, and acknowledge by the Planning Commission, India needs private investment in infrastructure to sustain the economic and social growth. Till now, the aviation sector in India is governed by three major legislations – the Aircrafts Act - 1934, Airports Authority of India Act - 1994 and Airport Economic Regulatory Authority Act - 2008. Perhaps, a case needs to be made for a redo of the aviation law – with an aim to tie-up the various nuances and interdependencies of the three Acts into one single legislation. This legislation should aim to achieve a balanced, reliable and supportive role for the sector at large. It needs to support both the day to day operations – by reducing the red-tape – as well as provide protection against such negative publicity. Globally, we have seen many examples which provide us with hope

In the case of Airports, the private sector has played a major role in Airport infrastructure over past few years by constructing world class Airports, bringing cost effectiveness in operation and maintenance. It has also ensured timely and adequate capacity expansion. Historically growth in demand for air travel outpaced Airport infrastructure facility. Realizing this Government decided to restructure and modernize Airports through Joint Venture Companies through PPP route with an objective to set up Airports of International standards and to utilize private funds and management expertise available with them. Private participation has helped to overcome this gap in demand and supply by constructing world class Airport in India who built or upgraded on PPP project models of Delhi, Mumbai, Hyderabad, Bangalore & Cochin Airports. It is needless to mention that the development of the sector requires a robust and Policy driven Regulatory framework. A fair and transparent Regulatory process ensuring Regulatory systems that are insulated from interference and political capture is very important for achieving the desired goal. Anticipating a progressive Regulatory framework private participants have invested heavily in the sector.

Establishment of credible Regulatory mechanism is vital for development of PPP projects. Planning Commission recognized this fact and noted in their policy papers on infrastructure that "the ability to mobilize private resources on large scale depends critically upon the creation of a supportive investor-friendly environment and the regulatory system is a critical component of that environment". Designing the Legislative, institutional and Regulatory framework for successful private partnership envisages determination of well thought out policies which are critical for strategic PPP framework, developing policies and Laws that promote competition, determining the Legal and institutional options for promoting investment and ensuring efficient service delivery. It is also important to understand that all the project risks in Planning, Financing, Economic, Political and Social issues and to evaluate and allocate the risk to all the relevant stakeholders are important. In addition understanding clearly the possible Government guarantees requirements for reducing the risk must be clearly defined. Contracts and Legal agreements are at the heart of any Public Private Partnership transactions. PPPs achieve the objectives set forth by the Government if the agreements are grounded in the rule of law with win - win approach for both the Government and the private participants. Needless to say that poorly structured agreement of PPP projects are doomed to fail. It is important that while designing the PPP project agreements enough care is to be taken while drafting sound PPP contracts so that the agreement should not be open for different interpretations. We should take advantages of International best practice to improve the PPP models which gives confidence to the investors and ensure efficient service delivery. There should be a mechanism to facilitate cross- sectoral pollination of experience and ideas.

Airports are witnessing many commercial activities other than the movement of flights. These commercial activities generate revenue. Resistance to change the mindset of the people are evident from the recent attempt by various agencies to control the PPP projects. More and more private operators are investing into the sector in the construction, operations and maintenance of Airports to world class standard. As explained in earlier para Establishment of Investor friendly regime is vital in attracting huge investments into the sector. Everybody agrees that without the involvement of private sector participation to infuse the much required funds the development of this sector is next to impossible. Hence, the Policy makers has to ensure an investor friendly environment for the smooth flow of both domestic and foreign investment into the sector. There are many issues which are not investor friendly or are rather obstacle for encouraging private participation such as proposal of CAG to audit PPP projects, declaration of private Airports as Public authority for the purpose of Right to Information Act etc. These issues are seriously affecting the investor's interest and willingness to invest in this sector. There are apprehensions that such intrusive Regulations will adversely affect the functional autonomy now available with the PPP projects which are essential for achieving performance. Too much of such oversight from multiple agencies can impede innovations which are badly needed for efficient performance rather than complying with the outdated rules and procedures.

As per the present Policy, no Airport should be allowed generally within 150 km from the existing Airports. However, there are attempts to setup few Airports even within 150 km of existing Airports which seem to be more for political reasons rather than on techno economic considerations. This also will result in duplication of resources and investments. The operators have serious concern on their long term viability. Such proposal should not be considered on routine basis. If at all any such proposal are to be considered, then the concerned Authorities must take into account all aspects including the viability of the existing operator, the traffic potential for both existing and new operator etc. before approving such proposals. More importantly, the viability of the existing Airports is to be ensured before taking a decision to setup a new Airport.

Hesitation In Allowing Full private Participation in 35 Non-Metro Airports

It is evidently clear that the steps taken by the Government for Private participation in Aviation sector is a big success. However in the case of the 35 Non-Metro Airports ear marked for expansion / modernization, the private operators are allowed to participate only for the development of city side and not given the opportunity and responsibility for the airside and terminal development. On one side there is argument that the Government does not have enough budget to undertake such large investments, whereas on the other side the private sector who are willing to invest are not being fully permitted. This is to be changed and Public Private Participation (PPP) model should be followed to allow private operators in the entire modernization process of developing these Airports across the country to world class standards and not limiting the private sector role to city side development alone. Many studies have proved that the PPP projects in the long run will provide the public service more efficiently and economically than a sole public entity. Efficiency consideration also suggests that the ownership of providing public service does not have to be exclusively on public bodies. Mixed public private ownership i.e. PPP will be more efficient in terms of cost and performance. There is no economic reason for limiting the private participation only on the city side development.

Levy of Airport Charges from LCC

Airports are getting revenue from Commercial Aircrafts on account of their using the Airport facilities. However smaller aircraft with 80 seater capacity and below are exempted from payment of landing charges. This results in revenue loss to the Airport operators. In order to encourage regional connectivity the Government had earlier exempted smaller aircrafts from payment of Landing charges. However, now due to robust growth in the economy, airlines are witnessing huge increase in capacity and demand and hence there is no justification for giving exemption to such smaller aircrafts even now as all the airlines are using such smaller aircrafts on commercial business model even on metro routes for generating revenue. Moreover, this is also against the principle of "user pays". The loss of revenue earning potential to the PPP operator is not negligible to ignore.

Conclusions:

Airports play a critical role in promoting trade, tourism and economic development of the country. All PPP Airport operators are striving their best to provide world class Airport infrastructure providing essential services and helping to accelerate the development of aviation sector in India. PPP models must be emulated in all sectors particularly in Airports so that the Government can attract the much required scarce resources which when effectively utilized will create vital infrastructure in a time bound manner. Experience in other countries shows that much higher private investment levels can be achieved with the right policies and incentives in place. Given a progressive, forward looking and investor friendly policy environment with a reliable Regulatory system the PPP projects would enhance the wealth and prosperity of the nation and in this exercise all the stakeholders will be equally benefitted. It is a win –win situation for all stakeholders.

Thus, learning from our own experience as well as that from the world, there is a significant case for a comprehensive, progressive, new aviation law to bring back the Golden era for the aviation sector. In fact, the correct way to look at the success of these projects is to look at the Economic Value Creation – overall impact on GDP, employment creation etc. besides the direct contribution to the aviation sector. I was just going through the recent Economic Impact study done by NCAER for Delhi airport. It was heartening to see the real impact of large Infrastructure creation. As per the report, in 2009-10, the Delhi airport contributed0.45% to the National GDP, 13.53% to the State GDP of Delhi it has created direct & indirect employment to the tune of 15,78,000 besides many other benefits.

PRIVITIZATION OF AIRPORTS

Since 1987 airport privatization has become a worldwide trend. As of early 1994, privatizing airports was on the agenda of more than 50 sell all or a partial interest in existing airports or airport authorities. In developing countries, where the principal need is major expansion and modernization, the usual pattern is for government to use a long-term franchise to have the countries. In developed countries, the general pattern is for the government to private sector finance and develops new terminals or entire new airports. A major factor in the growing interest in airport privatization is government fiscal stress. Developing countries often lack the resources to develop new airport capacity, so they turn to private capital and expertise to get the job done. Governments in developed countries increasingly view airports both as assets and as businesses. A commercial airport is an asset which often fails to produce a commercial rate of return, as operated by government. And as "reinventing government" becomes the guiding philosophy, airports are often seen as non-core functions that can better be managed as businesses, by a private-sector business enterprise. In part, the move to airport privatization reflects a changed paradigm of what an airport is supposed to be. The traditional paradigm views an airport as essentially a public service whose objective ought to be simply to enable aircraft and their users to arrive and depart while just covering its costs. The airport-as-enterprise paradigm views an airport as an entrepreneurial business, whose objective is to identify and meet the needs of a diverse clientele: not only airlines and private pilots but passengers, meters-and-greeters, airport staff, airport neighbors, and airport tenants, among others. Airport privatization is much further along overseas than in the United States. Developed countries generally seek to reduce or eliminate their need to invest scarce resources in airports, which can be commercially financed and operated. Developing countries seek world-class expertise, as well as capital, to ensure modern and efficient airports. Airport sales have taken place in four countries, and another seven have announced plans to sell major airports (with the issue under study in eight more). Franchises for new airport capacity projects are under way in 17 countries and under study in 14 others. In this country, the principal factor leading to interest in airport privatization is the growing trend toward reinventing government, seeking to replace monopoly government agencies with the competitive forces of the private sector. All U.S. air-carrier airports are owned by governments, and less than a dozen are currently leased or managed by private firms. However, since 1989 public officials in a number of cities have proposed the sale or lease of air-carrier airports, including Atlanta, Baltimore, Boston, Indianapolis, Los Angeles, New York, Philadelphia, Rochester, San Francisco, Syracuse, and Worcester. A number of jurisdictions are considering contracting out the management of general-aviation (GA) airports, including DuPage, Illinois; the state of Rhode Island, and San Diego County, California. The purpose of this guide is to explain how airport privatization applies in the U.S. context, so that public officials can consider their options for ensuring high-quality airport services.

PRIVATIZATION MODES

Existing Airports

There are three principal alternatives for making use of privatization in the context of an existing airport. In order of increasing reliance on the private sector, they are:

- contract management
- long-term lease
- sale

Contract Management

Many types of municipal facilities are being turned over to private contractors on relatively short-term (five years or less) management contracts. Convention centers, data-processing centers, golf courses, jails, sports arenas, and wastewater plants are among the facilities now routinely contracted out by city, county, and sometimes state governments. Governments use the competitive process to stimulate greater efficiency in the operation of these facilities, since a firm must rethink the way it does business in order to be competitive in winning an operating contract. Typically, in a facility management contract, the operating budget is proposed by the contractor and approved by the government; funds needed for budgeted items are appropriated by the government and passed through to the contractor. Fees and charges are paid by users to the government agency, not to the contractor. The contractor receives a management fee from the government agency, which may be based in part on the contractor's performance. The facility's employees and managers work for the contractor, not the government. Contract management can be used for airports of all sizes and economic conditions, though it is generally most applicable where an airport has been losing money. If an airport is inherently unprofitable (i.e. its costs are very much more than its current and likely future revenue potential), the motivation for contract management is usually to reduce costs and increase revenues, thereby reducing the extent of the airport's deficit. A nearly break even airport can potentially become profitable under contract management. A number of U.S. airports are operated by contractors. Table 1 lists the four air-carrier airports under contract management as of mid-1994. Also listed are a number of general-aviation airports also managed by contractors, including the five general-aviation airports in Los Angeles County.

Long-Term Lease

A long-term lease is quite different from a management contract. Generally, a lease is used in preference to a contract where significant airport development is anticipated. The aim is to shift a significant portion of the risk of development away from the taxpayers and to the private-sector lessee. The term of the lease is often related to the length of time needed by the private operator to recover its investment in new facilities. A lease arrangement transfers the principal responsibility for airport operations and development to the private lessee. Hence, unlike the management-contract case, in lease situation airport users pay fees and charges directly to the lessee, and the lessee must cover its operating and capital costs out of those revenues (and hope to have enough money left over to show a profit). The typical lease agreement provides for a lease payment to the government based, in part, on a percentage of the airport's gross revenue. This gives the government an incentive to work cooperatively with the lessee, since the government will share in the proceeds. But this arrangement also gives the lessee an incentive to minimize costs, so that it can maximize the difference between gross revenue and costs. And since the lessee is responsible for capital investment in the airport, it will have strong incentives to add only that amount of runway or terminal capacity that will produce an acceptable return on its investment. Several small air-carrier and large general-aviation airports in the United States are currently leased to private firms, as noted in the number of other airports have been leased by municipal governments to independent public authorities; a principal example is the lease by the cities of New York and Newark of Kennedy, LaGuardia, and Newark airports to the Port Authority of New York and New Jersey.

Sale

Worldwide, the most common mode of airport privatization is the sale of either a part-interest or the entire airport. Full divestiture (sale) is the mode of choice when the airport is profitable but may not be maximizing its entrepreneurial possibilities under government ownership and management. Governments generally sell entire airports as part of an overall program of divesting themselves of noncore businesses, using the proceeds either to reduce outstanding debt or for investment in other needed infrastructure. This was the motivation for the British government's 1987 sale of the British Airports Authority and the planned sale of the airports belonging to Australia's Federal Airports Corporation. In some cases, governments sell only a majority interest, retaining some fraction of ownership and therefore a direct voice in airport management. Liverpool, England sold a 76-percent interest in its airport to a single strategic investor, British Aerospace. Several other British cities are planning similar sales of majority interests. Some other countries are thus far selling only minority interests. Austria sold 27 percent of Vienna International in 1992 and plans to sell another 18 percent in 1994; the proceeds are being used for airport expansion. Denmark sold 25 percent of the Copenhagen Airport in 1994, and airport authorities in several other European countries are considering similar sales of minority stakes. Table 3 summarizes the status of airport sales worldwide as of mid-1994.

New Airport Capacity

New airport capacity may be developed privately in two ways. The more conventional is via the government granting of a long-term franchise (called a "concession" in most other countries), at the end of which the airport (or terminal) reverts to government ownership. This type of transaction (which sometimes involves some financial participation by the government) is a kind of public-private partnership. The other approach is for the private sector to develop an airport entirely on its own, subject only to the planning permissions required (airspace approval by the national aviation authority, local land-use regulations, etc.). In effect, the airport company has what amounts to a perpetual franchise, though there may not be an actual agreement to that effect (any more than there is for an investor-owned steel mill).

Long-Term Franchise (BOT or LDO)

Around the world, long-term franchises for infrastructure facilities are usually referred to as BOT projects, because under this type of contractual agreement the private sector builds, operates, and eventually transfers to government the facility in question. When a lease of the underlying land is involved, this type of arrangement is sometimes called Lease-Develop-Operate (LDO); in this case the "transfer" back to government is implicit, since the lease has a fixed number of years. The BOT approach is widely used for several reasons. First, it taps into a different pool of capital than is normally available for public infrastructure projects, thereby expanding the range of potential funding sources. Second, private consortia are often able to design and build large facilities in significantly less time than is possible via traditional government procurement methods. Third, both the up-front cost and the operating costs may be lower in a facility that is designed, built, and operated by a single team interested in long-term profitability. Fourth, BOT is a way of shifting many of the risks of project development from the public sector to the private sector. For these reasons, airport BOT projects have proliferated in recent years. As of early 1994, there were 15 airport BOT terminal or runway projects under way worldwide, and another five projects to develop entire new airports. In addition, another 18 such projects were under study. No outright airport BOT project has yet occurred in the United States, but Transport Canada used this process to develop the successful international terminal (Terminal 3) at Toronto (as will be discussed in the next section). Many U.S. airports have used something resembling an LDO process to develop new terminals sponsored by either one or a group of airlines, which gain exclusive control of the gates in that terminal. But this type of project raises important competition and access issues that do not arise when the developer/operator is an independent third party which relates to all airlines equally as users (as is the case with BOT terminal projects worldwide).

Perpetual Franchise

The number of fully private air-carrier airports (as opposed to small general-aviation fields) is quite small. Among those currently in operation are the London City Airport (a short/medium-haul airport in the Docklands area near the financial district), the Freeport airport on Grand Bahama island in the Caribbean, and the Punta Cana airport serving a resort area in the Dominican Republic. Hawaiian Airlines built and operated a small commercial airport in West Maui, HI in the 1980s, but turned it over to the state as unprofitable several years later. Several entrepreneurial private airport proposals have been made in the United States, several of them as potential “wayports”—freestanding hub airports aimed primarily at transferring passengers from one flight to another (and therefore not linked to a city's origin/destination market). One of the best-known is the proposed Aeroplex, planned to occupy 22,500 acres in northwest Martin County, on the east coast of Florida. Its developer received airspace clearance from the Federal Aviation dministration in 1991, but as of 1994 development had not begun.

Military Base Conversions

Over 100 major military bases are expected to be closed during the 1990s. Many of these are airfields, and quite a few are in or near urban areas. The general procedure for federal disposal of unneeded bases is that if no other federal agency needs the property, the local government has first claim on it; under certain conditions, the municipality may be able to obtain it at no charge. In the case of air fields, if the Federal Aviation Administration recommends the site for airport use, the property may be given to the local government for that purpose. Without such arecommendation, the municipality may buy the base or arrange for a private firm to purchase it. A number of military bases have been or are being converted to civilian airport use. Orlando International Airport is the former Strategic Air Command McCoy Air Force Base, converted in 1974. In New Hampshire, the former Pease AFB became a civilian airport, Pease International Tradeport, in 1991. Scott AFB, 15 miles east of St. Louis, is becoming Mid-America Airport. And in Austin, Texas, officials abandoned a Greenfield site for the city's new airport when Bergstrom AFB became available; the base is now being redeveloped as the replacement for Austin's outmoded air-carrier airport. The long-term franchise mode of privatization is the one most applicable to converting a military airfield to a civilian airport. Instead of attempting the complex task of developing, financing, and managing the airport project itself, the base-redevelopment authority can seek competitive proposals from private-sector consortia. In this way, not only can greater professional expertise be brought to bear, but much of the risk involved in new-airport development can be shifted from taxpayers to investors.

POTENTIAL BENEFITS OF AIRPORT PRIVATIZATION

Increased Operating Efficiency

One of the most common benefits of substituting a private operator for a government department is greater efficiency in operations. In part this is due to the different incentives at work in the two sectors. Private-sector managers are generally evaluated and compensated in part based on the economic performance of the enterprise; this is very seldom the case in the public sector. Second, the public sector is hampered by such constraints as civil service (which makes it difficult to fire incompetent staff or to reward outstanding performance), cumbersome government procurement regulations (which stretch out the time and increase the cost of purchasing supplies and equipment), and micromanagement from higher levels (either departmental or political). The private sector may also benefit from economies of scale. A firm that owns and/or operates multiple airports may be able to purchase supplies in bulk, operate centralized accounting, personnel, and other support services to serve all the airports, and take advantage of other economic benefits of larger size. In addition, the private sector is likely to be less constrained and more willing to contract out functions that can be performed more cost-effectively by other firms. For example, airport fire and rescue service at privately managed Burbank (CA) Airport is contracted out to a private firm. Thus, the single decision to privatize the airport (via management contract, lease, or sale) can serve to depoliticize a potential host of smaller-scale contracting-out decisions, each of which might have involved a political wrangle if it had to be made by a government department.

Additional Operating Revenues

It is increasingly being recognized that airports are economic enterprises able to generate more kinds and larger amounts of revenue than traditionally imagined. For smaller, currently unprofitable airports, privatization offers the potential of turning a loss-maker into a profit center. For larger airports which may already be operating in the black, the greater revenue potential under private management can lead to increased returns to the current governmental owner, either via lease payments or sale proceeds. For general-aviation airports, increased revenues may be derived from instituting landing fees (if none exist), better enforcement of fee payment, encouraging fixed-base operators (FBOs) to develop expanded offerings of goods and services (a percentage of whose proceeds flow to the airport-management company), and more intensively developing airport real estate. For air-carrier airports, the revenue opportunities are even greater. In some cases, landing fees and/or rental charges may be out of date and below market; likewise for current agreements with concessionaires. Perhaps more important, a privatized airport firm will typically adopt a more expansive retail approach involving a much broader array of goods and services aimed not only at passengers but also at airport and airline employees and airport neighbors. New business opportunities also include providing business services, conference facilities, hotel accommodations (both short-term and longer-term), as well as more intensively developing airport real estate. It is sometimes noted that there is nothing in the preceding list that is uniquely known to the private sector, which is correct. However, most of these activities require specialized knowledge and an entrepreneurial corporate culture which may not be present in the public sector. There is a higher risk of failure in seeking to convert civil servants into entrepreneurs than in hiring genuine entrepreneurs to do these things. In addition, the competitive process may well generate innovative new ideas for cutting costs or increasing revenues; ideas which would not otherwise have been brought to bear.

Improved Customer Amenities

The most dramatic difference which privatization can bring about is a new approach to airport retail activities. Air travelers who have used London's Heathrow or Gatwick airports (privatized via sale in 1987), the new international Terminal 3 at Toronto (developed via BOT/LDO and opened in 1991), or the new Pittsburgh terminal (whose concessions are managed privately by BAA under a 15-year lease) will have experienced airport retail that differs dramatically from other U.S. airports in three respects: 1) the amount of retail space is several times as much as in other terminals of comparable size; 2) the retailers include numerous national and international brand-name outlets; and 3) the prices charged are not high "airport prices" but are the same as one would find in the local shopping mall. The new privatized retail approach produces a situation in which all parties are better off. Air travelers like the lower prices and greater variety of goods and services, as proven by per-passenger sales two to three times higher than in traditional terminals. The airport operator is happy, because the higher sales volume produces higher net revenues. And the airlines are happy because concession revenues cover a higher fraction of total airport costs.

Reduced Risk of White Elephants

A principal reason why the World Bank is now urging privatization of major infrastructure (including airports) in developing countries is to minimize the risk of unwise investment, leading to "white elephant" projects which cost several times what they can generate in revenues. In this country, airlines have grown weary of being faced with grandiose plans for architectural monuments (often referred to as Taj Mahals) posing as new airport terminals. Recent cases in point include the (now-canceled) JFK 2000 project to build a new central terminal at New York's Kennedy International airport, the large new terminal at Washington National airport, and the very costly new Denver International airport. How and why does privatization make a difference in new-project development? Privatization of airport capital project development (whether by sale, long-term lease, or BOT) shifts many of the risks from the taxpayers to private investors. This, in turn, forces a high degree of "due diligence" in reviewing the design and cost of the project, and especially an insistence on "investment-grade" traffic and revenue forecasts. Privatization helps to ensure that project decisions are made on economic and financial grounds, not on political grounds.

Lease or Sale Proceeds

Under contract management, a city or county may be able to reduce or eliminate an airport's operating loss, thereby ending a drain on the taxpayers. But this type of short-term privatization may not produce net revenue for the municipality. That is because federal airport grant legislation makes it illegal for a city to "divert airport revenue" to municipal coffers. All revenues generated by the airport must be used solely for airport purposes, if the airport is to retain eligibility for federal grants. The only legal way around this restriction is for the municipality to cease being the airport operator. By selling or leasing the airport, the city or county can recover its investment of land (and capital, if any) in the airport, via the lease payments or sale proceeds. The private airport lessee or owner may choose to remain eligible for airport grants, working out its fee schedules and payment arrangements so as to obtain FAA approval, or it may opt to forego federal grants and operate free of FAA economic restrictions. (In the latter case, it may have to pay back the depreciated value of the facilities purchased with the grants.)

PROJECT PROFILES

Air Carrier Airport/Contract Management (Westchester)

The White Plains/Westchester County Airport is an 800-acre facility surrounded by affluent suburbs and office parks. In addition to scheduled airline service by four major airlines and several commuter carriers, the airport is the home base for numerous corporate jets and turboprops. Activist anti-noise groups made up of affluent homeowners have succeeded, via litigation in limiting the extent of growth in airline passengers over the years. Turned over to Westchester County by the federal government after World War II, the airport was operated by the airport's fuel supplier for 30 years. In 1977, faced with large operating losses (up to $250,000/year) at the airport, the county government decided to bid out airport management on a five-year contract basis. Pan Am World Services won the initial contract, and it and its successor company, Johnson Controls World Services, have won renewals every five years since then. Under contract management, the airport has become solidly profitable, with net income of up to $3 million per year. The company has achieved these gains by reducing operating expenses (e.g., by cross-training personnel so that fewer people are required), increasing revenues (e.g., by renegotiating ground leases to market levels and instituting paid parking in 1981), and fostering real-estate development. For example, there are now five fixed-base operators (FBOs) compared with three in 1977, as well as additional hangars and related facilities. Despite community-imposed growth limits, major airlines have been attracted to Westchester, compared with the mostly commuter airlines that provided service prior to 1977. The transition to contract operation was relatively smooth. The county requested the company to offer jobs to all the current airport employees, and all but two accepted such offers. After many years of political wrangling, a badly needed new terminal building is under construction and set for opening in the summer of 1995, funded by county-issued bonds. A parking structure and service building opened in summer 1994. The county is pleased with contract management because it insulates public officials from community complaints. Though the county retains all policy-making authority, it can cite and rely on the company's professional advice, thereby depoliticizing many decisions. In addition, of course, the airport's former operating loss has been turned into an operating profit.

General Aviation Airport/Concession Management (L.A. County)

Between 1958 and 1970 Los Angeles County acquired five general-aviation airports which their developers were unable or unwilling to maintain. Due to concerns about high operating costs and net low revenues, the county decided in 1990 to contract out these airports as a group. What evolved was a hybrid between contract management and a long-term lease. The 20-year agreement (with two five-year extension options) does not grant the firm a leasehold interest, but it operates financially like a long-term lease rather than a management contract. In other words, users and tenants pay fees to the contractor, out of which the contractor must pay all operating expenses and turn over a guaranteed minimum annual amount to the county. Prior to the award of the contract to COMARCO, there was strong opposition from GA pilots, airport employees, and some airport tenants. By the contract's second anniversary, privatization had “gained acceptance by most pilots and proved worth celebrating for some,” according to a local newspaper account. Board of Supervisors chairman Ed Edelman, who had voted against the contract in January 1991, wrote aletter of endorsement in January 1993, praising the success of the arrangement. Financially, during the first two years, COMARCO paid the county $2.7 million per year, compared to the County's net income of $2.2 million when it operated the airports itself. The increase was made possible by improved marketing of airport facilities, reduced operating costs, and a computerized revenue control system. Despite opponents' fears, there were no increases in user fees for the first two years of the contract. All fee increases must be approved by the county. COMARCO splits the airports' net income with the county according to a pre-arranged formula; the county puts all these revenues in its Aviation Division budget and uses them for capital improvements at the airports. COMARCO was required to offer jobs to all 56 county airport workers. Of these workers, two assistant managers and eight service workers went to COMARCO, five stayed with the Aviation Division, one resigned, one retired, and the others were transferred to other positions within the county's public works department. None were laid off.

Air Carrier Airport/Sale

The largest airport privatization to date was the British government's public share offering of the former British Airports Authority in 1987. At the time, BAA was the owner/operator of the three main London airports and the four principal Scottish airports (one of which, Prestwick, it subsequently sold). The initial share offering valued the company at $2.5 billion. Three years later, in 1990, the market value had grown to $4 billion, and by early 1994 to over $8 billion. What difference has privatization made to BAA's operations? A Reason Foundation study in 1990 addressed five indicators: capital investment, productivity and efficiency, pricing and revenues, noise mitigation, and customer satisfaction, and found positive results in all five.

As a public authority, BAA had limited access to capital; essentially, it was permitted to borrow only from the British Treasury, and the Treasury set stringent annual limits on borrowing by state-owned companies. In the first three years following privatization, BAA capital spending more than doubled. Terminal expansion at all three London airports accounted for the majority of the initial investment; in addition, on-airport hotels were added at all three. Furthermore, plans were drawn up for construction of Heathrow Express, a high-speed rail line connecting Heathrow with central London (in a joint venture with British Rail). Thus, a capital-short enterprise was able to increase capital spending on productive projects as a result of being privatized. Economic theory predicts that a privatized enterprise would have strong incentives to operate more efficiently. Data from BAA showed a steady upward trend from 1983 (as BAA began gearing up for privatization) to 1990 (the year of the study) in labor productivity, as measured by operating revenue generated per employee and by passengers handled per employee. In addition, BAA's unit labor costs (in terms of £ of expense per passenger) trended steadily downward. Airlines typically express concern that landing fees must increase as a consequence of airport privatization. Airports that possess monopoly power (such as BAA's London airports) might be able to increase landing fees above market levels. Because of this, the act authorizing BAA's privatization provided for regulation of airside charges. Rather than controlling individual charges, however, the price-cap regulation (RPI minus X, where RPI is the retail price index) applies to each year's airside revenue per unit of aircraft operation. In other words, the formula requires that the average unit charge on the airside increase by less than the rate of inflation. (The value of X is set by the regulator for each five-year period.) Thus, in real, inflation-adjusted terms, airside charges have steadily decreased at BAA's London airports. This flexible form of regulation permits the pricing structure to be based on market principles. Thus, at Heathrow and Gatwick, where significant airside congestion exists at certain hours and certain seasons, peak landing charges are much higher than those off-peak. In addition, BAA has abandoned the traditional weight based approach to landing fees, recognizing that the cost of handling the landing or takeoff of an aircraft bears little relation to its weight. Further, BAA makes use of noise-related surcharges and rebates to promote a shift toward quieter aircraft. With its airside revenues somewhat constrained by price-cap regulation, BAA has had strong incentives to increase revenues on the landside. Data show that while airside revenues made up 54 percent of BAA operating revenues in 1983, that fraction had declined to only 42 percent by 1990 (while overall revenues more than doubled). BAA accomplished this by aggressive expansion of the type and quantity of retail concessions in its terminals. Focusing on brand-name retailers and instituting a well-publicized guarantee that prices at airport shops would be no higher than in the same shops elsewhere, BAA developed the Heathrow and Gatwick terminals into the equivalent of shopping malls. BAA's airports remained subject to the same noise regulations before and after privatization, and the data showed continued downward movement in the figures for the amount of land impacted by various levels of airport noise. Finally, data from BAA's regular surveys of customer satisfaction (on such matters as catering, baggage-cart availability, cleanliness, and staff) showed either no change or slight improvements in the first three years following privatization.

Air Carrier Airport/Build-Operate-Transfer

In the mid-1980s Transport Canada, the federal agency that until recently owned and operated virtually all of Canada's major airports, decided that a new international terminal was needed at Toronto's Pearson International Airport. Its initial conceptual design called for a facility of 15 to 17 gates. Following the agency's normal development procedures, Transport Canada estimated that this facility would take seven years to develop, at a cost of C$1 billion. Instead of pursuing the traditional approach, the agency opted for a BOT project. The resulting terminal, which opened in 1991, has 24 gates (plus five in a satellite terminal for Canadian Airlines). From drawing board to opening day, it took just 33 months, rather than the seven years projected by Transport Canada, and cost only C$700 million rather than C$1 billion. In addition, it operates with 25-percent fewer people than in Transport Canada's plans. Terminal 3 was developed and is operated by a Canadian/U.S. joint venture, of which Lockheed Air Terminal is the U.S. member. Their 40-year concession (franchise) includes a land lease on 130 acres (with a 20-year option). The project included the 1.2 million sq. ft. terminal building, a 3,300-car parking garage, a 500-room hotel, and five miles of access roads with six overpasses. The terminal was designed with extensive retail space, including a mini shopping mall. Terminal 3 incorporates several innovations, including the first airport shopping mall in North America and the first cash-and-carry duty-free operation in Canada. Unlike typical U.S. practice, the airport terminal company retains control of all gates (i.e., they are not leased to individual airlines) and controls the arrival and dispatch of all aircraft onto the terminal's apron areas. It also controls the flight-information (closed-circuit TV) system, the public address system, and the baggage systems, rather than delegating some or all of these to individual airlines.

LEGAL ISSUES

Federal Grant Eligibility

Under the Airport & Airway Improvement Act of 1982 and subsequent amendments, the Federal Aviation Administration (FAA) makes grants to air-carrier and general-aviation airports. Air-carrier airports receive entitlement grants based on a formula related to annual enplanements. They and other airports may also apply for discretionary grants for specific projects, in competition with other airports. Airports accepting federal airport grants (generally known as AIP grants, meaning Airport Improvement Program grants) must sign contractual grant agreements with the FAA. Under the terms of those agreements, the recipient (the airport “sponsor”) must provide assurances that the airport be open to all users on a nondiscriminatory basis, that airport charges be fair and reasonable, and that “all revenues generated by the airport” must be used only for airport (or airport-system) purposes. It is well-established in federal law that the FAA's control over such economic issues as airport access and charges stems from the grant agreements. If an airport did not make use of federal grants, the FAA's jurisdiction would be limited to safety and air Traffic control issues only. How does privatization affect grant eligibility? Under contract management, the government which owns the airport remains the sponsor, and the airport remains eligible for the same types of grants for which it was eligible when managed directly by the municipality. Likewise, under most forms of long-term leases and BOT arrangements, the government which remains the airport owner would remain the airport sponsor, so grant eligibility would be unchanged. With respect to an airport sale, post-1982 federal law permits discretionary and noise-related grants to be made to privately owned airports, but entitlement grants are not permitted. Thus, an airport can be owned by the private sector and operated by it for profit and still receive federal grants for capital projects (though it must compete for such grants against other airports). To sum up, general-aviation airports can make use of any form of privatization without any impact on their grant status, since they do not receive entitlement grants (which are based on passenger enplanements) to begin with. Air-carrier airports can receive discretionary and noise related grants under any form of privatization, but if privately owned, cannot receive entitlement grants. Entitlement grants are a relatively small component of the revenue of large and medium airports, but can be significant for smaller air-carrier airports.

Lease or Sale Proceeds

In Section III it was claimed that a municipality could legally obtain a return on its investment in its airport, despite the federal prohibition on "diverting" airport revenue, by either leasing the airport (and receiving lease payments, not profits) or one-time sale proceeds. How strong are the legal arguments for this position? This question has been examined by several legal experts, each of whom has concluded that it is legally sound. These include former U.S. Transportation Secretary Jim Burnley5 and former FAA Chief Counsel E. Tazewell Ellett.6 One of the most detailed assessments was carried out by the law firm of Skadden, Arps, Slate, Meagher & Flom for the City of Los Angeles in 1992.7 The Skadden, Arps assessment concludes that current federal law permits the sale or lease of a municipal airport to a private firm, and that a privatized airport would be eligible to receive federal grants, as outlined in the previous subsection. What about the proceeds from such a transaction? With respect to a sale, Skadden, Arps concluded that a municipality would be able to use sale proceeds for general purposes because the term "airport revenues" asused in the 1982 Act (and amendments) refers to operating revenues, not the one-time proceeds from an asset transaction. This would be consistent with: 1) the legislative history of the 1982 Act; 2) accounting definitions; and 3) the FAA's own AIP handbook, which states that "Airport revenue does not include proceeds from the sale of real property owned by the sponsor." With respect to lease payments, Skadden, Arps notes that the FAA Compliance Manual already provides for the lease of entire airports. Not noted by Skadden, Arps is the fact that lease payments being made by private lessees in the case of airports such as Atlantic City are going "off the airport" today, to the general funds of the underlying government owners. The memorandum also notes a 1991 Department of Justice opinion regarding the proposed lease of Albany Airport, in which DOJ assumed that the lease payments were "airport revenues" but could still be used for general-fund purposes to the extent that they represented a recovery of the local government's original investment in the airport. But it notes that a 1992 Executive Order may supersede this opinion. President Bush's Executive Order No. 12803 (April 1992) was intended to remove federal barriers to the lease or sale of federally aided infrastructure facilities, including airports, by state and local governments. It directs the federal agencies which have made such grants (e.g., the FAA) to approve such requests. The only conditions attached to such transactions are that: 1) the proceeds from the sale or lease be used in accordance with the provisions spelled out in the Order (and with pre-existing federal law); and 2) that some sort of for its original purpose and that user charges will be structured so as to protect users from abuse. E.O. 12803 calls for the sale or lease proceeds to be used as follows. The first claim on the proceeds is for the government owner to recover its original investment in the facility, including any transaction costs. These funds may be put into its general fund. If there are funds remaining, the second claimant is the federal government, which may be entitled to recoup a portion of the previous federal grants to the facility (the full amount less accumulated depreciation, based on IRS accelerated depreciation tables). If there are still funds remaining, the final portion must be used only for investment in other infrastructure or for reducing debt or taxes. In 1994 President Clinton issued Executive Order 12893 on Principles for Federal Infrastructure Investment. It specifically directs each agency with responsibility for transportation, water, energy, and environmental facilities to “seek private-sector participation in infrastructure investment and management” and seek to work with state and local governments to “minimize legal and regulatory barriers to private-sector participation.” It also endorses market pricing for infrastructure and sound cost-benefit analysis. E.O. 12893 supplements and reinforces E.O. 12803; it does not supersede it.

Existing Bonds/Tax-Exemption

A change in the ownership (sale) or de-facto ownership (long-term lease) may affect the status of existing bonds used to construct a portion of the airport. In most cases, these bonds will have been issued by the municipality on a tax-exempt basis. Most airport bonds are revenue bonds (secured solely by airport revenues), though some may be general-obligation bonds (secured by the general taxing powers of the issuing government). Three factors must be looked at in connection with these bonds. First, the bonds themselves must be reviewed to determine if there are any provisions that restrict the use of revenues or require the bonds to be deceased or redeemed in the event of a sale or lease. Even in the absence of such provisions, the bond language may require that the bonds satisfy IRS requirements as to tax-exemption. Second, state law must likewise be reviewed to see if there are any comparable provisions. Having to decease or redeem the bonds may not prevent a sale or lease from taking place, but may affect its cost and therefore its financial feasibility. The third factor to consider is the IRS itself. Thanks to a recent change in its procedures, the IRS is now able to consider requests to retain the tax-exempt status of bonds when the facility which they have financed is sold or leased. In 1993 the agency issued Revenue Procedure 93-17, which allows interest on outstanding bonds to continue to be tax-exempt when the facility is sold or leased, if certain other conditions are met. The most important of these is that the disposition proceeds (i.e., the lease or sale payments) must be used in an alternative manner that would have qualified for tax-exempt status. Devoting the proceeds to other public works investment, for example, would be one such purpose. In addition, the facility must continue to be used for its original purpose for at least five years, and the new owner or lessee must transact business with the original government owner on an arms-length basis and for fair-market value. Hence, provided that neither state law nor the bond covenants prevent it, existing tax-exempt airport bonds may remain in existence (and tax-exempt) following the sale or long-term lease of an airport.

Access to Future Tax-Exempt Bonds

The difference in interest rates between taxable and tax-exempt bonds is in the vicinity of 200 basis points (e.g. two percentage points). In financing airport expansions, that difference in interest costs can lead to major differences in debt-service expenses. Thus, airport users would benefit from the availability of less expensive debt, other things being equal. Under contract management, capital expansions are the responsibility of the government owner of the airport, making use of tax-exempt bonds. Under BOT and long-term lease arrangements, it is generally possible for the government owner to issue tax-exempt revenue bonds on behalf of the private lessee or franchise-holder, with project revenues earmarked for debt service. (This is simply a variant on the common method of financing airline maintenance facilities and terminal buildings, in which the municipality or airport authority issues revenue bonds on behalf of the airline(s) committing to use the facility for a long-term period.) Under current federal and state tax law, it appears difficult or impossible for tax-exempt bonds to be issued for an airport which is owned and operated by the private sector. As a matter of public policy, this lack of a "level playing field" between public and private ownership is likely to skew the choice between public and private ownership, though it might not prevent full private ownership in certain cases of high profit potential.

POLICY ISSUES

Loss of Public Control

Airports are valuable community resources, providing a needed public service. Thus, it is to be expected that privatization, especially via sale or long-term lease, raises concerns about potential loss of public control. There are a number of mechanisms that can protect the public interest, while still retaining the benefits of private-sector operation. Under a management contract, the contract itself spells out the requirements and constraints under which the firm must operate. Although the more constrained the conditions, the less scope there may be for innovation and efficiency gains, the contract can potentially include any provisions desired. One particular benefit of contracting out is that measurable performance requirements can be specified, with appropriate penalties for failure to meet them (e.g., financial penalties and even termination of the contract). This is often a greater degree of real accountability for results than exists when the airport is operated by a government department that will remain in place regardless. A lease or franchise agreement, though much onger-term in nature, offers similar potential for including explicit provisions to protect the public interest and require achievement of certain performance targets. The temptation to micromanage the firms's operations via lease provisions should be resisted, however. Because far more of a financial commitment (and hence risk) by the private sector is involved in a lease than in a management contract, economic incentives will accomplish far more than detailed prescriptions in such arrangements. If an existing airport is sold, or if a new airport is built from the start as a private venture, how can the public interest be protected? With a sale, government can condition the sale on several factors. A deed restriction can be included, guaranteeing that the property continue to be used for airport purposes for, say, 99 years. Government may wish, as in Britain and some other countries, to retain a single share of ownership (the British call this a golden share), with special voting rights designed to protect specific public-interest concerns (e.g., foreign ownership in the case of BAA airports). For either a new airport or an airport sale, government could grant a perpetual franchise, administered by a municipal entity such as an airport commission. Under such an arrangement, the private firm would hold title to the airport in perpetuity, subject to compliance with the terms of the franchise. The commission would be able to revoke the franchise if the firm violated its explicit terms.

Economic Regulation

Airports are often referred to as a municipal utility, like electricity, gas, telephones, or water. Although an airport is very capital-intensive, like those utilities, the key question is whether or not it possesses monopoly power. If it does, then the issue becomes the most appropriate way of dealing with that power.

The first question is to what extent monopoly power exists, and for what set of customers. In most cases, the airport's land-side services (restaurants, car-rentals, etc.) are subject to competition from off-airport suppliers; no airport user is forced to deal with them. So these services generally will not be candidates for regulation.

On the airside, many cities have at least one general-aviation airport in addition to their air-carrier airport. Thus, GA users do not face a monopoly situation. Airline passengers may have the option of driving 50 or 75 miles to another location with airline service, in which case they are not really victims of a monopoly even with only one air-carrier airport in the city. And many urban areas (e.g., New York, Chicago, Detroit, Dallas, Houston, Los Angeles, San Francisco) have multiple air-carrier airports, such that privatizing one of them would not create a monopoly situation. Only selling an urban area's entire set of airports to a single firm (as the British did by privatizing BAA, rather then selling Heathrow, Gatwick, and Stansted separately) would lead to monopoly conditions.

But suppose that some degree of airside monopoly does exist under privatization. What are the possible remedies? First, if the airport continues to receive federal grants, its pricing must meet the FAA's definition of fair and reasonable, in compliance with the grant agreements. Second, unlike the public sector, privately owned airports would be subject to federal and state antitrust laws, which prohibit both price discrimination and price gouging. Third, international air service is subject to bilateral treaties which protect airlines (and hence passengers) from discriminatory pricing.

Given the protections offered by these three mechanisms, it is not clear that any further regulation would be necessary. But if it were, several choices are available. One would be to subject the airport to traditional public utility regulation, administered by the state public utilities commission (PUC). Given that in all likelihood only a portion of airside services would exhibit monopoly aspects, the costly and time-consuming PUC regulatory process would not be appropriate.

Two more-flexible alternatives are British-type price-cap regulation and franchise-based rate-of-return ceilings. Under the former, BAA's airside charges are limited each year to increase by less than the rate of inflation, as noted in Section IV, via the RPI minus X formula. All the recently privatized British utilities are regulated in this way. The alternative, as used in California's BOT franchises for private toll roads, is for the franchise agreement to set a ceiling on the annual rate of return the company can realize. This permits its pricing to respond to market conditions, but requires that any profits earned above the ceiling amount go into the state transportation fund.

As a general rule, any form of explicit economic regulation imposes costs and will reduce the attractiveness of an airport to potential investors. Thus, careful tradeoffs must be made to determine the extent of likely monopoly problems and the least-restrictive way of dealing with them.

IMPLEMENTATION

Once a municipality (or airport authority or state transportation agency) has determined that privatization might be applicable to an airport which it owns, what steps must be taken to move forward? Most or all of the following steps will apply in most cases.

Request for Information/Strategies

In order to ascertain the private sector's degree of interest, the agency can publish and publicize a request for private firms to submit expressions of interest in private management, operations, and/or development of the airport. If the agency is not sure which mode of privatization would be most suitable, this process can obtain expert opinions from airport professionals at very little cost to the agency. In 1994 Indianapolis received eight responses to such a request, from domestic as well as overseas firms. The Dupage, Illinois airport authority received 11 responses to its request for privatization ideas for its general-aviation airport.

Consultant Assistance

If the agency has already decided upon a privatization mode (contract management, lease, sale, BOT, etc.), its first step should be to retain a consultant knowledgeable about both airports and privatization to review its financial and operational data and assist with designing the competitive process and the required documents (RFQ, RFP, etc.). If the first step has been a request for strategies, the consultant can be of great help in assessing the (most likely) varied responses and helping the agency decide which mode of privatization makes the most sense, given the agency's objectives. Legal advice may also be advisable at this step, especially in the case of large airports and/or long-term modes of privatization (lease, sale, BOT).

Request for Qualifications

In the case of large, long-term privatization competitions, many governments make use of a two-step procurement process. The first step is to weed out those firms or consortia that are judged to be unlikely to succeed in meeting the requirements for operating, managing, and/or developing the facility. Hence, in this step the firms are asked to document in some detail their experience and qualifications. It is generally wise to spell out in some detail in the Request for Qualifications (RFQ) what factors will be used to evaluate the responses. This leads to some degree of self-selection, as clearly unqualified firms will be able to conclude that they have little hope of being judged qualified. Another way to discourage clearly unqualified firms is to require a filing fee large enough that only serious contenders will pay. Making the requirements and selection criteria as clear as possible may also serve to minimize the likelihood of legal challenges by firms which do not make the grade.

Request for Proposals

The next step is to issue a formal request for proposals to those firms which constitute the “short list,” by virtue of having survived the RFQ process. For large procurements, the agency may be well-advised to hold a bidders' conference for these firms prior to finalizing the RFP, at which it presents an early draft of the document and seeks feedback and suggestions from them. This kind of interaction can lead to a more realistic RFP, which will lead to more responsive proposals and should make the subsequent negotiations with the winning firm go more smoothly. Given that airport privatization is at an early stage in the United States (there is still no clear-cut policy guidance on the subject from the FAA or its parent, the U.S. Department of Transportation), an important element in the RFP should be for the bidder to document its plan for obtaining DOT approval of the transaction (which will be required in most cases, if the airport is to continue to receive federal AIP grants). This will involve demonstrating to the various stakeholders, especially the airlines serving the airport, that the privatization will not harm their interests. E. Proposal Evaluation Depending on the size and complexity of the privatization, bidders should be given from two to six months to prepare and submit their proposals. Rigorous evaluation should then be carried out by senior officials, possibly with consultant assistance. Here again, it is important that the evaluation process be as objective and "transparent" as possible, with detailed evaluation criteria having been spelled out in advance in the RFP. In addition, the scoring of proposals against these criteria should be documented and be made public following the completion of the process. The objective is to guard against subjective or biased decisions, as well as to minimize the likelihood of legal challenges by losing bidders.

Airport privatization is relatively new to the United States, but is rapidly becoming the model for airport operations around the world. Depending on the economic and political circumstances, contract management, a long-term franchise for new facilities, a long-term lease, or outright sale can offer benefits to taxpayers and airport users alike. The appropriate mode of privatization depends on the specifics of each case, and must be the subject of careful analysis. Done well, privatization can provide net benefits for all parties by adding value to the airport's operations. Airlines can receive assurances of cost controls; air travelers can obtain a higher level of service; the airport agency can obtain some new revenues; and the new airport operator a new source of business.

The fundamental choice in the privatization process appears to be how the government should exercise its control to sustain the public interest in open access to and fair rates for airport services. The major alternatives are between:

Government regulation, an inherently adversarial process; or Government ownership and partnership in the development of airports, a more collaborative approach. On balance, the partnership approach as practiced by numerous airport authorities throughout the United States seems most suitable for both assuring the public interest in fair operations and, most importantly, in assuring that the local community can express its desire for sufficient airport capacity for its purposes. The exact way that privatization should be accomplished, and the right balance of public and private involvement in the development of airport properties would seem to depend on the precise context of the project, the potential users, the region and the moment in time.

AIRPORT IN-TERMINAL CONCESSION AGREEMENT

The evolution of airports from rudimentary airfields to today's sophisticated centers of commercial transportation is paralleled by the development of in-terminal concession programs at airports.

In the opinion of airport concession managers interviewed for this project, in-terminal concession programs have over the years gained a higher profile and become more important contributors to the financial and operational success of today's airports. Developing and managing in-terminal concession programs requires the application of sound commercial practices adapted to the unique constraints of airport terminals, an understanding of the needs of passengers, and an understanding of the public procurement requirements under which individual airports operate.

The rapid growth in airline travel following World War II was characterized by a highly regulated airline industry and a growing need for new, modern terminals and airfield capacity.

The introduction of jet aircraft in the late 1950s made airline travel faster and more convenient, and required further expansion of airfields and terminals. While the need for new investment was great, airports at that time were unproven credit risks. To support the required new investment, airport sponsors turned to long-term lease and use agreements with the airlines and long-term concession agreements, often exclusive, which provided guaranteed revenues over the life of the agreements.

Airline deregulation in the late 1970s resulted in new startup airlines, expanded airline service, cheaper airfares, and rapid growth in numbers of passengers, followed by a significant period of terminal expansion.

Federal mandates to expand opportunities for minority businesses were introduced in the 1980s, and airport sponsors restructured concession agreements to provide opportunities for Minority Business Enterprises (MBEs, later changed to Disadvantaged Business Enterprises, or DBEs), adding to the scope of existing concession programs.

Over time, airport sponsors became less reliant on revenue guarantees and more concerned with improving the food and beverage, retail, and service concessions offered to passengers. The reduced reliance on exclusive contracts and long-term guaranteed revenues—based on a realization that the local market, and not individual airlines, was the driver of passenger demand— brought an end to the belief that passengers were a "captive market" most efficiently and profitably exploited by a few long-term concession agreements. From a contracting perspective, the award of concession agreements evolved from straight bids based solely on guaranteed revenues toward more customer-focused processes emphasizing customer satisfaction and convenience as well as revenue. Passengers showed clear preferences for concessions that more closely resembled their choices outside the airport.

In 1992, the new Pittsburgh International Airport terminal opened with a concession program run by a developer, BAA USA, a subsidiary of the U.K. airport operator BAA plc, the privately owned successor to the former British Airports Authority. Allegheny County, operator of the airport, and the hub airline, US Airways, wanted a new, sophisticated concession program that would help attract connecting passengers and make the airport more competitive with other hub airports. The Pittsburgh concession program featured international, national, and local brands and a major commitment to specialty retail. The program was a big success and marked a turning point in the evolution of in-terminal concessions. Soon, traditional concessionaires were embracing branding and offering portfolios of brands.

The increased competition and ease of market entry that led to the expansion of airline service and new airlines also put the older legacy carriers under financial pressure. Increased competition and excess capacity left these airlines vulnerable to economic downturns. Airlines pushed airport sponsors to reduce their rates and charges in the short term and to decrease their reliance on airline rates and charges by growing nonairline revenues. As a result, airport managers became even more focused on improving their concession programs.

Once considered ancillary services that offered basic passenger conveniences, in-terminal concessions have increased in importance as airport sponsors seek to increase nonairline revenues while meeting higher passenger expectations. Fortunately, there is a direct connection between the two.

REVENUES FROM IN-TERMINAL CONCESSIONS

Although numbers of enplaned passengers at our nation's airports have been volatile at times, airports and concessionaires have benefited from generally steady long-term growth in numbers of enplaned passengers, along with real growth in concession spending. This section presents an overview of traffic growth at U.S. airports, aeronautical and non-aeronautical revenue sources, and average passenger spending at U.S. terminal concessions.

Traffic Growth

Over the last four decades, the numbers of enplaned passengers on U.S. airlines have grown, on average, in 4 out of every 5 years. Since 1970, numbers of U.S. enplaned passengers have increased fourfold, at an average annual growth rate of 3.7%. In 2009, U.S. commercial enplaned passengers totaled 695 million, about 8.8% lower than the all-time high of 762 million in 2007.

In-terminal concession revenue correlates strongly with changes in passenger traffic. Over this period, growth in passenger traffic was interrupted five times by recessions, wars, and the terrorist attacks of September 11, 2001. Although growth in passenger traffic is occasionally disrupted by macroeconomic events, the recovery periods are typically short, and positive growth has returned relatively quickly. Of the five instances when year-over-year passenger traffic declined, in only three instances did the downturns extend for more than 2 consecutive years. This record of positive traffic and revenue growth has attracted strong interest in airports by potential concessionaires, as well as service providers, lenders, and investors.

Airport Revenue Sources—Aeronautical and Non-aeronautical

Airport revenues are classified by the FAA as either aeronautical or non-aeronautical. "Aeronautical revenues" generally refers to revenues from the use of airfields, aircraft aprons, and airline terminal buildings. "Non-aeronautical revenues" generally refers to revenues from other activities, including passenger-related sources, such as parking, rental cars, and terminal concessions, and non passenger-related sources, such as commercial ground leases, sale of mineral rights, or other revenue-producing activities

The contribution from non-aeronautical revenues varies widely among airports and depends on a number of factors, including the following:

- Availability of land for commercial or other non-aeronautical uses
- Distance from the major population centers and availability of alternate forms of ground transportation, which can affect demand for automobile parking and rental cars
- Passenger demographics, which can affect spending
- Numbers of international passengers, which can produce duty free and higher overall retail spending
- Time spent in the terminals by passengers (also referred to as dwell time), which can also affect spending
- Terminal configuration, which can dictate concession space layouts and sales performance
- Airport management practices and emphasis on developing nonaeronautical revenues
- Other factors unique to each airport

TYPES OF IN-TERMINAL CONCESSIONS

The number, type, and variety of concessions vary by airport. The major categories of in-terminal concessions discussed in this resource manual are food and beverage, convenience retail, specialty retail, duty free, advertising, and services.

Food and Beverage

At U.S. airports, food and beverage concessions generally occupy the most space and are the most productive in terms of sales and revenue. Food and beverage concessions typically occupy approximately 60% of concession space, although the total amount of concession space varies widely. Food and beverage concessions at large hub, medium hub, and small hub airports average 4.5 square feet, 6.5 square feet, and 10.4 square feet of space per 1,000 passengers respectively. The range of food and beverage space varies between 2 square feet and 10 square feet per 1,000 enplaned passengers at large and medium hub airports and between 4 square feet and as much as 17 square feet at small hub airports (with one small hub reporting 26 square feet per 1,000 enplaned passengers).

The types of food and beverage services offered at airports generally include the following:

- Casual dining restaurants offering meals, snacks, and full bar service, typically with wait staff and table service.
- Quick-serve (also called quick-casual) units offering specialized meals, snacks, and nonalcoholic beverages, typically using counter service. Quick-serve is the broadest service category and may include snack concepts (ice cream, frozen yogurt, cookies, and generic snack bars) and Mexican, Asian, sandwich, delicatessen, pizza, hamburgers, and many other concepts. Quick-serve units are often co-located in food courts where they share customer seating and back of-house facilities and create a major destination for food and beverage services.
- Bars offering a full range of alcoholic beverages, as well as snacks and light meals, using wait staff or counter service.
- Specialty coffee units offering premium coffee and espresso drinks, tea, pastries, juices, and, in most cases, packaged sandwiches and salads.

The number of primary passenger routes of travel through the terminal (i.e., flows) leading to departure gates and the volume of passengers in each separate flow are major determinants regarding the number of concession units that can be supported.

At many airports, food and beverage services are considered the most important concession from a customer service standpoint. Unlike specialty retail or duty free, which are discretionary purchases, food and beverage services are a necessity for many passengers and achieve the highest sales penetration by passengers. According to multiple surveys at airports by Airport Interviewing and Research, a survey research company, 73% of passengers on average make purchases at concessions. Of these, 68% make a food and beverage purchase, 25% make a newsstand purchase, and 11% make a specialty retail purchase. Some passengers make purchases in multiple categories. Food and beverage concessions are also used by airport employees more than any other concession. The operators of some airports, such as Fort Lauderdale-Hollywood and Sacramento airports, encourage concessionaires to offer employee discounts by assessing a lower percentage rent on sales to employees.

Convenience Retail

Convenience retail includes traditional airport retail concepts such as newsstands and news/ gift shops, as well as newer hybrid retail concessions, such as convenience stores. Convenience retail concessions offer a merchandise mix that has few parallels outside of transportation terminals.

Newsstands are the most ubiquitous convenience retail concession, offering merchandise mix centered on a large assortment of newspapers, magazines, and hardback and paperback books. Other newsstand merchandise typically includes sundries, candies, mints, gum, cigarettes and tobacco, health and beauty aids, traveler conveniences, and a range of souvenirs and general merchandise.

News/gift shops are larger, traditional airport retail units that offer newsstand merchandise, but devote a significant amount of overall space to souvenirs, gifts, packaged foods, and general merchandise. Although they are still the dominant form of airport retail concession, news/gift shops at larger airports have been supplemented by specialty shops. Most airport operators allow convenience retail units to offer bottled water, juices, and other cold beverages as a passenger convenience. A recent addition to the convenience retail category is the convenience store, offering typical newsstand merchandise along with snacks, delicatessen items, and cold and hot beverages. The convenience store concept serves as a "one-stop shop" that can provide the time-limited passenger with the most often purchased items in a single transaction.

According to a national concessionaire surveyed for this project, 15% to 45% of airport passengers typically make a purchase at some type of convenience retail concession.

Specialty Retail

Specialty retail refers to a retail shop offering a specialized line of merchandise, such as jewelry, leather goods, personal care products, luggage, gadgets, travel accessories, sports apparel, shoes, cosmetics, regional arts and crafts, clothing, toys, candy/chocolates, or other merchandise.

Specialty retail includes in-line shops as well as kiosks, retail merchandise units (RMUs), carts, and, more recently, sophisticated vending machines. Specialty kiosks and RMUs are often branded and may include established national and international brands, local brands, and some airport-only brands.

Specialty retail shops require greater numbers of passengers and, depending on the concept, certain types of passengers. Surveys have shown that less than one-quarter of airport passengers visit specialty retail shops, with only 10% to 15% of passengers making a purchase at such shops.

In-line specialty retail shops tend to be smaller than newsstands or news/gift shops, typically between 500 square feet and 900 square feet, although some concepts may support up to 1,300 square feet of space. In addition to in-line shops, specialty retail kiosks are an important part of the retail program at airports, where concession space is limited. Specialty retail kiosks may range in size from 200 square feet to 450 square feet and can be located along walls within circulation corridors of concourses.

Duty Free

Duty free shops are retail shops that mainly sell high-end luxury goods in five traditional core categories: perfumes and cosmetics, liquor, tobacco, fashion, and candy/chocolates/confectionery.

Duty free shops, with some exceptions, sell merchandise that is free of import duties, excise taxes, and local and state sales taxes. Sales are, by law, limited to departing international passengers.

Merchandise to be sold is purchased by a duty free operator directly from manufacturers and suppliers rather than through normal distribution channels, such as regional wholesalers and distributors, thus avoiding wholesale markups. Merchandise is delivered "in-bond," that is, in sealed containers under the supervision of Customs authorities. The combination of direct purchase from manufacturers and tax and duty free status results in large gross margins, which translates into attractive pricing for customers, particularly on expensive luxury goods. Airport operators share in these high margins through high guaranteed and variable percentage rents.

Depending on the size of the market and the nationalities and preferences of the international passengers, the duty free operator may also provide branded luxury boutiques or branded shopin-shop displays featuring men's and women's fashion items, gourmet foods, single-malt scotch, or other luxury goods.

The value proposition for duty free shops varies with the customers' nationalities. Passengers from countries with high import duties, high sales taxes, or value-added taxes (VATs) or countries that levy high excise taxes on certain luxury items are most likely to find duty free shopping attractive. Generally, passengers from Europe and, in particular, Asia come from high-tax environments and are avid duty free customers. Customers from Asia also tend to be very brand conscious and are heavy consumers of branded luxury goods.

The difference in the international passenger mix at airports can make a material difference in duty free sales and revenue. Duty free sales for U.S. East Coast airports averaged about $8.50 per enplaned international passenger in 2008, while duty free sales at U.S. West Coast airports with higher percentages of passengers from Asia averaged just over $13.00 per enplaned international passenger.

Outside the United States, major international airports, such as Dubai International, London Heathrow, and Seoul Incheon International airports, produce duty free sales approaching $1 billion annually because of their large volumes of international passengers, limited domestic traffic, and airline service to high-tax, high-duty destinations.

Advertising

In-terminal advertising includes traditional static airport advertising displays such as wall posters, backlighted wall displays, wall wraps, and large-format displays.

Other advertising media in airports may include interior and exterior loading bridge wall wraps, ads on luggage cart panels, banners and column wraps, and dynamic displays including flat-panel monitors, video projection systems, and displays with alternating, changeable printed media. The development of light-emitting diode (LED) displays, such as those used as high-definition video walls in sports stadiums, is providing new opportunities to create free-form, custom displays capable of dynamic graphics and video. Figure 2-8 shows a large and dramatic wall wrap at a highly trafficked area in the terminal at Munich airport.

Airport operators have also implemented nontraditional advertising strategies including airport advertiser-based, closed-circuit audio programming (in-terminal radio); advertising supported television in hold rooms, such as the CNN Airport Channel; manufacturer-sponsored televisions in hold rooms, such as the sponsored Samsung displays that usually offer local programming; sponsored children's play areas; sponsored business centers; and naming rights arrangements, such as exclusive pouring rights for soft drink companies.

Advertising using wall wraps within loading bridges is also becoming common and, in many cases, can provide advertisers with access to passengers travelling to a specific destination when the assignment of departure gates is well established. In-terminal advertising is mostly managed by a few specialist companies; however, some airport operators use local out-of-home advertising contractors, and the operator of at least one airport, Jacksonville International Airport in Florida, manages its advertising program in-house.

Services

Services include a variety of amenities and personal services for passengers, such as the following:

- Automated teller machines (ATMs), usually provided through a bank, although sometimes installed in airports by commercial vendors.
- Baggage storage services, where luggage can be stored for a few hours or a few days. Lockers are also available in some airports, although security regulations have restricted their use.
- Business centers offering express delivery pickup, copying, printing, computer use, and other business services.
- Foreign exchange kiosks, booths, or in-line units offering currency exchange services, sale of travelers' checks, and cash advances on credit cards.
- Game rooms offering coin- or token-operated video games. Changes in technology, availability of home and portable gaming devices, and noise concerns have reduced the viability of these machines in airports.
- Hair salons and barber shops.
- Internet kiosks.
- Luggage carts, which in the United States are usually offered on a pay basis. Free use of carts is offered in the international arrivals areas of some airports. Internationally, luggage carts are most often provided for free by the airport operator and carry paid advertising.
- Luggage wrapping, where suitcases are covered with clear plastic for protection, and luggage shipping, mainly for international passengers as an alternative to paying excess airline baggage charges.
- Massage services and spas offering a variety of massages, manicures, pedicures, facials, and other spa services. Figure 2-9 shows a typical spa unit at San Francisco International Airport.
- Medical clinics, offering urgent care to passengers, prescriptions for travelers in need, and general medical services to employees. Medical clinics may also provide employment and FAA flight physical examinations, treat work-related injuries on behalf of airport employers, administer drug screening tests, administer flu shots and vaccinations, and provide other services.
- Pay telephones. Demand for pay telephone services has declined dramatically with the popularity of cell phones, but are still a necessary service for many passengers.
- Postal services, including the sale of postage, express mail, mailboxes, mail drops, and other postal services. At larger airports, a service center may be staffed by the U.S. Postal Service.
- Shoeshine stands

- Wi-Fi, which was first offered on a pay basis, but is now offered by many airport operators through sponsorships or as a free service.
- The availability of these services will depend upon such factors as the layout of the terminal building, numbers of passengers, and availability of suitable locations. Airports with efficient layouts and concentrated passenger flows are best able to offer a broad range of services. Clustering services together can make them easier for passengers to find.

ATTRIBUTES OF SUCCESSFUL CONCESSION PROGRAMS

The profile of airport concessions has increased steadily over the years. Passenger surveys show that concessions, which are used by more than half of all passengers, are an important factor in evaluating the overall passenger experience of the airport. The highest-rated airports in the United States and around the world all have highly regarded concession programs.

The 2009 ACI World Airport Service Quality passenger survey, a voluntary, fee-based program administered by ACI, which involves surveys of passengers around the world, ranked Seoul Incheon International, Singapore Changi, Hong Kong International, Beijing Capital International, and Ghandi Hyderabad International airports as the best airports worldwide (Airports Council International 2010). All of these airports have well-regarded concession programs.

In North America, the airports serving Austin, Halifax, Ottawa, Jacksonville, and Portland, Maine were ranked as the best airports in terms of their well-regarded concession programs. The ACI-World 2009 Airport Service Quality Index award winners are shown on Table 2-1 (Airports Council International 2010).

Successful concession programs share a number of key attributes.

- **Aesthetics.** Successful concession programs are characterized by concession units that are contemporary in design, visually interesting, built with durable high-quality materials, and inviting to potential customers, and that complement the terminal building and surroundings.
- **Capacity.** The ability to meet customer demand during seasonal and daily peaks affects customer service and revenues. The peak demand characteristics of airports vary and must be taken into account in planning the concession program.
- **Customer service.** Most purchases are discretionary. Passengers do not travel to the airport to shop or eat. Providing helpful customer service is important to maximizing sales and encouraging multiple purchases.
- **Revenue production.** Revenue production is a principal objective of any concession program.
- However, airports with successful concession programs have demonstrated that revenue production is not an end in itself; rather, it is the result of successfully incorporating multiple attributes into the concession program and providing passengers with an array of concession choices that meets their needs.
- **Sense of place.** Successful concession programs often reflect the unique attributes of their city and region, offering passengers from other places a brief look into the local community and culture. Whether it is barbecue in Memphis, Cuban food in Miami, seafood in Seattle, or

beignets in New Orleans, concession programs benefit by offering local favorites. Bringing in successful local food and retail concepts and incorporating local materials and design aesthetics can also help create a sense of place that differentiates the airport from others.

- **Value.** Historically, value for money has not always been a widely held attribute of airport concession programs, with some airport operators allowing concessionaires to charge customers what the market will bear. Airport operators have adopted a variety of pricing policies, ranging from true "street pricing" to no pricing policy at all. While pricing is important, it is not the only component of creating value for customers.
- **Variety.** Passengers want choices in food and beverage, retail, and services. The broader the range of choices, the more likely it is that the customer will find something he or she wants, and the more likely it is that the concessionaire will achieve higher sales and that the airport operator will have higher revenues.
- **The "wow" factor.** Passengers spend considerable time in airports, and concessions provide choices on how to use that time. Concessions that are unique, visually interesting, and exciting add to the overall passenger experience.

RECENT TRENDS IN CONCESSIONS

In recent years, a number of broad trends have helped shape the current state of in-terminal concession programs. These trends include the following:

Raised expectations. As airport operators improve their concession programs, frequent travelers including elected officials, members of the media, civic leaders, and other influential residents, will naturally compare airports they visit with their home airport. As concession programs have become larger, more developed, and more successful, the attention they receive in airport industry publications, the business press, and the general media has increased.

Decline in airline meal service. With changes in airline competition, particularly the rise o low-cost carriers (LCCs), airlines have reduced costs—including limiting free meal service— to remain price competitive. The decline in free meal service has increased demand for in-terminal food and beverage services, including food that can be taken aboard the aircraft and enjoyed in-flight. Airlines compete for this business with in-flight snack and meal sales, but the offerings are limited compared with what can be offered within terminals.

Healthy, fresh food. Airport operators have responded to changes in customer demand for fresher, healthier foods by adjusting their concession mix to include freshly prepared foods, including foods cooked or prepared to order within concession units, often in sight of the customer. At the same time, the use of centralized commissary food preparation has declined. Passengers have embraced good, fresh food and rewarded concessionaires and airports that have emphasized quality and diversity in their food and beverage offerings. In the 1990s, offerings at airports were expanded to include more branded foods, including fast foods. While traditional fast food brands still have a place at airports, fresher, higher quality concepts that respond to the preferences of passengers seeking better or healthier foods are also being offered.

Local and regional brands and concepts. According to the survey conducted for this research project, about 29% of the food and beverage brands at airports are local or regional, while about 26% of specialty retail brands are local or regional. Another 10% of newsstands carry the name of a local or national newspaper or magazine, a news or business television network, or a local television station.

Local and national "celebrity" chefs. Recent competitive proposals for airport food offerings have spurred a rise in food and beverage concepts that are licensed or created by celebrity chefs made popular through cable food networks. Kathy Casey, Todd English, Masaharu Morimoto, Wolfgang Puck, and Martin Yan are a few of the well-known chefs who have created successful restaurant concepts for airports. Similarly, cable television's Food Network and the Culinary
Institute of America have partnered with airport concessionaires to create new and unique food and beverage offerings.

Smaller leasing packages, more concession agreements. As airport concessions have grown in scale and sophistication, airport operators have sought to increase the level of competition and attract a broader range of concession concepts to their airports. To effect this change, the operators of larger airports are awarding multiple concession agreements and using more direct leasing to improve their concession mixes and attract high-quality specialist tenants.

Branding. For passengers, travel involves a series of decisions and risks, and brands are a way of minimizing the risk of a poor decision while in the airport. Passengers have indicated a strong preference for the proven and familiar. Brands can also provide a proven, built-in quality control system with external monitoring that reduces the airport operator's risk of substandard operations. For example, brands with off-airport locations can be used as a benchmark for ensuring that prices are consistent with the pricing policy at the airport.

Kiosks, retail merchandise units (RMUs), and wall-huggers. With airport concession space often constrained by the needs of airlines, many airport operators are incorporating RMUs or kiosks in their concession programs as a means to increase revenues, expand the concession offering, and provide services in underserved areas of the terminal. For example, at Hartsfield- Jackson Atlanta International Airport, retail and food and beverage RMUs have been installed on concourses where passenger demand exceeds the supply of concession space. Wall huggers, a form of RMU that takes minimal floor space and stands against an available wall, are also effective in space-constrained airports.

Less time pre-security. Online check-in and self-service check-in terminals have decreased the time passengers spend in pre-security areas, allowing them to proceed directly to the security checkpoint.

Increased security checkpoint processing times. Although automation is reducing the time passengers spend at ticket counters, they are spending more time in security queues undergoing more stringent security inspections. TSA security checkpoint procedures have increased passenger processing times and lengthened queues, which has, in turn, reduced demand for pre-security concessions and increased demand for post-security concessions.

Volatility in passenger demand. Until the attacks of September 11, 2001, there were few examples of "systemic shocks" that could broadly affect airline passenger demand. Previous events, including air traffic controller strikes and airline bankruptcy filings, did not compare to the sudden downturns caused by security concerns following the attacks of September 11, 2001, or the decrease in demand resulting from the "great recession" of 2008–2010. (The 2002–2003 severe acute respiratory syndrome [SARS] epidemic also caused sharp declines in passenger travel, mostly to or within Asia.) The heightened sensitivity to systemic declines in passenger demand has caused concessionaires and airport operators to consider the financial effects of a decline in traffic and the effect of such a decline on the obligation to pay minimum guarantees. While long-term passenger demand is expected to grow, the concern over a sudden traffic decline is being factored into decisions by concessionaires, particularly where the length of term is short and there is less time for a recovery.

Changes in the airline industry. LCCs claimed a 27% share of domestic passenger traffic in 2009 and in 2010 provided more than 29% of available domestic seats. Much of this share is taken from the established network, or legacy, carriers, and the remainder is new traffic stimulated by new service and lower fares. Other changes in the airline industry include the rapid growth in LCC traffic at secondary airports serving major cities, a decrease in the share of connecting traffic flowing through major hubs, and a shift to LCCs in price-sensitive leisure markets. Airline bankruptcies and consolidations through mergers (AirTran Airways and Southwest Airlines, Delta Air Lines and Northwest Airlines, US Airways and America West Airlines, Continental and United Airlines) have resulted in some significant shifts in traffic, particularly at connecting hub airports.

Integration of concession areas with hold rooms. Some new airport terminals are blurring the line between airline-leased hold rooms and concession areas with good effect, making it easier for passengers to use concessions without losing sight of their departure gates. The JetBlue Airways terminal at John F. Kennedy International Airport in New York includes devices for remote ordering of food and beverages along with hold rooms with tables and counters so that passengers can eat close to their departure gates. At San Francisco International Airport (see Figure 2-11), in its redevelopment of Terminal 2, food and beverage concessions are located closer to departure gates, and alternative types of seating (including benches, tables, and chairs) and traditional airport seating are mixed to allow passengers to enjoy their food and beverage purchases closer to their departure gates.