JURISPRUDENCE

OF

CYBER LAWS

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CHAPTER I

DEFINING CYBER SPACE

"We are approaching the new era with 21st century technologies with 20th century governing processes and 19th century governance structures"

Harold A. Linstone, Professor Emeritus,
Portland University, Oregon

Introduction

Cyber Space - a term coined by Novelist William Gibson - denotes a place without physical walls or even physical dimensions has connected the globe in the shortest span of time to the extent no technology has done before in human history. It will be news to many that Internet - the nervous system of the body called cyber space is almost three decades old. Its origins in 1968 and 1969 with the initiative of the British Physical Laboratories and with the United States military project called the Advanced Research Projects Agency. (1) The basic idea of the project was to connect the defence network computers to safeguard it from attacks on the physical telephone network. The leading Universities which assisted the network later formed a sister network on the same lines, which was sponsored by the National Science Foundation, called as the NSFnet. The students involved in such development had a closed user group, as the navigation of such network is a complicated one and needed special skills. It was only in 1993, it became a tool of the masses with the invention of a browser called " Mosaic". This browser is a simple tool, which allowed even those who did not have

computer knowledge to share information. Today the Internet connects almost 200 million people- people from 195 countries- approximately 3% of the world population and back home the connectivity is estimated to grow around 125% annually over the next three years.

The moot point is what does it mean to people? Can Internet provide water or food or will it eradicate Aids? Will it stop crime or wars? Do we need legislations to promote the phenomenon or we need legislations to control and regulate it? Or simply should it be let off without any legislations? The answers are much complex than the cyber revolution itself. For optimists the cyber revolution holds a new path of prosperity, connectivity, exchange of information, trade and business and for those who are skeptical it will create digital divide with the division of knows and know-nots slicing through the haves and have-nots. If these are extreme viewpoints there is a huge shade of gray area in which cyber space operates and in such polarization of views emerges the cyber jurisprudence, which is chasing the speeding technology on the information highway to formulate the traffic regulations. As the traffic systems are varied and chaotic depending on the country you drive, the same is true for the cyber laws of the respective environment you operate in. The following chapter will deal with the questions of how to define cyber space? What relevance or impact it has on the subject of 'Law'? Do we need to formulate and study a new segment called 'cyber laws'? If so what will be the basic ingredients of such study?

Understanding Cyber Space

In tune with the emergence of new and radical technologies necessitated by War, the history of Internet dates back to 1968. In the backdrop of cold war, UK and USA on both sides of Atlantic attempted to construct a large-scale network that could provide safe transmission of information. The telephone network, which allows point-to-point information, was considered unsafe and vulnerable to physical networks. Unlike the fixed pathways of the telephone network the attempt was to create a network of computers, which will send information as "packets" and these packets "bounced" over these networks. Even if a particular pathway is destroyed the "packets" will search for alternate pathways and will reach their desired destinations safely.

This experiment was a collaboration of the military establishment and some leading Universities and called as the Advanced Research Projects

Agency (ARPANET). The initial experiments of this technology were based on incompatible operating systems of the various universities and the military establishment. This could be possible only with the confidentiality and trust among the collaborating partners – a popular concept among the net called as "netiquette"- based on appropriate social behaviour of using Internet. In due course of time Universities established their own sister network called as the "NSFnet" with the help of the National Foundation of Science, USA for using the technology for research and educational purpose. The students involved in the project took this technology along with them to their new employers heralding the corporate use of this technology.

In 1972 the first electronic mail programme was born to be distributed in the ARPANET and a year later the mail became international with connections established with UK and Norway. Soon a commercial network TELNET emerged online in 1973. These ventures were backed by software developments of which Transmission Control Programme (TCP) was a breakthrough. In 1984 'Domain name servers came into existence. In 1989 the 'World Wide Web' – a protocol in Internet made its appearance raising hopes of wider use of this technology. In 1993 Hyper Text Transfer Protocol (HTTP) emerged along with software back up in the form of HTML-Hyper Text Marked Language. In 1993, software called 'Mosaic' was invented which is the first web browser. Mosaic and its successors Netscape, Internet Explorer heralded the Internet Revolution – the phase of human history where technology could become part of everyone directly or indirectly. This allowed mind-boggling amount of information to be stored, vested and exchanged and was aided by the development of the search engines like Google, Altavista, Infoseek and others.

Internet today is a technology used by millions of surfers connecting millions of computer worldwide; the rate of growth of this technology is quantitatively and qualitatively different than its predecessors like telephone, radio or television. Internet is a single platform where all the others can converge - information; speech and visual combined as digital information. Unlike the other technologies often referred as 'push technologies' where the process is one-way from those who produce to those who consume, Internet is referred as 'push and pull technology' offering interactive process.

Nevertheless, the social behaviour of 'netiquette' of the early group of users based on mutual trust and conditioning will also change in the various stages of the history of Internet. The contemporary understanding of this 'free space of the commons' is often debated on themes like 'cyber terrorism' and 'cyber crime' marking the new jurisprudence of 'cyber laws' and the great debate of 'freedom vs. regulation'.

Interface of Technology and Law

Human history in a sense is a story of technology from flint stones to that of genetic clones. The tribulations and triumph of such a journey, which will continue in the future, has one aspect, constant at its core – "the laws that govern them". Technology - if defined as 'set of refined processes' resulting in 'various application of daily use' in our lives seems to be harmless marvel in its basic construct and explanation. A deeper understanding and implications of 'technology' could lead us to other scary construct. Leading such a thought is the 'nuclear technology' perfected to the core and yet a debate on how to 'deconstruct' the same. After 9/11 incident the focus of debate is on 'Bio-war fare technology'. Hence the inevitable intervention of 'law' on shaping, banning and encouraging 'technology' remains a constant. 'Law' as instrument of 'governance of human behvaiour' closely shadows 'technology'. To understand a broader perspective of the interface of 'technology and law' the following construct by professor Harold A. Linstone of Portland University of Oregon 1.

"The pace of growth of technology and governance are not compatible raising a series of serious problems. The combination of explosive population growth and rapidly evolving technology is in effect shrinking the earth to a global village. The earth's 5.77 billion in 1996 may swell to 9.4 billion by 2050. At the same time the widening gap between technological and organizational rates of change is producing a growing mismatch: we are approaching the new era with 21st century technologies, 20th century governance processes, and 19th century governance structures. Some view this mismatch as one between physical and social technologies. The combination of shortsightedness, irresponsibility, gullibility, human greed, and fear of change is impeding homeostatic evolution of a knowledge society. Demographics are playing a significant role in the widening gap in the

developed world. Youth have galvanized the Information Technology revolution: the personal computer or PC is the creation of startling young computer hackers and entrepreneurs (e.g. Steve Jobs and Apple and Bill Gates and Microsoft). On the other hand, the aging of the population as well as the damage to youth caused by deteriorating education and brains impaired by the drug epidemic and poverty-bred malnutrition raise the barriers to effective social change. Technology is serving, molding and insulating the elite, while diverting or narcotizing the masses with entertainment, and marginalizing the poor. The uncontrolled exacerbation of such patterns portends serious societal tensions and fractures, accompanies by governance dysfunction and systematic instability. These effects will impact both advanced and developing countries. It is by no means assured that democracy can survive the resulting turbulence and resist the lure of say, a majority based "friendly fascism".

The urge to minimize the yawning technology-organization chasm suggests two possibilities:

Path 1- SLOWING DOWN THE TECHNOLOGICAL PACE OF CHANGE - This scenario is unthinkable for most people, particularly scientists and engineers. The technological pace appears unstoppable. A new Dark Age is as inconceivable as it must have seemed to the forecasters in the Golden Age of Imperial Rome.

Path 2 - ACCELERATING THE ORGANIZATION PACE OF CHANGE - There is little question that information, communication and transportation technologies permit dramatic and profound changes in organizations and governance. Industry is already showing us new forms of organization, such as downsized, "virtual", decentralized and global corporations. Taking just one example, we see today that Information Technology makes possible as never before SIMULTANEOUS localization and globalization, fragmentation and integration, decentralization and centralization, in many societal aspects. Organizational innovation based on coordination-intensive structures is one consequence.

The Evolution of Complex Systems: A Metaphor

It is interesting to observe that complex system evolution generally appears to proceed by periodic swings between centralization and

decentralization. One metaphor to gain insight about the evolution of complex systems is their depiction as alternating processes of separation and combination. A simple hierarchical system, say a tribe or a small company, grows until it can no longer be effectively managed or controlled centrally. Then it separates into smaller units with considerable autonomy. When there is too much decentralization and the system is no longer effective, reunification occurs, usually at a higher level of complexity than existed previously. In other words, successful evolution proceeds to increasing system complexity by periodic restructuring that oscillates between differentiation and integration.

Lessons from the Past

History provides fascinating clues on centralization and decentralization. The vast Roman Empire could only operate with considerable decentraliztion, even though it had outstanding communications for its time. It was physically impossible to exercise centralized day-to-day control. It worked as follows. Great care was taken at the Centre to appoint a provincial governor or military commander. He was highly trained in the way the Roman system operated and Roman policies were deeply ingrained in him. He had to hold high office in Rome before being appointed to a distant post. Thus coordination between the provinces and Rome was assured. The fall of Rome led to decentralization and an attempt by the Catholic Church to affect a new centralized form of governance. The Holy Roman Empire was a temporary compromise. The power struggle between religious centralized and secular decentralized control led Europe for centuries in the Middle Ages until the latter won out. The Information Technology revolution triggered by the printing press played a crucial role. A challenge for the third century is to create, in Madison's words, a new "happy combination", balancing global/regional, national and local governance levels in a way appropriate to the shrunken global village and the coordination-intensive structure made possible by today's Information Technology based revolution.

Rethinking Governance

Coordination–intensive structures can help to develop effective new arrangements. There is a growing recognition that governance is possible

without formal government. Social institutions and informal organizations can be created to deal collectively with specific issues, developing rules of the game and settling conflicts. There are physical and biological systems that lie outside the jurisdiction of any one national government, such as Antarctica, the oceans, the electromagnetic spectrum, and the global climate system. Such "International commons" may be managed by regional or global forms of governance. A characteristic of this restructuring is maximum flexibility and coordination: an aim is UNITY IN DIVERSITY. An overhaul and streamlining of governance is an essential task in adapting the society to the fluid information-intensive environment of the 21st century. Technology now offers us individually and collectively a remarkably powerful prosthesis of human brain. It makes "unity in diversity" and well-being in the global village realizable objectives, but their achievement demands innovative leadership and unprecedented institutional flexibility."

The above excerpt will give one interesting perspective on the interface of technology and–governance and the link to laws, which are instruments of regulating, and directing to such desired goals. The subject of 'technology' has been audited from various perspectives- appropriate technology vs. technology for the chosen few, dangerous technologies vs. useful ones, technology as a trading tool in the division of haves and have-nots vs. people oriented and people owned technologies- the debate goes on. Information Technology has added a new dimension of a new matrix of haves and have-nots combined with know and know-nots often termed as digital divide.

These debates underline one important, inevitable inescapable fact that technology is there to stay and most importantly method and manner of its regulation through law will be the crux of the issue. Technology and Law in the last few decades dominates the substantive and procedural part of the evolution of legal system. Technology impacts Law and in turn Law shapes up the contours of future technologies and their appropriate use in the society.

Defining Cyber Laws

The term Cyber Laws has gained a wide recognition often spoke about in seminars, workshops and symposiums. Literature has been published

using words Cyber Laws, Law of the Internet, Law relating to Computers. In Academic settings, there are centres for Computer and the Law, Cyber Law and research and so for and so forth. The important question is whether these terms are used to denote a specific branch of study, or just a popular usage without coming to grips with what exactly is this branch of law, is it still evolving or is it a generic usage of dealing with varied existing laws on a glamorous pre-fix or suffix?

The fact is that it has gained currency and popularity in usage, yet an uncharted territory without clear consensus on the boundaries, overlaps and interfaces it has with conventional branches of law. To understand this first one needs to question what exactly necessities the segregation of a separate branch of study –the cyber laws? This will lead us to the question if computers and Internet are mere technological processes like many in the history of technologies, what is the need of segregating a special branch of law? It is a fact that in the evolution of technologies, some have impacted the human life with their reach and applications leading to new sets of laws like - Press laws, broadcasting laws, telecommunication laws. In these developments the laws enacted took into account how these processes affected human behaviour and evolved the rules of the game where the various stakeholders will benefit by them and also the methods by which conflicts can be resolved. It is in the same breadth the need for comprehensive sets of Laws called as those who support such a branch advocate 'cyber laws'. The votaries also argue that unlike other technologies like radio, telephone or television the impact of the Internet is phenomenal not just in numbers but the complexity in which it has impacted the society and human behaviour.

One such argument also rests on the fundamental challenge to the way hitherto functioning of the legal systems. Various legal systems in the world finally operate through the prism of territory. It is thus referred as the 'law of the land'. The legal system operates in the matrix of the sovereignty, customary norms evolved in such territory and has a finality about them decided by the justice delivery system accepted as part of the constitution of the country. In this context the breakthrough technologies of the past are relatively easier to regulate and operated on national and international boundaries. In the case of the Cyber space, the fundamental concept itself is one that of a character of international presence and not distinguishable as national and

international operations. The underlying utility and its construct itself such that it has to be global to be called as cyber space and at the same time the challenge is to regulate on the basis of the 'law of the land'. It is a catch 22 situation where one wants keep the cake and eat it too.

In such scenario it can be concluded that the branch of "cyber laws" is an evolving one which interfaces with all the constitutional provisions, various statutes of other traditional branches of law, various other cases involving individuals, corporates and institutions who transact through the 'Internet' using the emerging technology of hardware and software. Such a sketch will include interfacing technology processes like telecom, Internet services, educational services, cable & broadcasting services, media services, regulatory services, law & order agencies, intelligence services, entertainment services, health services, financial services, judicial services and others which may become part of this future revolution. In short it encompasses all services and players of such services who use and consume 'internet'.

Having widened the scope of subject matter of "cyber laws" it is essential to concentrate on core issues in the immediate vicinity of its operation. Such core areas of focus can grouped as (a). Jurisdiction in cyberspace (b). Contracts in cyber age (c). Intellectual Property Rights regime in cyber space (d). E-commerce & Taxation issues in cyber space and (e). Cyber Crimes. There is no hard and fast rule of the above demarcation or chronology of its importance but just an entry point to cover some areas due to the importance based on the current usage of Internet in certain focused areas and keeping in view of this short term course and its time frame in tune with the syllabi prepared. Learners are encouraged to go beyond this coverage and specialize an area of their choice of this expanding field of study and its unchartered territory and legal issues involved in them.

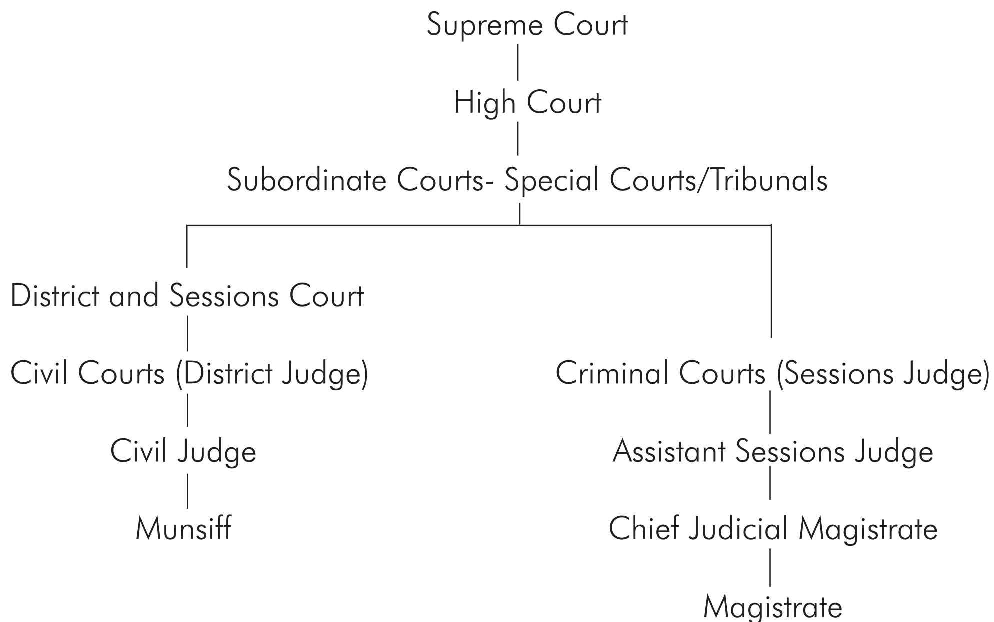
CHAPTER II

JURISDICTION IN CYBER SPACE

Concept of Jurisdiction

'Jurisdiction' is the concept whereby in any legal system, the power to hear or determine a case is vested in an appropriate court. The justice delivery system of any legal system operates through structures called 'courts' and the starting point of such functionality is that of 'jurisdiction' by which the verdict of the court becomes validated as a proper 'judgment' to be carried in accordance with law. The system of `Courts of Law' needs to be understood to understand the principle of jurisdiction. Statutes create the institutions of Courts, which clothes them with appropriate power and jurisdiction. The Courts adjudicate and administer justice based on such powers conferred on them. In Indian context, the Constitution has provided for the creation of Supreme Court - the apex court for the country and a High Court in each State. Such institutions are conferred with original and appellate jurisdiction to adjudicate on any issue arising between citizen and the State, State and other States or between a State and the Union. The Courts are structured as civil and criminal on the basis of Jurisdiction, territory and monetary parameters. The Criminal Procedure Code provides for the creation of the Magistrate Courts - First Class, Second Class - above them Sessions Court in the district level. These courts have specific powers of punishment. These courts are subordinate to the High Court of the State. The State Laws and Civil Procedure Code or Criminal Procedure Code will determine the setting up of the subordinate courts.

On the Civil side, the Civil Procedure Code will provide for the creation of Munisiffs Court, the Sub-Divisional Court, and the District Court. Here again the pecuniary and territorial jurisdiction will vary based on the hierarchy of the courts. Apart from these civil and criminal court set up there can be special courts for specific categories of adjudication like the Sales Tax Tribunals, Central Administrative Tribunal, State Administrative Tribunal, Motor Vehicles Compensation Tribunal and like others. The High Courts and Supreme Court have civil, criminal and writ jurisdiction. The President with the advice of the council of ministers makes the appointments to the higher judiciary.



In this system the Civil Procedure Code determines the jurisdiction of the various court structures based on the nature of the claim, value of the subject matter and the territorial limits where the dispute arose. Such jurisdiction is clearly spelled out by specific laws and also expressly prohibits jurisdictions by specific laws. One such example is that of the Income Tax Tribunal are the only forums to decide about the disputes of income tax and hence special jurisdiction in that regard. The High Court of the State assumes jurisdiction over the entire State and the hierarchy of courts like the District

Sessions Court in criminal side and the Civil Courts – District Judge on the civil side and the lower courts of Munsiff and Chief Judicial magistrate in respective civil and criminal sides will exercise jurisdiction based on the territories. The Courts also exercise jurisdiction based on the value of the suit decided by the Suits Valuation Act.

On the special courts or the tribunals, there could be formation new tribunals where the pending cases in the regular courts will be transferred if they are found fit to be adjudicated under the tribunal. These tribunals have judges and also subject specialists designated as 'judges' and are not bound by the procedures and technical requirements of the regular courts. On the criminal side, the jurisdiction operates on the basis of the authority and territorial demarcation conferred on the various courts by the Criminal Procedure Code. Certain judgments like the death penalty have to be confirmed by the High Court if passed by the sessions court.

Within a country the legal system operates through the process of jurisdiction, which can be classified as

a. Pecuniary jurisdiction

b. Subject matter jurisdiction

c. Territorial matter jurisdiction

Here the pecuniary jurisdiction denotes to the monetary limits involved in the dispute. Here the jurisdiction operates on a set monetary limit of the value of dispute and accordingly courts have to be approached. If the dispute is for a set amount the court to be approached will be the district courts and above such limits it will be the High Court of the State.

The subject matter jurisdiction specifies the nature of the jurisdiction based on the type of disputes that are involved. A company winding up procedure can be dealt only in the High Court and not a district court is an example. A family court will be the place for initiating a dispute on divorce.

The territorial matter of jurisdiction involves the geographical factor where the dispute can be brought before a particular type of court.

Such criteria is based on the hierarchy of court structures of a legal system clothing power based on territory in its initial stages of contention of a dispute with rights of appeal gradually moving upwards towards the apex

court. And again on criteria are set for magnitude and seriousness of the disputes to approach appropriate courts. Even if a court by oversight or wrong interpretation admits a contention to be dealt by the court there are provisions to challenge the same and render such a verdict null and void based on the principle of 'jurisdiction'? In essence immaterial of the merits of a case, the process of resolving the dispute and enforcing the same will depend on the correct 'jurisdiction'.

Having explained the concept of jurisdiction, in the context of 'cyber space' the territorial jurisdiction assumes the importance in terms of challenges posed by Internet operations. Such jurisdiction is determined by the relevant civil procedure code where various possibilities depending the subject matter in which the issue of 'jurisdiction' has to be decided. For example if it is a property issue, what jurisdiction will apply will be part of the civil procedure code enumerating the various options of courts to be approached based on the complexity of the property involved in terms of its location. Similarly the issue of 'jurisdiction' of a contract drawn can be decided on the options of: (a). particular choice of legal action decided by the parties themselves or (b). based on the principles of `cause of action' or where the plaintiff resides.

Here 'cause of action' means of a bundle of rights to the plaintiff to prove the place where the 'cause of action' arose for him or her to seek judicial remedy on which the courts can assume jurisdiction. On the other hand if the plaintiff proves no such fact however partial, the defendant will succeed in the judgment on the grounds of jurisdiction of such effort by the plaintiff. Such 'cause of action' to be proved is based on the facts of the individual case.

Here again such concept of 'jurisdiction' assumes greater importance on the fate of the case in the legal system like United States where each state has its own sets of laws itself complicating the efforts of the plaintiff and whereas Indian context it is less cumbersome as the laws are uniform through the length and breadth of the country and only issue being approaching the appropriate courts. The issue of jurisdiction will assume complex proportions in case of multiple parties as part of the plaintiff with multiple defendants and the dispute involving different places of operations.

Here the courts will have to look carefully to assume jurisdiction or to abandon the same.

Uniform and Varied Jurisdiction

In Indian context, the jurisdiction issue is uniform as the statutes are enacted for the entire country and for all states. But in countries like United States of America which is also a federal set up like India, each state has its own laws and hence jurisdiction assumes importance. In situation of conflict on the issue of jurisdiction, United States Courts apply various principles based on the claim of property, tort, contract etc. In case of the tort cases the courts apply the principle of *lex loci deliciti* or the "the law of the place of the wrong". In case of the claim for a property - the jurisdiction issue is approached based on the first restatement principle of *lex situs* - "the law of the physical location" later enlarged by the principle of second restatement of law in 1971 – "when faced with the choice between jurisdictions court should apply the law of the jurisdiction with the significant relationship to the litigation." On contractual claims the courts apply the principle of "minimum contacts" for corporations as well as individuals. This principle is based on the obligations arising out fair play and substantial justice on the transaction and its relationship to the forum state. Thus the issue of jurisdiction has varied interpretations and expansions based on developments in industrial transactions affected by the technological revolution.

Internet Jurisdiction

In the context of internet or cyber transactions, jurisdictions pose a major challenge in interpretations in countries like United States where there is a conflict of laws as it is not uniform throughout the country and States having their own laws. As we already saw "Internet" and transactions happening through the Internet has multiple parties residing in various territories. Let us take an example of simple transaction in Internet of ordering a book. A orders a book advertised for a price X in a website B. The Website is operated by Y who resides in another country C. The website is launched through a server located in country D operated by Z. A finds his credit card statement showing money paid but did not receive the book and now decides to take action. In this case Y who operates the site is in a neighboring country and

implicates the server provider Z for faulty configuration, which has caused the problem to A. How, does A proceed to sue for his losses? Or in another example the Police in Hyderabad come across objectionable material in a website which is launched by someone in Pakistan but hoisted from Italy through a server? Under which jurisdiction can the offence be brought?

Those who argue that jurisdiction as a major issue in the Cyber Space and Internet argue that the traditional method of assessing such jurisdiction is complicated in Internet transactions. In a traditional contract, the jurisdiction is arrived at 1. The place the defendant resides and 2. Where the cause of action arose? In illustrations as above they argue it is complex to understand jurisdiction. Especially for those who run in commerce through Internet may land up in different jurisdictions when sued by the consumers around the world. On the other hand it is also argued that the hapless consumer will also be left without any defense in cases where the service providers and intermediaries in cyberspace are spread out in various jurisdictions.

Against this argument, many jurists and cyber law experts argue that the complications of jurisdictions are blown out of proportions and can be resolved by simpler yardsticks of existing principles of jurisdiction. They argue that issue of jurisdiction is either mistakenly or mischievously exaggerated, as what ever transactions are taking place it takes place on physical locations with physical sellers and buyers and only the links are more in such transactions. They argue that firstly, most complications are avoided if there are explicit provisions among the contracting parties on their choice of law governing such contracts; secondly, in cases of contracts which are silent in respect of the choice of the law, the courts have come to grips with the situation and thus the intent, purpose and other factors of the websites will decide the jurisdiction rather than anywhere or everywhere jurisdiction phobia.

Countering this others argue that it is finally left to the pattern of judgments of the courts which will decide the issue of jurisdiction where the private international law cannot play any meaningful and constructive role. In this background the international efforts of jurisdiction assumes significance in cyberspace, which will be dealt in the subsequent modules.

Jurisdiction - Indian Context

As discussed earlier the jurisdiction of Civil Courts in India is based on pecuniary, subject matter and territorial aspects where the pecuniary aspect is based on the valuation of the dispute in terms of money, subject matter deals with specified disputes allocated to specified courts and territorial aspect is based on the 'residence' and 'cause of action' but again subject to the pecuniary and subject matter parameters of the dispute to be adjudicated. In this context due to the unitary and uniform structure of laws throughout the country one can easily dismiss the complexity of Internet Jurisdiction issues as it is dealt in United States. However, Internet being a global phenomenon the jurisdiction issues of those who reside outside India and vice versa of those who reside in India will assume importance in case of adjudication and effectiveness of the same.

Let us look at some important provisions in this regard to understand the Jurisdiction issues and its operation in the Indian legal system:

1. S.13 of Civil Procedure Code (CPC) - this section deals on foreign judgments-

A foreign judgment shall be conclusive as to any matter thereby directly adjudicated upon between the same parties or between parties under whom they or any of them claim litigating under the same title except-

a. Where it has been pronounced by a court of competent jurisdiction;

b. Where it has been given on the merits of the case;

c. Where it appears on the face of the proceedings to be founded on an incorrect view of international law or a refusal to recognize the law of India in cases in which such law is applicable;

d. Where proceedings in which the judgment was obtained are opposed to the natural justice;

e. Where it has been obtained by fraud;

f. Where is sustains a claim founded on a breach of any law in force in India.

By these provisions it is implied that foreign judgments are binding if the above exceptions are taken care in the adjudication. Here again any explicit

acceptance of the jurisdiction of any foreign court by an Indian citizen or a corporation is bound by that as the individual or corporation has taken.

Jurisdiction by Consent

If the contracting parties consent specifically to have a jurisdiction of a particular country, it would be binding on the parties and cannot later turn the argument that the court has no jurisdiction on general grounds. Connected to this is the general principle that the court cannot pass an *ex-parte* decree against a party who did not appear or contest in such litigation. This often leads to the notion that mere non-appearance will allow the defendant to get away with the proceedings. But there are various instances where Indian Courts have interpreted S 13(d) of CPC to uphold natural justice and thus mere procedural loopholes cannot be taken as excuse for violation of substantial aspects of natural justice to let the offender to get away and has enforced jurisdiction in such cases.

Added to this S 13 CPC states that a judgment of a foreign court is in violation of the Indian Law it cannot be sustained, in substance it can be stated that any judgment of the foreign court on an Indian citizen if it satisfies S 13 of the CPC can be upheld in Indian Courts. Such an analysis leads to the conclusion that any legal transaction carried out in Internet has the potential of litigation in the country where such services are provided and are subject to the legal regime of such country. It can take effect in Indian jurisdiction as long as they meet the requirements stipulated in S 13 of the CPC.

On the flip side, of the jurisdiction of the Indian Courts over Foreign residents or citizens again, can be dealt under the section 19 of the CPC. It is understood that in cyber transactions the damage or injury is caused to the movable property. Here under S 19 of CPC, allows for filing a suit for the compensation of the wrong done to the person or to the movable property. Such a suit is instituted either at the place of residence or the place of business activity of the defendant or at the place of the wrong committed. The specific clause of such suit and its jurisdictions is spelled out in S 20 of CPC, which is as follows:

20. Other suits to be instituted where the defendant resides or cause of action arises: -

Subject to the limitations aforesaid, every suit shall be instituted in a Court within the local limits of whose jurisdiction –

a) The defendant, or each of the defendants where there are more than one, at the time of the commencement of the suit, actually and voluntarily resides, or carries on business, or personally works for gain; or

b) Any of the defendants, where there are more than one, at the time of the commencement of the suit, actually and voluntarily resides, or carries on business, or personally works for gain, provided that in such case either the leave of the Court is given, or the defendants who do not reside, or carry on business, or personally work for gain, as aforesaid, acquiesce in such institution; or

c) Where the cause of action, wholly or in part, arises.

In interpreting the above three components of the section, the first and second components are much clearer and in case of the Internet specially, the third component of the 'cause of action' needs to be analyzed. A cause of action whether wholly or partly will determine the validity of the suit under s 20 (c) of the Code of Civil Procedure. If interpreted the following points will emerge:

1. Cause of action as a complete bundle of material facts for the plaintiff to institute a suit and failure to produce such facts will fail the case of the plaintiff.
2. Cause of action will constitute even the smallest fact constituting such an action and not necessarily any defined portion of the cause of action.
3. Cause of action will constitute the facts and circumstances of each case.
4. Cause of action if arises partially in different places, the plaintiff is vested with the choice to initiate and claim for jurisdiction
5. Cause of action based on the principle of some part of it arising in India will lead to the jurisdiction of Indian Courts over a non-resident foreigner.

We shall discuss the application of such jurisdictions in the chapter on Contracts in detail. Further to the above provisions such executions of decrees

outside India assumes importance and the following sections have to be borne in mind:

S 45. Execution of decrees outside India. - So much of the foregoing sections of this Part as empowers a court to send a decree for execution to another Court shall be construed as empowering a Court in any State to send a decree for execution to any Court established by authority of the Central Government outside India to which the State Government has by notification in the Official Gazette declared this Section to apply.

S 44A. Execution of decrees passed by Courts in reciprocating territories.-

(1) Where a certified copy of a decree of any of the superior Courts of any reciprocating territory has been filed in a District Court, the decree may be executed in India as it had been passed by the District Court.

(2) Together with the certified copy of the decree shall be filed a certificate from such superior Court stating the extent, if any, to which the decree has been satisfied or adjusted and such certificate shall, for the purposes of proceedings under this section, be conclusive proof of the extent of such satisfaction or adjustment.

(3) The provisions of S 47 shall as from the filing of the certified copy of the decree apply to the proceedings of a District Court shall refuse execution of any such decree, if it is shown to the satisfaction of the Court that the decree falls within any of the exceptions specified in clauses (a) to (f) of S 13.

Explanation 1. - 'Reciprocating Territory' means any country or territory outside India which the Central Government may by notification in the Official Gazette, declare to be a reciprocating territory for the purpose of this section; and 'Superior Courts' with reference to any such territory, means such courts as may be specified in the said notification.

Explanation 2. - 'Decree' with reference to a superior Court means any decree or judgment of such Court under which a sum of money is payable, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty, but shall in no case include an arbitration award, even if such an award is enforceable as a decree or judgment.

On the criminal side of jurisdiction the following sections are pertinent to analyze the implications of cyber crimes, which will be dealt in detail in the fourth module. The important sections to be kept in mind at this stage are:

1. *Section 177 of Criminal Procedure Code: Ordinary place of inquiry and trial*- Every offence shall ordinarily be inquired into and tried by a court whose local jurisdiction it was committed.
2. *Section 178 of Criminal Procedure Code: Place of Inquiry or trial:*
   (a) When it is uncertain in which of several local areas an offence is committed, or
   (b) Where an offence is committed partly in one local area and partly in another, or
   (c) Where an offence is a continuing one, and continues to be committed in more local areas than one, or
   (d) Where it consists of several acts done in several different local areas, it may be inquired into or tried by a Court having jurisdiction over any of such local areas.
3. *Section 179 of Criminal Procedure Code: Offence triable where act is done or consequence ensues.* - When an act is done by reason of anything, which has been done, and of a consequence, which has ensured, the offence may be inquired into and tried by a court within whose local jurisdiction, such thing has been done or such consequence has ensued.
4. *Section 182. -Offence committed by letters.* - (1) Any offence which includes cheating may, if the deception is practiced by means of letters or telecommunication messages, be inquired into or tried by any Court within whose local jurisdiction such letters or messages were sent or were received: and any offence of cheating and dishonestly inducing delivery of property may be inquired into or tried by a Court within whose local jurisdiction the property was delivered by the person deceived or was received by the accused person.

Jurisdiction and IT Act 2000

On the jurisdiction of the Internet or cyberspace IT Act of 2000 section 13 is of relevance. The sub-sections (3), (4) and (5) deal with the cause of action clause, which is of significance in Internet transactions to determine the jurisdiction.

S 13(3) – Save as otherwise agreed to between the originator and the addressee, an electronic record is deemed to be dispatched at the place where the originator has his place of business, and is deemed to be received at the place where the addressee has his place of business.

S 13(4) – The provisions of sub-section (2) shall apply notwithstanding that the place where the computer resource is located may be different from the place where the electronic record is deemed to have been received under the sub-section (3)

S 13(5) - For the purposes of this section: -

(a) If the originator or the addressee has more than one place of business, the principal place of business shall be the place of business;

(b) If the originator or the addressee does not have a place of business, his usual place of residence shall be deemed to be the place of business;

(c) "Usual place of residence" in relation to a body corporate, means the place where it is registered."

Jurisdiction Issues in International Perspective

Interpreting these clauses it is abundantly clear that it is not mere jurisdiction the issue, the effect of such jurisdiction and enforcing the decrees needs reciprocal arrangements. Apart from this on the issue of arbitration in Internet, the Foreign Awards (Recognition and Enforcement) Act of 1961 based on the New York Convention of 1958, by India allows arbitration and recognition of foreign awards.

The issue of jurisdiction in international private law currently is addressed by the Hague Convention on jurisdiction.

The general framework for the convention is as follows.

1. Countries which sign the convention agree to follow a set of rules regarding jurisdiction for cross-border litigation. Nearly all civil and commercial litigation is included.

2. So long as these jurisdiction rules are followed, every country agrees to enforce nearly all of the member country judgments and injunctive orders, subject only to a narrow exception for judgments that are "manifestly incompatible with public policy," or to specific treaty exceptions, such as the one for certain antitrust claims.

3. A judgment in one country is enforced in all Hague convention member countries, even if the country has no connection to a particular dispute.

4. There are no requirements to harmonize national laws on any topic, except for jurisdiction rules, and save the narrow Article 28(f) public policy exception, there are no restrictions on the types of national laws that to be enforced.

5. All "business to business" choice of forum contracts are enforced under the convention. This is true even for non-negotiated mass-market contracts. Under the most recent drafts of the convention, many consumer transactions, such as the purchase of a work related airline ticket from a web site, the sale of software to a school or the sale of a book to a library, is defined as a business to business transaction, which means that vendors of goods or services or publishers can eliminate the right to sue or be sued in the country where a person lives, and often engage in extensive forum shopping for the rules most favorable to the seller or publisher.

6. There are currently 49 members of the Hague Conference, and it is growing. They include: Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Chile, China, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland, Former Yugoslav Republic of Macedonia, France, Germany, Greece, Hungary, Ireland, Israel, Italy, Japan, Republic of Korea, Latvia, Luxembourg, Malta, Mexico, Monaco, Morocco, Netherlands, Norway, Peru, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Suriname, Sweden, Switzerland, Turkey,

United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay and Venezuela.

James Love of the CPT (Consumer Protection Technology) addresses certain issues on the efforts of the Hague Convention and the following excerpts are reproduced highlighting the salient features of the convention "negotiations for a new treaty that seeks to strengthen the global enforcement of private judgments and injunctive relief in commercial litigation. While the convention would clearly have some benefits, in terms of stricter enforcement of civil judgments, it would also greatly undermine national sovereignty and inflict far-reaching and profound harm on the public in a wide range of issues.

The treaty is called the Hague Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters, and is being negotiated under the little known Hague Conference on Private International Law. The treaty is complex and far reaching, but is effectively unknown to the general public.

The Consequences of Global Enforcement of Non Harmonized Laws

The early discussions on the current convention began in 1992, largely in the context of judgments where businesses would be the defendants, for disputes involving physical goods or traditional services. Only recently has there been recognition of the far-reaching consequences of using the treaty framework for addressing disputes involving the Internet, or litigation involving intellectual property claims or information in general.

The Internet issues deserve special attention. The treaty gives nearly every member country jurisdiction over anything that is published on or distributed over the Internet. If the treaty (as written) is widely adopted, it will cripple the Internet. The reason is fairly straightforward. The Hague framework begins with the notion that there will not be harmonization of substantive law, only harmonization of rules regarding jurisdiction and enforcement of laws. So it is a fundamental part of the Hague treaty that laws that are very different from each other will be enforced, across borders.

For example, under the treaty, different national laws concerning libel or slander will give rise to judgments and injunctions, as will different national

laws regarding copyright, patents, trademarks, trade secrets, unsolicited email, unfair competition, comparative advertising, parallel imports of goods, and countless other items. As a consequence, people well find that activities that are legal where they live are considered illegal in a different country and that under the treaty, the foreign country will likely have jurisdiction, and their laws will be enforceable in all Hague member countries.

To be more concrete, note that under different national copyright laws, authors can liberally use quotations from other authors in some countries, but not in others. Software engineers can decompile or use other reverse engineering techniques to find out how to make software programs work together (be interoperable) in some countries, but not in others. In some countries school teachers can distribute newspaper stories and other copyrighted materials in class rooms as a fair use, but such distribution would be illegal in other countries. Some countries allow the use of parody as an exception to copyright or trademark laws, while other countries do not. In some countries it is permissible to disparage products or publish comparative price advertisements, while in other countries it is not. In some countries it is permitted to publish leaked memorandums and documents that embarrass governments or corporations, but in other countries this would be considered a violation of copyright laws (as in the *UK David Shayler* case), or a wrongful disclosure of proprietary business information. Rap music that legally uses "sampling" of music under US law will violate certain European copyright regimes where this is illegal. In some countries a failure to obtain permission to hyper-link to a web page or use a meta-tag with the name of a business is considered an infringement of intellectual property, while in other countries it is not. This list of examples could go on and on.

There are fundamental problems with enforcing every country's national trademark laws on the Internet, because different firms sometimes claim the same mark in different countries, and what may be a generic term in one country is a proprietary mark in another country. These are important and difficult conflicts and it is useful for policy makers to seek solutions to these jurisdictional disputes, but a "solution" that simply enforces everyone's laws on everyone is really no solution at all.

In the patent area, the Hague convention would force European governments to begin enforcing judgments and injunctive relief from US

software and business methods patents, even though software and business methods cannot be patented in many European countries. As the rest of the world is forced to pay for US software and business methods patents, they will enact their own anti-competitive and poorly managed software and business method patent systems, and US citizens will have to pay for those too.

The Internet related cases are the most obvious areas where the Hague Convention will cause problems, but hardly the only cases.

As noted above, under all current drafts of the convention, "business to business" choice of court clauses must be enforced, even those involving mass marketed non-negotiated contracts. In the Edinburgh drafts, business to business contracts are defined as everything that does not involve personal household use, and so every library, every university and school, and every work related purchase, will be considered business to business transactions, and even click on or shrink wrapped licenses with choice of court clauses must be honored. This is spelled out in Article 4 of the proposed Convention.

In an earlier attempt to negotiate a treaty on jurisdiction, this choice of court provision was not mandatory in all contracts, and in particular, there was good language to exempt contracts that were abusive or unfair. The 1965 text, which has *NOT* been used in the current treaty negotiations, read: "The agreement on the choice of court shall be void or voidable if it has been obtained by an abuse of economic power or other unfair means." With the elimination of the safeguards against unfair and abusive contracts, you now have a mandatory choice of court clause in Article 4. This will have a huge effect on national sovereignty, because any publisher or seller of any product can simply shift jurisdiction, by contract, to a different country.

One effect will be in the area of books or videos, where publishers can use contracts to shift jurisdiction to countries (there are many in Europe) that do not recognize the "first sale" doctrine which permits zero royalty lending by libraries or video stories. The South Africa victory over the pharmaceutical companies for parallel imports of medicines could be undermined by choice of forum contracts that select courts that did not recognize the first sale doctrine. Airlines, banks and any number of institutions can use these choice of court agreements to change the country where disputes are heard. Any

seller can use Article 4 to shop for favorable national laws, and also to deny the public the opportunity to seek redress or defend actions in the countries where they live, which is a huge burden for most people and small businesses and non-profit organizations.

The contracts can also shift jurisdiction on software to countries that do not permit reverse engineering. Web pages that have terms of service agreements on such issues as hypertext linking or use of company or brand names in meta-tags, or that require prior approval for reviews of products, or any number of other clauses, all of which exist today, would be much stronger because companies could simply point the choice of court to the jurisdiction most likely to actually enforce these provisions. The free software movement would be particularly vulnerable to these provisions, as well as the expanded reach of overly broad national laws on software patents and trade secrets.

The Significance of Mandatory Enforcement of all Sui generis Intellectual Property Laws on Markets for Data, Music, Movies, Pharmaceuticals and Biotechnology.

Sui generis systems for protecting intellectual property are those that are special systems - one of a kind - that fall outside of traditional IPR regimes like copyright, patents or trademarks. For example, the US has a *sui-generis* regime to protect data from clinical trials on pharmaceutical drugs, Europe is implementing national *sui generis* legislation on databases, and several African, Asian and Latin American countries have *sui generis* regimes on traditional learning and culture, and a there are quite a few efforts to create *sui generis* regimes on genetic and biological resources, to mention only a few areas where *sui generis* regimes are being discussed.

There is no doubt about the status of *sui-generis* IPR regimes in the Hague convention -- they are all enforceable, regardless of what they are. At present these laws are often controversial, because they push protections into new areas, that would otherwise be in the public domain. But under the convention, countries could get enforcement of judgments globally, even if no other country had a similar regime.

For example, if Cuba enacted a *sui generis* regime and declared that the Cuban "beat" was intellectual property, it could get a judgment in Cuba against US record companies that were engaged in cultural "piracy," and demand for example, 5 percent of the revenues from global sales of music that use the Cuban beat. Other countries could do the same thing. These judgments would be enforceable globally, under the Convention. So too would bio-piracy judgments against US and European biotechnology and pharmaceutical companies, for "stealing" traditional knowledge, or exploiting without benefit sharing a variety of biological and genetic resources. The motion picture industry could be hit with new *sui generis* IPR liabilities by countries that give rights in history. Countries like China, which is a member of the Hague Conference, could use this to limit who could actually make films about China. The Hague convention would instantly create a legal framework to legitimatize all of these new IPR claims, and it would not even matter if the "infringing" party did business in the country at all, since the judgments would be enforceable globally, in any Hague member country, and the claims could be based upon shares to global (rather than local) revenues of products.

Some would consider this a positive feature of the Convention, because it would give the developing countries opportunities to "tax" the rich countries, under new and controversial IPR regimes. But of course, the rich countries could and will also enforce their own regimes, including, for example, the European Union *sui generis* regime on database protection. The US and EU would probably modify their *sui generis* regimes on pharmaceutical registration data to make it illegal for developing countries to rely upon those data for registration of generic products in poor countries, an approach already included in the new US-Jordan "Free Trade" agreement. And in general, would one observe is a new dynamic of everyone trying to create their own "rights" in everything, until the public domain shrinks if not disappears altogether.

The Hague negotiators have never been willing to explore and discuss the merits of including national *sui-generis* laws regarding intellectual property in the Convention.

The Article 28f Public Policy Exception Fails to Protect the Public, and the Convention Undermines Common Carrier protections for ISPs

In discussions regarding the treaty, we have brought to the attention of the delegates all of the issues and many others as well. We have indicated the treaty will shrink the public's rights to only those that exist in every country, which of course is smaller than what exists in *any* country -- a frightening outcome, and we have pushed to have intellectual property or e-commerce removed from the convention, and we have pushed for a variety of more minor fixes, such as to improve Article 4 or Article 7 or to exempt the first sale doctrine. In these discussions, the Hague Negotiators frequently refer to the so-called public policy exception, which provides that judgments need not be enforced if:

> 28(f) recognition or enforcement would be manifestly incompatible with the public policy of the State addressed.

This provision is of course quite important, but it should not be used to justify a convention that is fundamentally the wrong approach. Moreover, its usefulness is much undermined by the fact that judgments will be enforced in *any* Hague member country - the so called "you can run but you can't hide" provision. Moreover, for Internet related disputes, the ISP will typically be sued, both because it has deep pockets and because it has assets in many countries. In those cases, the IPS will only escape the judgment if *every* country finds the judgment "manifestly incompatible public policy." And the plaintiff need only find one country that is willing to enforce the judgment. Also, there are all sorts of creative ways that suits can bring in parties that are vulnerable to enforcement. In addition to suing ISPs like AT&T or Verizon that clearly have assets all over the place, one could sue an IPS that had a peering relationship with another ISP, and refused to block bits from an offending site. ICANN could be hit with cross border injunctive requests to remove IP numbers or domains. Lots of things are possible.

Moreover, it is not at all clear that it will be easy to get countries to refuse to enforce judgments under Article 28f, because they will want their own judgments enforced, particularly countries like the USA or in Europe,

that are anxious to have intellectual property infringement cases enforced globally. All of this the practical effect of undermining the common carrier status of IPSs, because they will likely not be considered a common carrier in all countries where they have assets. This will lead to content regulation by IPSs, who will fear liability in countries with restrictive laws. A Chinese lawsuit against a US citizen who criticizes a Chinese official, might be undertaken in China, but enforced against AT&T in Korea, Romania or anywhere else, creating a limitation on speech in the USA that would never involve a US judge. Indeed, this could happen even is the USA does not sign the convention, if other countries do."

CHAPTER III

UNDERSTANDING ELECTRONIC CONTRACTS

The Indian Law of Contract

Introduction

To understand electronic contracts, it is essential to understand the general principles of contract and also the law governing contracts in Indian context. Contracts are in essence an agreement between two or more parties to conduct any business transaction. Such a contract has to be valid and legally binding on the parties to mutually benefit their interest and transactions. Such contract can be oral or written as may be required by law in specific cases and is validated by the law. Before the evolution of the complex legal systems, agreements were oral and carried out by mutual trust. In community settings any breach of contract is settled through community adjudication system, which inquired into the breach and set right things. As the society grew complex and so were the complexity of the transactions. With the evolution of the legal system, contracts came to be governed by specific laws under the respective legal systems.

It can be stated that 'a contract is a agreement for a specified transaction between two or more parties for a specified consideration and is binding upon on the transacting parties.' The Contract, which could be oral or written, is arrived through a process of negotiation with offers/ proposals, counter offer/counter proposals towards

acceptance by the contracting parties. Such an acceptance gives rise to an agreement. Indian Contracts Act 2(h) states that 'an agreement enforceable by law is a contract.'

A Contract enforceable by Law

The Indian Contract Act 1872-s10 states:

S 10. What agreements are contracts: All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.

Nothing herein contained shall affect any law in force in India, and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents.

Interpreting the section 10 of the Act the positive aspects can be enlisted as:

1. **Free and conscious consent of the parties to the contract:** In other words there should not be any coercion, undue influence, fraud, misrepresentation or mistake which will not be considered as free consent and will be considered as void.
2. **Persons entering to the contract should be competent:** In other words persons who are minors by law, persons with unsound mind are not competent and any contract entered with them is non-enforceable.
3. **Lawful Consideration :**In other words any contract which is violative of any other law or considerations which not legal will not be valid and will be void
4. **Lawful Object:** The purpose of any such contract has to be lawful in its object or else will be rendered as void.

From this one can infer that a contract enforceable by law is a process, which has a vital significance in any transaction whether it is manufacturing, trading or service. The significance of the contract assumes importance in the cyber world where anonymity and speed of transactions are key elements.

E-Commerce can succeed only on these strengths and if ignored could turn out to be a huge liability. In order to understand the electronic contracts and its special position let us look into the fundamentals of the contract in the Indian Contract Act.

Proper Law of Contract

The Indian Contract Act section 1 deals with the proper law of contract to create legally binding contract based on the agreement and such an agreement and the proper law takes its validity on the following:

a. The place of contracting

b. The place of performance

c. The place of residence

d. The subject Matter of Contract

e. All other facts

Section 2 of the Act enumerates the following:

S 2 (a) - When one person signifies to another his willingness to do or abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to be making a proposal.

S 2 (b) 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.

S 2 (c) The person making the proposal is called the 'promisor' and the person accepting the proposal is called the 'promisee'

S 2 (d) When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.

S 2 (e) every promise and every set of promises, forming the consideration for each other, is an agreement.

S 2(f) Promises, which form the consideration or part of the consideration for each other, are called reciprocal promises.

S 2(g) an agreement not enforceable by law is said to be void

S 2(h) an agreement enforceable by law is a contract

S 2 (I) An agreement that are 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.

S 2(j) a contract that ceases to be enforceable by law becomes void when it ceases to be enforceable.

Communication and Acceptance in Contract

Section 4 of the act pertains to the communication in the contract and is as follows:

The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made.

The Communication of an acceptance is complete-

As against the proposer, when it is put in a course of transmission to him so as to be out of the power of the acceptor, as against the acceptor, when it comes to the knowledge of the proposer.

The Communication of a revocation is complete- as against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it;

As against the person to whom it is made, when it comes to his knowledge."

Section 5 - Revocation of Proposals and Acceptance:

A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards."

The essence of the above sections is that of the binding force of the contract. It denotes the effect of the binding nature of the contract on

acceptance in the mode prescribed by the offer and is deemed as accepted only on receipt where as it complete as for as the acceptance is done through post or telegram. It is in this context the internet is different in the sense the offer or acceptance depending on the position is instantaneous there is no scope for second though of revocation which is possible by a telegram before a post reaches or by personal letter before a telegram reaches.

Competence to Contract

S 11- every person is competent to contract:

Who is of age to 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

S 12- a person who is usually of unsound mind, but occasionally of sound mind, make a contract when he is of sound mind. A person, who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is unsound mind.

Consenting parties

S 13 Two or more parties are said to consent when they agree upon the same thing in the same sense. The mutual understanding is based on

a. subject matter of the agreement

b. the nature of transaction

c. the language or expression used in recording the understanding

S 14- free consent is defined as one, which is not done through

S 15 coercion

S16 undue influence

S17 fraud

S 18 misrepresentation

S 20 mistake

Void Voidable agreements

S 19 - This section deals with the instance of an agreement which is concluded by coercion, fraud, or misrepresentation, the contract does not

become void automatically but is voidable at the option of the party whose consent was caused by those listed in section 14- 20.

To illustrate that A enters into an agreement with B to sell his business with misrepresenting the facts of profit and goodwill and later when B finds about the same, B has the choice to make the contract void or can still proceed with the contract for other extraneous reasons and thus the contract is not void but had the choice to be made voidable by B who chose not to do so.

Void Agreement

1. s 20 Both parties are under mistake as to the matter of facts
2. s 24 Consideration and objects are unlawful in part
3. s 25 Absence of consideration, except under certain cases
4. s 26 The agreement in restraint of marriage
5. s. 27 The agreement in restraint of trade
6. s 28 The agreement in restraint of legal proceedings
7. s 29 The agreement in restraint of uncertainty
8. s 30 Agreement based on wager/gambling
9. s 56 Agreement becomes impossible to perform

Contingent Contract

S31- 36- speaks about the type of contracts entered which has to be performed or not to be performed based on the eventuality of an event to happen or not to happen and is enforceable accordingly. However the contingent contract would be void if the event becomes impossible to happen.

Breach of Contract

Section 73. - speaks about the breach of contract and appropriate remedies. This section enforces the binding nature of the contract and its legal validity. This section enumerates the loss or damage occurred to one party by the breach of contract of the other party, which is due to such breach of contract or prior knowledge of such consequence when the contract

was entered to be compensated by the party who has breached it. In such calculation of loss or damage, the means of such consequence resulting from the non-performance of such contract has to be taken into account.

CONSTRUCTION OF ELECTRONIC CONTRACTS

Contracts in the traditional information technology prior to the Internet age pertained to

1. Manufacturing contracts of hardware products, accessories and peripherals
2. Contracts for software products
3. Contracts for service and maintenance
   and post- online era brought in the
4. Electronic Contracts or Online contracts

With the emergence of internet and electronic commerce the contract of e-commerce in terms of Business to Business (B to B), Business to Consumer (B to C) and Consumer to Consumer (C to C) has assumed importance in terms of its complexity and reach. Electronic Banking, . Com ventures, Music download, E-books have spanned the usage of Internet and online -contracts have assumed significance.

Among these contracts the manufacturing contract of hardware is that of any other type of contract in manufacturing industry except that of the latest issue of monopoly or anti-trust where browsing software is bundled with that of the hardware to keep up the market share, which shall be dealt latter in module 3

On the software contracts the contracts assumed significance based on the type of software as

a. Standard package software
b. Bespoke software and
c. Customized software

The standard software is the type of software written and produced to address mass consumers around the world. Microsoft Windows and its different versions fall under this category.

Bespoke software is the type of software specially commissioned and written to meet the needs of specific needs of varied clients. Many Indian software firms are involved in bespoke software production. E.g. an airline company may want bespoke software, which will suit its operations. Infosys in the early nineties did software for retailing Reebok shoes.

Customised software is a standard software package, which is altered to the needs of the clients. Many hospital and hotel administration software packages are standard software packages often modified to meet the variations of the customers. There are many networking packages, which are tinkered and tailored to meet client specific needs.

The contract of these software are dealt as manufacturing contracts where hardware manufacturers can bundle as standard software packages and the others like customized and bespoke software are dealt as contracts between parties based on the functionalities and thereby the terms of the contract. It is in this area care has to be taken in construction of contracts which will include offshore and on-site issues involved in developing such packages. On-site contracts need to take into account of not merely the technical aspects and delivery of the software but also labour laws, gender laws and other accounting aspects of the country where the firm intends to operate in drawing up the contracts.

Electronic Contracts

Electronic contracts facilitate transactions and agreements electronically without the parties meeting each other. This means that the traditional contract process of offer, acceptance and agreement to transact through electronic mode than physical mode of paper. E-Commerce to succeed such contracts need to be validated legally as alternate mode of transaction through online using the latest technological developments. This is aimed at:

1. To create a secure atmosphere of transacting online with alternate mode to paper and writing.
2. To create a electronic documentation system which will safeguard the contracting parties on par with the traditional mode of contracts
3. To create statutory status and monitoring/verifying authorities for such electronic transaction

4. To check frauds intentional or unintentional transactions to promote and build confidence in genuine online transactions
5. To create necessary legal structures to oversee such transactions
6. To establish standard rules and regulation for smooth functioning of online transactions
7. To make Digital signature legally valid and incorporating the same with the existing legal regime of contracts, sale of goods, evidence and consumer acts.

Such electronic transactions will depend on the appropriate legal framework, which recognizes 'electronic records' or 'writings' or 'digital signatures'. It should facilitate for a secure system of such transactions and should create evidentiary value of such records. The Indian IT Act 2000 section 2 deals with various definitions involved in internet transaction and Chapter II and section 3 deals with the definition of digital signature and its authentication for legal purposes.

Section 4 of the IT Act 2000 reads as follows:

4. Legal recognition of electronic records. - Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is-

(a) Rendered or made available in an electronic form; and

(b) Accessible so as to be usable for a subsequent reference

COMMENTS

If any information or matter is rendered or made available in an electronic form, and accessible so as to be usable for a subsequent reference shall be deemed to have satisfied the requirement of the law, which provides that information or any other matter shall be in writing or in the typewritten form.

S5. **Legal recognition of digital signatures. -** Where any law provides that information or any other matter shall be authenticated by affixing the

signature or any document should be signed or bear the signature of any person, then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government.

Explanation. - For the purposes of this section, "signed", with its grammatical variations and cognate expressions, shall, with reference to a person, mean affixing of his hand written signature or any mark on any document and the expression "signature" shall be construed accordingly.

COMMENTS

If any information or any other matter is required by law to be authenticating by affixing the signature then such requirement shall be deemed to have been satisfied if such information or matter is authenticated by means of digital signature affixed in the prescribed manner.

Thus with the IT Act 2000 the necessary legal validity for electronics has been established. In this context the earlier Indian Contract Act has been supplemented with the online transaction as a valid form of contract. In electronic contracts the twin aspects of time and place of dispatch assumes importance between the contracting parties. Online contracts whether it is B to B or B to C will to be validated, the place of the dispatch and time factors are crucial. IT Act by section 11. -

11. -Attribution of electronic records. -

An electronic record shall be attributed to the originator-

(a) If it was sent by the originator himself;

(b) By a person who had the authority to act on behalf of the originator in

Respect of that electronic record; or

(c) By an information system programmed by or on behalf of the originator to operate automatically.

12. - Acknowledgment of receipt. -

(1) Where the originator has not agreed with the addressee that the acknowledgement of receipt of electronic record be given in a particular form or by a particular method, an acknowledgment may be given by-

(a) any communication by the addressee, automated or otherwise; or

(b) any conduct of the addressee, sufficient to indicate to the originator that the electronic record has been received.

(2) Where the originator has stipulated that the electronic record shall be binding only on receipt of an acknowledgment of such electronic record by him, then unless acknowledgment has been so received, the electronic record shall be deemed to have been never sent by the originator.

(3) Where the originator has not stipulated that the electronic record shall be binding only on receipt of such acknowledgment, and the acknowledgment has not been received by the originator within the time specified or agreed or, if no time has been specified or agreed to within a reasonable time, then the originator may give notice to the addressee stating that no acknowledgment has been received by him and specifying a reasonable time by which the acknowledgment must be received by him and if no acknowledgment is received within the aforesaid time limit he may after giving notice to the addressee, treat the electronic record as though it has never been sent.

In internet transactions the time and place of dispatch and receipt of electronic records will play a crucial role in the aspects of territorial jurisdiction, applicable laws, evidentiary issues, period of limitation on initiation of litigations and other issues. To validate such contracts, section 13 of the IT Act has enabling provisions.

S 13. - Time and place of dispatch and receipt of electronic record. -

(1) Save as otherwise agreed to between the originator and the addressee, the dispatch of an electronic record occurs when it enters a computer resource outside the control of the originator.

(2) Save as otherwise agreed between the originator and the addressee, the time of receipt of an electronic record shall be determined as follows, namely: -

  (a) If the addressee has designated a computer resource for the purpose of receiving electronic records, -

    (i) Receipt occurs at the time when the electronic, record enters the designated computer resource; or

(ii) If the electronic record is sent to a computer resource of the addressee that is not the designated computer resource, receipt occurs at the time when the electronic record is retrieved by the addressee;

(b) If the addressee has not designated a computer resource along with specified timings, if any, receipt occurs when the electronic record enters the computer resource of the addressee.

(3) Save as otherwise agreed to between the originator and the addressee, an electronic record is deemed to be dispatched at the place where the originator has his place of business, and is deemed to be received at the place where the addressee has his place of business.

(4) The provisions of sub-section (2) shall apply notwithstanding that the place where the computer resource is located may be different from the place where the electronic record is deemed to have been received under sub-section (3).

(5) For the purposes of this section, -

(a) If the originator or the addressee has more than one place of business, the principal place of business, shall be the place of business;

(b) If the originator or the addressee does not have a place of business, his usualplace of residence shall be deemed to be the place of business;

(c) "Usual place of residence", in relation to a body corporate, means the place where it is registered.

Section 12 and 13 read together is the online equivalent to the traditional contract act transaction aspects of offer and acceptance.

Issues of Security

In electronic commerce the issue of security and a statutory monitoring agency become crucial factors and the same will become crucial aspects of electronic contracts for the consumers to protect their interests and for the business establishments to conduct their business without costly legal battles. The essential security aspects of e-commerce, which need to be taken care in contracts, are:

a. Entity authentication (identifying with whom you are transacting)

b. Message integrity

c. Payment non-repudiation

d. Effective audit

e. Privacy

Such security requirements should also be affordable and the process requires uniform platforms in terms of scalability and transaction models backed by technology. These issues are crucial in drawing up the contracts, which are not part of the physical transaction contracts existing hitherto. As E-commerce means global business in volume and transactions anywhere at anytime with customers not known prior to transactions, it is crucial these aspects are taken care. The current IT Act provides for the security aspects through sections 14, 15 and 16.

14. -Secure electronic records. -

Where any security procedure has been applied to an electronic record at a specific point of time. then such record shall be deemed to be a secure electronic record from such point of time to the time of verification.

15. Secure digital signature. -

If, by application of a security procedure agreed to by the parties concerned, it can be verified that a digital signature, at the time it was affixed, was-

(a) unique to the subscriber affixing it;

(b) capable of identifying such subscriber;

(c) created in a manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated, then such digital signature shall be deemed to be a secure digital signature.

16. Security procedure. -

The Central Government shall for the purposes of this Act prescribe the security procedure having regard to commercial circumstances prevailing at the time when the procedure was used, including-

(a) the nature of the transaction;

(b) the level of sophistication of the parties with reference to their technological capacity;

(c) the volume of similar transactions engaged in by other parties;

(d) the availability of alternatives offered to but rejected by any party;

(e) the cost of alternative procedures; and

(f) the procedures in general use for similar types of transactions or communications.

Apart from these issues, the Act enables for a certifying authority and officers and functions in section 17 and they're of from section 18 to 34 on the various aspects of security and privacy issues.

17. Appointment of Controller and other officers. -

(1) The Central Government may, by notification in the Official Gazette, appoint a Controller of Certifying Authorities for the purposes of this Act and may also by the same or subsequent notification appoint such number of Deputy Controllers and Assistant Controllers as it deems fit.

(2) The Controller shall discharge his functions under this Act subject to the general control and directions of the Central Government.

(3) The Deputy Controllers and Assistant Controllers shall perform the functions assigned to them by the Controller under the general superintendence and control of the Controller.

(4) The qualifications, experience and terms and conditions of service of Controller, Deputy Controllers and Assistant Controllers shall be such as may be prescribed by the Central Government.

(5) The Head Office and Branch Office of the office of the Controller shall be at such places as the Central Government may specify, and these may be established at such places as the Central Government may think fit.

(6) There shall be a seal of the Office of the Controller.

Issues of Privacy

In Internet transactions, e-commerce to succeed the issue of privacy plays a crucial role. Apart from consumer transaction in terms of personal data, the application of internet in banking, privacy is very crucial if not maintained can lead to major financial loss and there of huge litigation costs both to establishments as well as the clients. Hence privacy plays strategic as well as other non-monetary aspects of business in e-commerce.

Contracts drawn in cyber world need to take care of the mutual interest of the establishments and the clients. This needs an adequate legal framework and the IT Act section 35- 39 deals on the digital signature and its various aspects which will be dealt in length in module 3 on e-banking. However the Act also specifies duties of subscribers which is of importance in contracts drawn from the point of the establishments under Chapter VIII as:

DUTIES OF SUBSCRIBERS

40. Generating key pair.

Where any Digital Signature Certificate, the public key of which corresponds to the private key of that subscriber which is to be listed in the Digital Signature Certificate has been accepted by a subscriber, then, the subscriber shall generate the key pair by applying the security procedure.

41.Acceptance of Digital Signature Certificate.

(1) A subscriber shall be deemed to have accepted a Digital Signature Certificate if he Publishes or authorises the publication of a Digital Signature Certificate-

(a) to one or more persons;

(b) in a repository, or otherwise demonstrates his approval of the Digital Signature Certificate in any manner.

(2) By accepting a Digital Signature Certificate the subscriber certifies to all who reasonably rely on the information contained in the Digital Signature Certificate that-

(a) the subscriber holds the private key corresponding to the public key listed in the Digital Signature Certificate and is entitled to hold the same;

(b) all representations made by the subscriber to the Certifying Authority and all material relevant to the information contained in the Digital Signature Certificate are true;

(c) all information in the Digital Signature Certificate that is within the knowledge of the subscriber is true.

42. Control of private key.

(1) Every subscriber shall exercise reasonable care to retain control of the private key corresponding to the public key listed in his Digital Signature Certificate and takes all steps to prevent its disclosure to a person not authorised to affix the digital signature of the subscriber.

(2) If the private key corresponding to the public key listed in the Digital Signature Certificate has been compromised, then, the subscriber shall communicate the same without any delay to the Certifying Authority in such manner as may be specified by .the regulations.

Explanation. -

For the removal of doubts, it is hereby declared that the subscriber shall be liable till he has informed the Certifying Authority that the private key has been compromised.

CHAPTER IV

TYPES OF ELECTRONIC CONTRACTS

Employment Contracts

The Information Technology is driven by manpower in Indian context and thus employment contracts are crucial. With a high attrition rate as well as the confidentiality involved in the work, employment contracts become crucial. Apart from that Indian Labour practices are based on strong labour laws and not the hire and fire processes of the first world. In this context copyright issues of software development assumes crucial importance. This is dealt in detail in module II but however due care should be taken on the aspect of restraint of trade which could be void in any contract. Apart from that contracts for on-site development and sending the workforce abroad and indemnity clauses will play a crucial role in employment contracts. Firms hiring personnel abroad apart from their personnel need to incorporate the relevant employment contract of the place of operation.

Consultant Agreements

The normal provisions of Indian Contracts Act of 1872 will apply on any consultant agreement. But especially in Information Technology industry where the infrastructure to operate is low and connectivity is very high consultancy with experience in marketing and business development and technology development is a very prevalent mode of transaction. Here proper care to be taken in Consultant agreements where issues of Intellectual Property Rights,

Confidentiality will play a key role. If care is not taken it may lead to loss of business and loss of clients.

Contractor Agreements

As manufacturing companies outsource their business, Information Technology also outsource their work due to fluctuating orders and would like to cut on the cost of regular workforce and attendant legal and financial problems. At the same time in manufacturing industry strong labour laws like the Contract Labour (Abolition and Regulation) Act of 1970 in force could lead to a different type of legal tangle. However if care is taken to outsource keeping the provisions of the contract Act and the Contract Labour abolition act the desired objectives could be met. Here again confidentiality, consumer liability and copy right issues assume great importance and care to be taken in drawing such contracts.

Sales, Re-Seller and Distributor Agreements

In software and Internet transactions though the hierarchy of middle men are done away with, it still requires a distribution network and hence contractual issues come into play in that aspect of business. In first place one needs to see whether software is a good under the Sale of Goods Act.

Software is a code of instructions, which operate the system or hardware to function in an intended manner. Hence there arises a difficulty to classify and define in legal terms of the intangible nature of software in comparison with other products. The code and its source can be interpreted as information organized in a way to operate the system leading to the conclusion it is not a property and not a good in the legal sense. In Aerodynamics Systems Product v General Automation limited, the argument raised by the defendants that although software can be a subject matter of sale, software itself is pure information, and the transfer of software is a service and not sale of goods. There is another interpretation of Software to be considered as Goods where it is compared to that of a book containing information, which is considered as goods under the Sale of Goods Act. As the value of the book is not the mere value of the cover jacket, paper and materials used in its production, but one that of the value of the information contained in it, software is also

a product -a floppy, or a CD-Rom or simply stored in hard disc but the value is much higher than the simple storage device.

Hence software due its high value in terms of application is considered as goods for the purpose of legal classification. Having established it as good the distribution, reseller agreement should take care of the aspect of Monopoly Restrictive Trade Practices (in future the competition law) territorial jurisdiction and other tax mechanisms.

Non-Disclosure Agreements.

Non-Disclosure Agreements are part of IT contracts, which specify binding agreements with employees apart from the standard confidentiality agreements. The Indian Contract Act 1872 has provisions for the same and it assumes importance in an industry which is purely knowledge based and one which can be easily duplicated ruining the business.

Software Development and Licensing Agreements

A license is a permission given to do a specific manufacture/sales/ marketing/distribution, which is lawful. License plays a prevalent form of contract in mass marketing activity of any kind including Information Technology. Software licensing has a historical background where originally it was bundled with the hardware and was given free and its use and application was limited to that of operating the system and few other features. Later in late 60's and early 70's hardware manufacturers in Europe marketed software separately. Later software manufacturers resorted to license their products separately from that of the hardware. In normal ownership the product sold becomes the exclusive property of the buyer who can do what ever he wants. In case of software, the product can be copied easily and will adversely affect the manufacturer of his sale and thus the entire investment-return processes and future incentive to invest in producing software.

Thus software business became a business of license regime. These licenses are issued in perputation or for a limited period. Licensing agreement normally prohibits reverse-engineering, de-compiling or any other manipulation of the software, which can be marketed easily with some modifications. Licenses are issued for a single machine usage at a specified

location with a provision for backup in the same machine in case of a crash or defective functioning. Multiple machine licenses are also given. The license agreement also indemnifies the user from any copyright or other intellectual property violation of the manufacturer. The licensing agreements become crucial in Cyber Contracts.

Similarly software development is another agreement between joint ventures of companies or for awarding development of software to multiple parties, which assume crucial importance in contracts of cyber world.

Shrink Wrap Contracts

A Shrink Wrap contract is the prior license agreement enforced upon the buyer when he buys software. Before he or she tears the pack to use it, he or she is made aware by tearing the cover or the wrap that they are bound by the license agreement of the manufacture.

This is done as earlier discussed to protect the interests of the manufacturer where the consumer cannot reproduce the package, copy it or sell it or donate it to others affecting the sale of the software. The license, which is shrunk and wrapped in the product, which becomes enforceable and taken as consent before the buyer tears the package. The usual clauses that are part of the shrink-wrap license are that of

a. prohibiting unauthorized creation of copies
b. prohibiting rentals of the software
c. prohibition of reverse engineering, de-compilation or modification
d. prohibition of usage in more than one computer specified for that purpose
e. disclaimer of warranties in respect of the product sold
f. limitations of liability

The logic and business sense is that to protect the manufacturer of the package, as it is easy to copy, manipulates and duplicate under other brand name. Critiques argue that shrink-wrap license agreement is against the basic principle of contract of offer, consideration and acceptance as the

licensee is debatable. Several cases to this effect have been dealt in US courts. A detailed analysis of the cases will be dealt in the website of nalsarpro.

SOURCE CODE ESCROW AGREEMENTS

In software development many principal firms who invest in development are keen to guard the source code of the software, which is the most valuable and secretive part of the computer programme. Copyright holders of such source code may have to disclose this to various developers who will be developing specified software based on the source code. In these circumstances the copyright owner will deposit the source code to specified source code escrow agents who will disclose the code on the development of the product upon agreed terms. In cyber contracts such agreements and also the terms and conditions to deal with the escrow agents becomes crucial.

CHAPTER V

CYBER CONTRACTS AND INDIAN LEGAL POSITION

Legal issues in Cyber Contracts

The Intellectual Property Rights plays a crucial part in Information Technology and there by in the contract formation of software development and Internet business. In Indian context software is categorized under copyrights of the IPR regime where as in United States software comes under patents regime. This difference has to be borne in mind in formation of contracts depending on domestic and international operations. Here again the IPR differs with the type of software classification. In case of bespoke software the intellectual property rights are vested in the software user. The copyright aspect is very crucial in the bespoke software compared to that of the confidential aspect of information. Mere commissioning of a software development itself need not vest the copyright with a firm if the clauses in the contract are not specific.

In U.K. the standard conditions of contract published by Government for information systems have provided for ownership of copyright and other rights in bespoke software to vest in the software house, and not in the government. Even if the ownership of the rights in the software vests in the software house, the customers competitive edge can be preserved by imposing a restriction on the ability of the software house to market the software to the competition of the customer.

Contract liability

Contract liability is another crucial area to be taken care in cyber contracts. One of the general distinctions in contract liability is based on the classification of the utility of the software in transaction.

(a) License of Intellectual property.

(b) Development and / or supply of a copy of the software.

In the licensing aspect of the software the usual contractual risk arises in the third party possessing the Intellectual property rights which is overriding that of the rights of the licensee. The phrase software contracts connote a valid and a legally binding relationship created by the parties to enrich their interest. Parties to such software contracts generally include the consultant (a company or a partnership or a sole proprietor represented through business manager or technical manager or finance manager) and the customer who seeks software related services from the consultant company. The nature of the services may include sale of software products or software maintenance services either in the form of fixed priced project or time in maintenance.

Online Contracts

It is a common practice that transactions of many goods and services depend and use standard form of contract of terms and conditions, which are quite often hidden from the user or not prominently displayed. As the going is good there is no problem on such practices but in a business where the volume and risks are high such fine print or hidden terms may prove too costly when someone decides to act. Simply 'I agree' button displayed in front without reasonable and adequate display of the terms and conditions displayed to the buyer or user could lead to costly litigations in online transactions especially in B to C business. This necessitates effective and clear drafting of the terms of contract where the drafting language has to be clear, transparent, to place across the business proposition or offer without jeopardizing the interest of the business where the language could lead to multiple interpretations and running the risk in a court battle. Such drafting requires the drafter to understand the fundamentals of

1. The relevant law in operation;
2. The practical implications of such law
3. The purpose and goal of the firm intends to achieve by such offer
4. How to use the relevant law and its implications to the maximum advantage
5. How to minimize the liability risks in unforeseen circumstances

DRAFTING OF CYBER CONTRACTS **

** (Extracted from nlsiu law shop series on software contracts-Jan 1999)

Description of the Parties

In all but the shortest of documents it is obviously more convenient and clearer to refer to the various parties by such descriptive terms as vendor purchaser, guarantor, franchisee, etc. These terms are so basic to the agreement that they are invariably set out at the head of the document as part of the descriptions of its registered office or (particularly in the case of foreign companies which may not have a registered office) its principal place of business. Although it is not strictly necessary to cite the company's registration number, it is sometimes useful to do this, as it may facilitate any search which has to be carried out and may avoid confusion where companies in a group with similar names are involved in the transaction.

Language of the Agreement

In International contracts particularly, specifying the language of the agreement can have a number of advantages, including:

(a) If the agreement has been drawn up in versions in different languages, it will be desirable to state which is the authoritative versions in different languages, it will be desirable to state which is the authoritative version, in the event of a difference in meaning between different versions.

(b) It may also be desirable to state that any amendments to the agreement should be in the same language as the original. In some jurisdictions the language of the agreement may influence the court when deciding under which country laws the agreement is made, and which country's courts should have jurisdiction. Ideally the agreement should state these matters specifically.

Recitals

After the description of the parties to a document, come the recitals. Recitals in a document are synonymous to the preamble of a statute. The recitals make out the state the preliminary ground or introduction for the

execution of the Agreement. They constitute a brief history of the facts and events leading to the execution of the Agreement. Recital in a document means a statement in an agreement or other formal instrument introduced to explain or lead up to the operative part of the agreement. Recitals are of two types i.e. narrative and introductory.

Definitions and Interpretation

Particularly in long or complex agreements it is good practice to group all defined terms, together with their definitions, in a separate 'Definitions' clause, and to indicate elsewhere in the test of a document that a term has been so defined by starting the word or words defined with a capital letter. This will signal to anyone reading a clause in the body of the agreement that particular term has a special defined meaning in that agreement. It is essential using this method, for all defined terms to be capitalized on every occasion they are used, and that any term which is used in a wider sense than the one which is defined should not be capitalized. Whichever style is used, care must be taken when preparing a document to distinguish defined terms from terms of non - specific application.

It is convenient to list the defined terms in alphabetical order, in a clear, easily assimilated layout. Where the meaning of a term will involve a lengthy description or list, the details can be assigned to a schedule or exhibit. In drafting practice, interpretation provisions are often combined with the definitions of terms used in the agreement under the heading Definitions and Interpretation'. The usual interpretation provisions deal with the following:

Amendment/replacement of statutes;

Persons/singular/plural: For the sake of brevity and to avoid any confusion; Reference to clauses: To ensure a clear economical style of drafting; Headings

CONDITIONS AND ASSURANCES

(1) Commencement

Unless it is otherwise provided, an agreement takes effect immediately it has been signed by all parties or, in the case of an agreement executed as

a deed, upon delivery of the deed. Sometimes parties will wish to provide for a different commencement date. This should be done by including a clause and not by misstating the date of the agreement (i.e. the date of the last signature) as this can amount to a forgery.

(2) Conditions precedent

Sometimes an agreement is stated not to come into effect until the happening of an event (this might refer, e.g., to finance being raised or government approvals being obtained or facilitating of base materials by the concerned contracting party. Such terms are known as conditions precedent. The clause does not need to use the phrase condition precedent' but the consequences of the condition not being met should be clearly stated. In particular, does the agreement as a whole automatically come to an end or do certain provisions continue? Is there a time limit for conditions to be met? All these details should be specified in the agreement to avoid confusion.

(3) Further action required after completion

In contracts of the single transaction type, in particular sale agreements, mortgages, intellectual property assignments and licenses etc., it is likely that after completion of the transaction further action will be required by one or both parties to perfect title or conform to statutory rules or in some other way to finish off the transaction satisfactorily. In order to avoid argument or delay in respect of such matters it is usual to provide exp of attorney must be expressly stated to be irrevocable.

Force Majeure

Where a contract becomes impossible to perform, or is capable of performance only in a manner substantially different from that originally envisaged, then in the absence of express provision by the parties further performance is excused under the common law doctrine of frustration. This doctrine only operates where the frustrating circumstances are not due to the fault of either party (See Denmark productions Ltd. v Boscobel Productions Ltd. (1969) QB 699 at 725. (1968) 3 All ER 513, 533 CA), but it does not follow that in all contracts any act of negligence will deprive a party of the

defence of frustration. (See Joseph Constantine SS Line Ltd. v Imperial smelting Corn Ltd (1942) AC 154 at 166, 179,195, 205 (1941)) All ER 165 at0173, 182,193,199,200 HL)

To avoid bringing the contract to an end under the law of frustration, a 'force majeure' clause is frequently incorporated into Indian law contracts, under which the parties expressly agree to exempt each other from performance of the contract or liability for breach of contract where the failure to perform is due to factors beyond that party's control. Thus where force majeure or an event of force majeure is deferred to in the agreement, it should be clearly defined.

Warranties and Indemnities / Guarantees

Many commercial contracts contain warranties by one or both parties. These may include warranties as to matters which are central to due performance of the contracts but which cannot easily be verified by the other party. The exact nature of these warranties will depend on the transaction being entered into. Whereas some types of warranties are specific to the individual transaction, others are found in many types of commercial agreement.

Warranties as to a party's ability to enter into an agreement of the type in question, and as to the good standing of each party, are sometimes inserted in commercial agreement. In the longer type of agreement, it is frequent for the numerous detailed warranties to be given by, say, a vendor to be set out in a schedule to the agreement and for that party to give in the agreement an overall warranty as to the truth and accuracy of the scheduled warranties. A party giving warranties will commonly seek to limit the warranties to matters, which are within its knowledge.

An indemnity clause, often of a general and all embracing nature, is frequently included in agreements and contracts for services and the documents. Such a clause, whereby one party undertakes a separate and independent obligation to make good on request any loss or damage suffered by the other party as a result of breach of a contract term, is wide in effect.

Where an indemnity clause extends to cover losses suffered by the indemnifying party as well as third parties, it is in effect a kind of exclusion clause.

Typically, contracting party where the other party is a subsidiary company within a group, and where the first party is concerned that the subsidiary might not be able to meet its contractual commitments or might be liquidated by the parent if problems were to arise under the contract will demand a parent company guarantee. Alternatively, the first party may have entered into the contract on the basis that the other party is part of a large and reputable group and may wish to avoid the risk of the other party being sold, e.g., to its management.

Ascertainment of Price and Payment terms

The price of the goods may be fixed by the contract, (If the price is to be fixed by an agreement, and no such agreement is in fact come to, the contract will be void: see May and Butcher Ltd. v R (1934) 2 KB 17n HL) or may be determined by the course of dealing between the parties. If the price is not determined, the buyer must pay a reasonable price, and what is a reasonable price is a question of fact dependent on the circumstances of each particular case.

Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party, and that third party cannot or does not make such valuation, the agreement is avoided, provided that, if the goods, or any part of them have been delivered to and appropriated by the buyer, he must pay a reasonable price for them. Even in the absence of bad faith, a valuer brought in to fix a term in a contract is liable to be sued damages (See Arenson v Casson Beckman Rutley & Co. (1977) AC 405 (1975) 3 All ER 901, HL, where it was held that an auditor of a private company who on request had valued shares in the knowledge that his valuation would determine the price to be paid for them under a contractor sale was liable to be sued by the buyer or the seller if his valuation was carried out negligently. See also Burgess v Purchase & Sons (Farms) Ltd (1983) Ch 216 (1983) 2 All ER 4).

Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain an action for damages against the party in fault.

Where the contract is for the manufacture of particular goods, or for the supply of goods over a period of time, the price is commonly made subject to variation by reference to increases in the cost, for example, of raw materials and labor.

Sometimes contracts will state a price or rate for the undertaking of the contractual obligations, but will fail to state when or how that price is to be paid. Whilst the court may be prepared to interpret such a contract as requiring payment within a reasonable period, it is generally better to state specifically what the payment terms are to be.

Retention of Title

The question of retention of title on of has been the subject of much discussion (See e.g. Aluminium Industries Vassen BV v. romalpa Aluminium Ltd (1976) 2 All ER 552, (1976) 1 WLR 676, CA (the Romalpa case) and R. Bradgate Commercial Law (2nd Edn) para 18.4). The limits on the efficacy of such provisions may need to be carefully explained to the seller, proceeding from basic principles.

Firstly, what is retention of title and what is its significance? It is the right of the seller to retain ownership of the goods sold until payment, notwithstanding that he has parted with possession of the goods to the buyer. It is vital to bear in mind that, as a general rule, where a contract for the sale of foods has been entered into between the parties for goods in a deliverable state then, under the Sale of goods Act ownership of the goods will pass to the buyer at the time the contract is made, irrespective of whether the goods have been paid for or delivered.

It will therefore be obvious that retaining ownership in goods delivered to the buyer but not paid for will be an extremely important right in the event of the buyer becoming bankrupt or going into liquidation. In the event of an insolvency practitioner disposing of the goods or interfering with them, the seller could bring legal proceedings against the practitioner for wrongful interference with the goods and claim damages for their market value.

There are, however, a number of practical problems. In particular, mantelpiece of retention of title clause creates a charge over the goods and (in the case of a corporate buyer) that charge will be void unless registered at the Registrar of Companies. Registration is often considered not practical.

So far as the effectiveness of the retention of title), a typical clause will provide further extension on the rights of the seller.

Intellectual Property

A significant asset of most businesses is the value of various intellectual property rights, which it owns. These can range from patents to copyright and design rights to protection through registered designs and trademarks to the existence of know-how (both technological and commercial) and other confidential information. If the business is in the high technology market or in a research based industry, these rights are likely to be of substantial value. E.G., if what is being acquired is a pharmaceutical business, patent protection may be vital to the profitability of the business. If the business is a computer software company, the copyright position will be relevant in that it will be important to ensure that the company does in fact have the right to license, use, exploit, etc., the software that it produces. If the business is based substantially on a franchise operation, trademarks and brand names will be fundamental.

Confidentiality

The need for and the scope of, a clause imposing an obligation on one or both parties to keep all matters connected with their agreement confidential will depend on the subject matter and the relationship between the parties. In many cases a short general clause will suffice. Where, however, as part of the agreement sensitive information is supplied by one party to the other (e.g. in a software license, or a company take over or merger), then more detailed provision is called for. The need for secrecy may, for commercial reasons, be so strong that a party, e.g. a vendor of a business, may be advised to insist that the other give a separate detailed confidentiality undertaking before negotiations over the deal are commenced.

Usually, the recipient of confidential information is required by the agreement to take certain steps to prevent it becoming public knowledge,

for example, to keep in it a secure place when it is not in use, to take all reasonably practicable measures to prevent the information falling into the hands of unauthorized their parties and to limit access to the information to those of his employees who need to know or use it (and who sign a written undertaking to maintain it in confidence). The interests of the recipient are often safeguarded by a proviso that the confidentiality obligation does not extend to such information as it is already a part of the domain of public knowledge when it is disclosed to him or a s afterwards may become a part of the same through its publication by the discloser of a third party.

Parties sometimes forget to include restrictions on use of the confidential information. Such a restriction may be just as important as an obligation of nondisclosure. The duration of the confidentiality obligations, and in particular whether they survive termination of the agreement, should be stated.

Announcements

Companies may often wish to control the issue of public announcements about agreements they have made or are negotiating. Sometimes public statements are required, e.g., if a contracting party is listed on a Stock exchange and is required to notify significant transactions to the Exchange. The wording of the announcement may have an effect on the share price. Contracting parties sometimes agree to the text of a joint press release in the course of the contractual negotiations and attach the final form as a schedule to the contract.

Costs and Stamp duty

The language stating that each party is to bear its own legal costs is probably most useful in situations where there is a long established practice that one party bear all costs, as e.g., in the case of property leases. In many types of contract such a clause may be thought unnecessary.

In transactions in which stamp duty may have to be paid, e.g., conveyances of property and intellectual property assignments, it may be useful to state which party is responsible for having the relevant documents stamped and for paying the duty. This matter for commercial negotiation,

but as it will more often than not be the purchaser who wishes to rely on the stampable document in court; he will more typically be the party, which pays the duty. The court will not admit in evidence documents, which are stampable but have not been duly stamped.

Taxation

An international sale will attract any applicable exchange controls or customs duties. A sale of goods will constitute a disposal of assets for the purposes of tax on capital gains. It goes without saying that any business transaction must be made to work satisfactorily from a tax point of view, and this will be a major consideration in devising a suitable structure.

Insurance

Contracts sometimes include warranties as to the level and scope of insurance cover held by a contracting party and / or obligations on a party to insure against specified risks and / or to arrange for the other party to be added as a named party under the first party's insurance policy.

Parties to commercial contracts sometimes misconstrue an obligation on a party to insure against a risk as a statement that party is liable for any losses associated with that risk. Insurance clauses should not be used as a substitute for statements as to which of the contracting parties bears the risk of a particular event happening. The ability of a party to insure against a risk is a factor to be taken into account by the court when assessing whether an exemption clause is reasonable.

Termination

Sometimes agreements are stated to have a fixed term. In such cases the parties will often intend that the agreement will terminate automatically by expiry at the end of that period and it is better to state this rather than assume that this is implicit from the fixed term. If the agreement may terminate earlier, e.g., under another clause allowing for termination in the event of breach or insolvency, the clause providing for the fixed term should be stated to be subject to earlier termination as provided elsewhere in the agreement. Sometimes agreements allow a party to terminate the agreement on notice to the other party (i.e. without specifying a cause, such as for

breach or insolvency). If the agreement is silent as to its term, it may (in some situations) be interpreted as being terminable by either party on giving reasonable notice. To avoid such uncertainties it is desirable to specify the term of the contract.

(1) Termination for insolvency

It is customary to provide that certain specified kinds of default will entitle the innocent party to terminate the agreement. The description of the particular events, which will constitute such a breach, will vary from contract to contract. The insolvency of a party is almost always stipulated as an event entitling the other party to terminate the agreement. In the absence of such a provision, the bankruptcy or winding up of one party may of itself be insufficient to terminate the contract. It is always advisable to be specific when framing such a provision.

(2) Termination for breach

The innocent party may be entitled to terminate a contract de futuro (le terminate the contract or bring it to an end as to the future, or rescind it de futuro. Distinguish rescission ab initio for misrepresentation) on any of the following grounds.

(3) An express provision in the contract allows the innocent party to terminate the contract either on the grounds le terminate the contract or bring it to an end as to he future, or rescind it de futuro. Distinguish rescission ab initoio for misrepresentation that the other party has committed a breach listed in the contract as having such an effect or because the happening of some event (including performance by the other party) is a condition precedent to his liability.

(4) In any agreement containing obligations of a continuing nature one party will wish to be able to terminate the agreement if the other party is in serious default. At common law, one party may rescind the contract where the other party has committed a serious or fundamental beach by defective performance or has repudiated the contract. It is always advisable to provide expressly for the circumstances in which either party may treat the contract as at an end. In the absence of such provision it is not always clear whether a particular branch would entitle the innocent party to rescission, each contract will be construed on a case-by-case basis.

Remedies

Rescission for misrepresentation

Wherever a party is induced to enter into a contract by a material misrepresentation, whether innocent or fraudulent, he has a prima facie right to rescind ab inito, although the contract will normally continue to force unless he so elects. Where a person has entered into contract after a misrepresentation has been made to him, notwithstanding that the misrepresentation has become a term of the contract or the contract has been performed, then, if that person would otherwise be entitled to rescind the contract without alleging fraud, he is entitled to rescind the contract. This right is subject, however, to the power of a court or arbitrator to award damages in lieu of rescission if of the opinion that it would be equitable to do so, having regard to the nature of the misrepresenting and the loss that would be caused if the contract were upheld as well as to the loss to the other party if rescission was permitted.

Repudiation

Any unequivocal refusal by a contracting party to perform his contractual obligation (including self-induced frustration. As to frustration including self induced frustration) may amount to a repudiation (See further 9 Halsbury's Laws (4th Edn) Para 546 et seq. But repudiation is a serious matter and not to be lightly inferred, see Ross T Smyth & Co Ltd. v T.D. Bailey, Son & Co. (1940) 3 All ER 60 at 71 HL per Lord Wright). The repudiation may be express, or it may be implied, the implication may be made by statute, or in law, as where a party incapacitates himself from performing his contractual obligations, (As by a supplier wrongfully reselling goods) or completely fails to perform his side of the bargain. (E.g. Gill & Duffus SA v Berger & Co. Inc (1984) 1 All ER 438, Hl, Eg Gill & Duffus SA v Berger & Co. Inc. (1984) AC 382 (1984) AC 382 (1984) if he elects to keep the contract alive, each must perform his own side of the contract, but the innocent party may claim damages by reason of the breach. However, if he elects to rescind, the effect is to discharge both parties from any duty of further performance of the primary promises made under the contract but, whilst the guilty party remains liable for damages for past and future breaches, the innocent party is liable for damages only for past breaches.

Damages

An action for damages may lie at the suit of the buyer for breach of contract, tort of misrepresentation.

1. Specific enforcement

Two equitable and discretionary remedies may be available. First, in an action for breach of contract to deliver unique, specific or ascertained goods the court may, if it thinks fit, on the plaintiff 's application, by its judgment direct that the contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment of damages. Second, the buyer may obtain an injunction preventing the supplier disposing of those goods to a third party.

2. Damages for breach

This paragraph deals with the situation where a buyer has an action in damages for breach of the sale contract against his seller. The rules here will differ according to whether or not the breach by the seller amounts in law to a failure to deliver the goods.

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4. Damages for non-deliver

This category covers not only the situation where no goods are delivered at all, but also where the goods tendered by the seller are lawfully rejected and the contract discharged on the grounds that they do not conform to the contract in quantity or quality. The Sale of Goods Act provides that where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may maintain an action against the seller for damages for non-delivery. Subject to the ordinary rule of remoteness, the Act lays down a prima facie rule for measuring damages where there is an available market in which the buyer may obtain a replacement.

5. Damages for other breaches

This category covers not only the situation where the seller is only in breach of warranty, but also that where the buyer elects, or is completed, to

treat a breach of condition as a breach of warranty. The measure of damages is subject to the ordinary rules of remoteness.

Proper Law and Jurisdiction

Where there is a foreign element in the contract, it may become necessary, in the event of a dispute between the parties, for a court or arbitrator to decide whether the contract is governed by the Indian law or by some foreign law. there may also be uncertainty as to which courts have jurisdiction to hear the case. E.g., if either the offer or acceptance of the contract took place outside India, or if any services are to be performed under the contract or goods are to be delivered outside India. In The absence of a binding agreement between the contracting parties in relation to the law and jurisdiction to be applied, it will be necessary to fall back on rules on conflicts of laws and jurisdiction. Applying such rules may lead to an undesired outcome for one of more parties (i.e. being required to litigate in a foreign country and / or have the contract interpreted under foreign laws). To avoid such an outcome it is important to specify which law shall govern the contract and which courts shall have jurisdiction.

Exclusive and non-exclusive jurisdiction

If it is agreed that any proceedings between the parties in connection with the contract should be brought only in the Indian courts, the jurisdiction of those courts should be expressed to be exclusive. The effect of this will be that judgments given by a foreign court in proceedings brought contrary to an express agreement between the parties that another court should have jurisdiction will not be recognized or enforced.

On the other hand, if non-exclusive Indian court jurisdiction is specified, it will be possible to bring proceedings in a foreign court on a matter over which that court has jurisdiction. Where cross-border rights (e.g. intellectual property rights) are the subjects of the agreement, it may be in the owner's interest to insist on the inclusion of this term in order to reserve the right to take protective action abroad. If an urgent injunction might be needed (e.g. to prevent disclosure of confidential information), it may be desirable to reserve the right to bring interlocutory proceedings in the other party's home jurisdiction.

Arbitration and Alternative Dispute Resolution

Arbitration is a process by which disputes between two or more persons are determined with final and binding effect by impartial third person acting in a judicial manner, rather than by a court of law. The arbitrator's authority is derived from the agreement of the parties concerned. In contrast to proceedings in court, arbitration takes place in private (this may be an important reason for preferring arbitration to court proceedings), and the contracting parties may in general confer on the arbitrator such procedural powers as they think fit. Arbitration is sometimes thought to be speedier and less expensive than a court action.

Arbitration is not the only alternative to court proceedings. Reference to an expert may be preferred, particularly if a technical, rather than a legal, issue needs to be decided. In recent years, mediation and other forms of non-binding ADR (Alternative Dispute Resolution) have become popular. In the majority of agreements, and where both parties are domiciled in India, the parties will agree to refer disputes to a sole arbitrator, leaving the choice of arbitrator to be agreed on by them. Where there may be practical difficulties in agreeing on in the more complex commercial agreements, it may be advisable to provide for the appointment of two or more arbitrators, presided over by an umpire. Usually the umpire is appointed by the arbitrators, and has no part in proceedings unless the arbitrators fail to agree, in; which case the umpire will enter the proceedings and make an award as if he were sole arbitrator. It may be thought advisable to make the basic rules of procedure clear in the initial agreement.

Arbitration clauses are usually to be found in agreements in which the parties are more or less on an equal footing, and which confirm and formalize their desire to cooperate in a project or transaction. Typical examples might be shareholders' agreements, joint ventures, research and technical aid agreements, partnership deeds and certain contracts for services. In this type of transaction the parties will often wish difference to be settled quickly inexpensively, and with a minimum of animosity or publicity. An arbitration clause may not be appropriate where one of the parties has, by the very nature of the transaction, the upper had, as e.g. in an agency or franchise agreement or contract of employment, or financing and loan agreement. Each case must, of course, be treated on its merits.

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ANNEXURE 2

CASE LAWS

SUPREME COURT OF THE UNITED STATES

No. 98—1682

UNITED STATES, et al., APPELLANTS v. PLAYBOY ENTERTAINMENT GROUP, INC. ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE

[May 22, 2000]

Justice Kennedy delivered the opinion of the Court.

This case presents a challenge to §505 of the Telecommunications Act of 1996, Pub. L. 104—104, 110 Stat. 136, 47 U.S.C. § 561 (1994 ed., Supp. III). Section 505 requires cable television operators who provide channels "primarily dedicated to sexually-oriented programming" either to "fully scramble or otherwise fully block" those channels or to limit their transmission to hours when children are unlikely to be viewing, set by administrative regulation as the time between 10 p.m. and 6 a.m. 47 U.S.C. § 561(a) (1994 ed., Supp. III); 47 CFR § 76.227 (1999). Even before enactment of the statute, signal scrambling was already in use. Cable operators used scrambling in the regular course of business, so that only paying customers had access to certain programs. Scrambling could be imprecise, however; and either or both audio and visual portions of the scrambled programs might be heard or seen, a phenomenon known as "signal bleed." The purpose of §505 is to shield children from hearing or seeing images resulting from signal bleed.

To comply with the statute, the majority of cable operators adopted the second, or "time channeling," approach. The effect of the widespread adoption of time channeling was to eliminate altogether the transmission of the targeted programming outside the safe harbor period in affected cable service areas. In other words, for two-thirds of the day no household in those service areas could receive the programming, whether or not the household or the viewer wanted to do so.

Appellee Playboy Entertainment Group, Inc., challenged the statute as unnecessarily restrictive content-based legislation violative of the First Amendment. After a trial, a three-judge District Court concluded that a regime in which viewers could order signal blocking on a household-by-household basis presented an effective, less restrictive alternative to §505. 30 F. Supp. 2d 702, 719 (Del. 1998). Finding no error in this conclusion, we affirm.

Playboy Entertainment Group owns and prepares programs for adult television networks, including Playboy Television and Spice. Playboy transmits its programming to cable television operators, who retransmit it to their subscribers, either through monthly subscriptions to premium channels or on a so-called "pay-per-view" basis. Cable operators transmit Playboy's signal, like other premium channel signals, in scrambled form. The operators then provide paying subscribers with an "addressable converter," a box placed on the home television set. The converter permits the viewer to see and hear the descrambled signal. It is conceded that almost all of Playboy's programming consists of sexually explicit material as defined by the statute.

The statute was enacted because not all scrambling technology is perfect. Analog cable television systems may use either "RF" or "baseband" scrambling systems, which may not prevent signal bleed, so discernible pictures may appear from time to time on the scrambled screen. Furthermore, the listener might hear the audio portion of the program.

These imperfections are not inevitable. The problem is that at present it appears not to be economical to convert simpler RF or baseband scrambling systems to alternative scrambling technologies on a systemwide scale. Digital technology may one day provide another solution, as it presents no bleed

problem at all. Indeed, digital systems are projected to become the technology of choice, which would eliminate the signal bleed problem. Digital technology is not yet in widespread use, however. With imperfect scrambling, viewers who have not paid to receive Playboy's channels may happen across discernible images of a sexually explicit nature. How many viewers, how discernible the scene or sound, and how often this may occur are at issue in this case.

Section 505 was enacted to address the signal bleed phenomenon. As noted, the statute and its implementing regulations require cable operators either to scramble a sexually explicit channel in full or to limit the channel's programming to the hours between 10 p.m. and 6 a.m. 47 U.S.C. § 561 (1994 ed., Supp. III); 47 CFR § 76.227 (1999). Section 505 was added by floor amendment, without significant debate, to the Telecommunications Act of 1996 (Act), a major legislative effort designed "to reduce regulation and encourage 'the rapid deployment of new telecommunications technologies.'" *Reno* v. *American Civil Liberties Union,* 521 U.S. 844, 857 (1997) (quoting 110 Stat. 56). "The Act includes seven Titles, six of which are the product of extensive committee hearings and the subject of discussion in Reports prepared by Committees of the Senate and the House of Representatives." *Reno, supra*, at 858. Section 505 is found in Title V of the Act, which is itself known as the Communications Decency Act of 1996 (CDA). 110 Stat. 133. Section 505 was to become effective on March 9, 1996, 30 days after the Act was signed by the President. Note following 47 U.S.C. § 561 (1994 ed., Supp. III).

On March 7, 1996, Playboy obtained a temporary restraining order (TRO) enjoining the enforcement of §505. 918 F. Supp. 813 (Del.), and brought this suit in a three-judge District Court pursuant to §561 of the Act, 110 Stat. 142, note following 47 U.S.C. § 223 (1994 ed., Supp. III). Playboy sought a declaration that §505 violates the Constitution and an injunction prohibiting the law's enforcement. The District Court denied Playboy a preliminary injunction, 945 F. Supp. 772 (Del. 1996), and we summarily affirmed, 520 U.S. 1141 (1997). The TRO was lifted, and the Federal Communications Commission announced it would begin enforcing §505 on May 18, 1997. *In re Implementation of Section 505 of the Telecommunications Act of 1996*, 12 FCC Rcd. 5212, 5214 (1997).

When the statute became operative, most cable operators had "no practical choice but to curtail [the targeted] programming during the [regulated] sixteen hours or risk the penalties imposed … if any audio or video signal bleed occur[red] during [those] times." 30 F. Supp. 2d, at 711. The majority of operators–"in one survey, 69%"–complied with §505 by time channeling the targeted programmers. *Ibid*. Since "30 to 50% of all adult programming is viewed by households prior to 10 p.m.," the result was a significant restriction of communication, with a corresponding reduction in Playboy's revenues. *Ibid*.

In March 1998, the District Court held a full trial and concluded that §505 violates the First Amendment. 30 F. Supp. 2d, at 702. The District Court observed that §505 imposed a content-based restriction on speech. *Id.,* at 714—715. It agreed that the interests the statute advanced were compelling but concluded the Government might further those interests in less restrictive ways. *Id.*, at 717—720. One plausible, less restrictive alternative could be found in another section of the Act: §504, which requires a cable operator, "[u]pon request by a cable service subscriber . . . without charge, [to] fully scramble or otherwise fully block" any channel the subscriber does not wish to receive. 110 Stat. 136, 47 U.S.C. § 560 (1994 ed., Supp. III). As long as subscribers knew about this opportunity, the court reasoned, §504 would provide as much protection against unwanted programming as would §505. 30 F. Supp. 2d, at 718—720. At the same time, §504 was content neutral and would be less restrictive of Playboy's First Amendment rights. *Ibid*.

The court described what "adequate notice" would include, suggesting "[operators] should communicate to their subscribers the information that certain channels broadcast sexually-oriented programming; that signal bleed … may appear; that children may view signal bleed without their parents' knowledge or permission; that channel blocking devices … are available free of charge … ; and that a request for a free device … can be made by a telephone call to the [operator]." *Id.*, at 719.

The means of providing this notice could include "inserts in monthly billing statements, barker channels (preview channels of programming coming up on Pay-Per-View), and on-air advertisement on channels other than the one broadcasting the sexually explicit programming." *Ibid*.

The court added that this notice could be "conveyed on a regular basis, at reasonable intervals," and could include notice of changes in channel alignments. *Ibid.*

The District Court concluded that §504 so supplemented would be an effective, less restrictive alternative to §505, and consequently declared §505 unconstitutional and enjoined its enforcement. *Id.,* at 719—720. The court also required Playboy to insist on these notice provisions in its contracts with cable operators. *Ibid.*

The United States filed a direct appeal in this Court pursuant to §561. The District Court thereafter dismissed for lack of jurisdiction two post-trial motions filed by the Government. App. to Juris. Statement 91a—92a. We noted probable jurisdiction, 527 U.S. 1021 (1999), and now affirm.

II. Two essential points should be understood concerning the speech at issue here. First, we shall assume that many adults themselves would find the material highly offensive; and when we consider the further circumstance that the material comes unwanted into homes where children might see or hear it against parental wishes or consent, there are legitimate reasons for regulating it. Second, all parties bring the case to us on the premise that Playboy's programming has First Amendment protection. As this case has been litigated, it is not alleged to be obscene; adults have a constitutional right to view it; the Government disclaims any interest in preventing children from seeing or hearing it with the consent of their parents; and Playboy has concomitant rights under the First Amendment to transmit it. These points are undisputed.

The speech in question is defined by its content; and the statute which seeks to restrict it is content based. Section 505 applies only to channels primarily dedicated to "sexually explicit adult programming or other programming that is indecent." The statute is unconcerned with signal bleed from any other channels. See 945 F. Supp., at 785 ("[Section 505] does not apply when signal bleed occurs on other premium channel networks, like HBO or the Disney Channel"). The overriding justification for the regulation is concern for the effect of the subject matter on young viewers. Section 505 is not "'justified without reference to the content of the regulated speech.'" *Ward* v. *Rock Against Racism,* 491 U.S. 781, 791 (1989) (quoting *Clark* v.

Community for Creative Non&nbhyph;Violence, 468 U.S. 288, 293 (1984) (emphasis deleted)). It "focuses *only* on the content of the speech and the direct impact that speech has on its listeners." *Boos* v. *Barry,* 485 U.S. 312, 321 (1988) (opinion of O'Connor, J.). This is the essence of content-based regulation.

Not only does §505 single out particular programming content for regulation, it also singles out particular programmers. The speech in question was not thought by Congress to be so harmful that all channels were subject to restriction. Instead, the statutory disability applies only to channels "primarily dedicated to sexually-oriented programming." 47 U.S.C. § 561(a) (1994 ed., Supp. III). One sponsor of the measure even identified appellee by name. See 141 Cong. Rec. 15587 (1995) (statement of Sen. Feinstein) (noting the statute would apply to channels "such as the Playboy and Spice channels"). Laws designed or intended to suppress or restrict the expression of specific speakers contradict basic First Amendment principles. Section 505 limited Playboy's market as a penalty for its programming choice, though other channels capable of transmitting like material are altogether exempt.

The effect of the federal statute on the protected speech is now apparent. It is evident that the only reasonable way for a substantial number of cable operators to comply with the letter of §505 is to time channel, which silences the protected speech for two-thirds of the day in every home in a cable service area, regardless of the presence or likely presence of children or of the wishes of the viewers. According to the District Court, "30 to 50% of all adult programming is viewed by households prior to 10 p.m.," when the safe-harbor period begins. 30 F. Supp. 2d, at 711. To prohibit this much speech is a significant restriction of communication between speakers and willing adult listeners, communication which enjoys First Amendment protection. It is of no moment that the statute does not impose a complete prohibition. The distinction between laws burdening and laws banning speech is but a matter of degree. The Government's content-based burdens must satisfy the same rigorous scrutiny as its content-based bans.

Since §505 is a content-based speech restriction, it can stand only if it satisfies strict scrutiny. *Sable Communications of Cal., Inc.* v. *FCC,* 492 U.S.

115, 126 (1989). If a statute regulates speech based on its content, it must be narrowly tailored to promote a compelling Government interest. *Ibid*. If a less restrictive alternative would serve the Government's purpose, the legislature must use that alternative. *Reno*, 521 U.S., at 874 ("[The CDA's Internet indecency provisions'] burden on adult speech is unacceptable if less restrictive alternatives would be at least as effective in achieving the legitimate purpose that the statute was enacted to serve"); *Sable Communications, supra*, at 126 ("The Government may … regulate the content of constitutionally protected speech in order to promote a compelling interest if it chooses the least restrictive means to further the articulated interest"). To do otherwise would be to restrict speech without an adequate justification, a course the First Amendment does not permit.

Our precedents teach these principles. Where the designed benefit of a content-based speech restriction is to shield the sensibilities of listeners, the general rule is that the right of expression prevails, even where no less restrictive alternative exists. We are expected to protect our own sensibilities "simply by averting [our] eyes." *Cohen* v. *California*, 403 U.S. 15, 21 (1971); accord, *Erznoznik* v. *Jacksonville*, 422 U.S. 205, 210—211 (1975). Here, of course, we consider images transmitted to some homes where they are not wanted and where parents often are not present to give immediate guidance. Cable television, like broadcast media, presents unique problems, which inform our assessment of the interests at stake, and which may justify restrictions that would be unacceptable in other contexts. See *Denver Area Ed. Telecommunications Consortium, Inc*. v. *FCC*, 518 U.S. 727, 744 (1996) (plurality opinion); *id*., at 804—805 (Kennedy, J., concurring in part, concurring in judgment in part, and dissenting in part); *FCC* v. *Pacifica Foundation*, 438 U.S. 726 (1978). No one suggests the Government must be indifferent to unwanted, indecent speech that comes into the home without parental consent. The speech here, all agree, is protected speech; and the question is what standard the Government must meet in order to restrict it. As we consider a content-based regulation, the answer should be clear: The standard is strict scrutiny. This case involves speech alone; and even where speech is indecent and enters the home, the objective of shielding children does not suffice to support a blanket ban if the protection can be accomplished by a less restrictive alternative.

In *Sable Communications*, for instance, the feasibility of a technological approach to controlling minors' access to "dial-a-porn" messages required invalidation of a complete statutory ban on the medium. 492 U.S., at 130—131. And, while mentioned only in passing, the mere possibility that user-based Internet screening software would "'soon be widely available'" was relevant to our rejection of an overbroad restriction of indecent cyberspeech. *Reno, supra*, at 876—877. Compare *Rowan* v. *Post Office Dept.,* 397 U.S. 728, 729—730 (1970) (upholding statute "whereby any householder may insulate himself from advertisements that offer for sale 'matter which the addressee in his sole discretion believes to be erotically arousing or sexually provocative'" (quoting then 39 U.S.C. § 4009(a) (1964 ed., Supp. IV))), with *Bolger* v. *Youngs Drug Products Corp.,* 463 U.S. 60, 75 (1983) (rejecting blanket ban on the mailing of unsolicited contraceptive advertisements). Compare also *Ginsberg* v. *New York,* 390 U.S. 629, 631 (1968) (upholding state statute barring the sale to minors of material defined as "obscene on the basis of its appeal to them"), with *Butler* v. *Michigan,* 352 U.S. 380, 381 (1957) (rejecting blanket ban of material "'tending to incite minors to violent or depraved or immoral acts, manifestly tending to the corruption of the morals of youth'" (quoting then Mich. Penal Code §343)). Each of these cases arose in a different context–*Sable Communications* and *Reno*, for instance, also note the affirmative steps necessary to obtain access to indecent material via the media at issue–but they provide necessary instruction for complying with accepted First Amendment principles.

Our zoning cases, on the other hand, are irrelevant to the question here. *Post*, at 4 (Breyer, J., dissenting) (citing *Renton* v. *Playtime Theatres, Inc.,* 475 U.S. 41 (1986), and *Young* v. *American Mini Theatres, Inc.,* 427 U.S. 50 (1976)). We have made clear that the lesser scrutiny afforded regulations targeting the secondary effects of crime or declining property values has no application to content-based regulations targeting the primary effects of protected speech. *Reno, supra*, at 867—868; *Boos,* 485 U.S., at 320—321. The statute now before us burdens speech because of its content; it must receive strict scrutiny.

There is, moreover, a key difference between cable television and the broadcasting media, which is the point on which this case turns: Cable systems have the capacity to block unwanted channels on a household-by-

household basis. The option to block reduces the likelihood, so concerning to the Court in *Pacifica, supra*, at 744, that traditional First Amendment scrutiny would deprive the Government of all authority to address this sort of problem. The corollary, of course, is that targeted blocking enables the Government to support parental authority without affecting the First Amendment interests of speakers and willing listeners–listeners for whom, if the speech is unpopular or indecent, the privacy of their own homes may be the optimal place of receipt. Simply put, targeted blocking is less restrictive than banning, and the Government cannot ban speech if targeted blocking is a feasible and effective means of furthering its compelling interests. This is not to say that the absence of an effective blocking mechanism will in all cases suffice to support a law restricting the speech in question; but if a less restrictive means is available for the Government to achieve its goals, the Government must use it.

III. The District Court concluded that a less restrictive alternative is available: §504, with adequate publicity. 30 F. Supp. 2d, at 719—720. No one disputes that §504, which requires cable operators to block undesired channels at individual households upon request, is narrowly tailored to the Government's goal of supporting parents who want those channels blocked. The question is whether §504 can be effective.

When a plausible, less restrictive alternative is offered to a content-based speech restriction, it is the Government's obligation to prove that the alternative will be ineffective to achieve its goals. The Government has not met that burden here. In support of its position, the Government cites empirical evidence showing that §504, as promulgated and implemented before trial, generated few requests for household-by-household blocking. Between March 1996 and May 1997, while the Government was enjoined from enforcing §505, §504 remained in operation. A survey of cable operators determined that fewer than 0.5% of cable subscribers requested full blocking during that time. *Id.,* at 712. The uncomfortable fact is that §504 was the sole blocking regulation in effect for over a year; and the public greeted it with a collective yawn.

The District Court was correct to direct its attention to the import of this tepid response. Placing the burden of proof upon the Government, the

District Court examined whether §504 was capable of serving as an effective, less restrictive means of reaching the Government's goals. *Id.,* at 715, 718—719. It concluded that §504, if publicized in an adequate manner, could be. *Id.,* at 719—720.

The District Court employed the proper approach. When the Government restricts speech, the Government bears the burden of proving the constitutionality of its actions. *Greater New Orleans Broadcasting Assn., Inc.* v. *United States,* 527 U.S. 173, 183 (1999) ("[T]he Government bears the burden of identifying a substantial interest and justifying the challenged restriction"); *Reno,* 521 U.S., at 879 ("The breadth of this content-based restriction of speech imposes an especially heavy burden on the Government to explain why a less restrictive provision would not be as effective …"); *Edenfield* v. *Fane,* 507 U.S. 761, 770—771 (1993) ("[A] governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree"); *Board of Trustees of State Univ. of N. Y.* v. *Fox,* 492 U.S. 469, 480 (1989) ("[T]he State bears the burden of justifying its restrictions …"); *Tinker* v. *Des Moines Independent Community School Dist.,* 393 U.S. 503, 509 (1969) ("In order for the State … to justify prohibition of a particular expression of opinion, it must be able to show that its action was caused by something more than a mere desire to avoid the discomfort and unpleasantness that always accompany an unpopular viewpoint"). When the Government seeks to restrict speech based on its content, the usual presumption of constitutionality afforded congressional enactments is reversed. "Content-based regulations are presumptively invalid," *R. A. V.* v. *St. Paul,* 505 U.S. 377, 382 (1992), and the Government bears the burden to rebut that presumption.

This is for good reason. "[T]he line between speech unconditionally guaranteed and speech which may legitimately be regulated, suppressed, or punished is finely drawn." *Speiser* v. *Randall,* 357 U.S. 513, 525 (1958). Error in marking that line exacts an extraordinary cost. It is through speech that our convictions and beliefs are influenced, expressed, and tested. It is through speech that we bring those beliefs to bear on Government and on society. It is through speech that our personalities are formed and expressed. The citizen is entitled to seek out or reject certain ideas or influences without Government interference or control.

When a student first encounters our free speech jurisprudence, he or she might think it is influenced by the philosophy that one idea is as good as any other, and that in art and literature objective standards of style, taste, decorum, beauty, and esthetics are deemed by the Constitution to be inappropriate, indeed unattainable. Quite the opposite is true. The Constitution no more enforces a relativistic philosophy or moral nihilism than it does any other point of view. The Constitution exists precisely so that opinions and judgments, including esthetic and moral judgments about art and literature, can be formed, tested, and expressed. What the Constitution says is that these judgments are for the individual to make, not for the Government to decree, even with the mandate or approval of a majority. Technology expands the capacity to choose; and it denies the potential of this revolution if we assume the Government is best positioned to make these choices for us.

It is rare that a regulation restricting speech because of its content will ever be permissible. Indeed, were we to give the Government the benefit of the doubt when it attempted to restrict speech, we would risk leaving regulations in place that sought to shape our unique personalities or to silence dissenting ideas. When First Amendment compliance is the point to be proved, the risk of non-persuasion–operative in all trials–must rest with the Government, not with the citizen. *Id.,* at 526.

With this burden in mind, the District Court explored three explanations for the lack of individual blocking requests. 30 F. Supp. 2d, at 719. First, individual blocking might not be an effective alternative, due to technological or other limitations. Second, although an adequately advertised blocking provision might have been effective, §504 as written did not require sufficient notice to make it so. Third, the actual signal bleed problem might be far less of a concern than the Government at first had supposed. *Ibid*.

To sustain its statute, the Government was required to show that the first was the right answer. According to the District Court, however, the first and third possibilities were "equally consistent" with the record before it. *Ibid*. As for the second, the record was "not clear" as to whether enough notice had been issued to give §504 a fighting chance. *Ibid*. The case, then, was at best a draw. Unless the District Court's findings are clearly erroneous, the tie goes to free expression.

The District Court began with the problem of signal bleed itself, concluding "the Government has not convinced us that [signal bleed] is a pervasive problem." *Id.*, at 708—709, 718. The District Court's thorough discussion exposes a central weakness in the Government's proof: There is little hard evidence of how widespread or how serious the problem of signal bleed is. Indeed, there is no proof as to how likely any child is to view a discernible explicit image, and no proof of the duration of the bleed or the quality of the pictures or sound. To say that millions of children are subject to a risk of viewing signal bleed is one thing; to avoid articulating the true nature and extent of the risk is quite another. Under §505, sanctionable signal bleed can include instances as fleeting as an image appearing on a screen for just a few seconds. The First Amendment requires a more careful assessment and characterization of an evil in order to justify a regulation as sweeping as this. Although the parties have taken the additional step of lodging with the Court an assortment of videotapes, some of which show quite explicit bleeding and some of which show television static or snow, there is no attempt at explanation or context; there is no discussion, for instance, of the extent to which any particular tape is representative of what appears on screens nationwide.

The Government relied at trial on anecdotal evidence to support its regulation, which the District Court summarized as follows:

"The Government presented evidence of two city councillors, eighteen individuals, one United States Senator, and the officials of one city who complained either to their [cable operator], to their local Congressman, or to the FCC about viewing signal bleed on television. In each instance, the local [cable operator] offered to, or did in fact, rectify the situation for free (with the exception of 1 individual), with varying degrees of rapidity. Included in the complaints was the additional concern that other parents might not be aware that their children are exposed to this problem. In addition, the Government presented evidence of a child exposed to signal bleed at a friend's house. Cindy Omlin set the lockout feature on her remote control to prevent her child from tuning to adult channels, but her eleven year old son was nevertheless exposed to signal bleed when he attended a slumber party at a friend's house.

"The Government has presented evidence of only a handful of isolated incidents over the 16 years since 1982 when Playboy started broadcasting. The Government has not presented any survey-type evidence on the magnitude of the 'problem.'" *Id.,* at 709 (footnote and record citations omitted).

Spurred by the District Court's express request for more specific evidence of the problem, see 945 F. Supp., at 779, n. 16, the Government also presented an expert's spreadsheet estimate that 39 million homes with 29.5 million children had the potential to be exposed to signal bleed, 30 F. Supp. 2d, at 708—709. The Government made no attempt to confirm the accuracy of its estimate through surveys or other field tests, however. Accordingly, the District Court discounted the figures and made this finding: "[T]he Government presented no evidence on the number of households actually exposed to signal bleed and thus has not quantified the actual extent of the problem of signal bleed." *Id.*, at 709. The finding is not clearly erroneous; indeed it is all but required.

Once §505 went into effect, of course, a significant percentage of cable operators felt it necessary to time channel their sexually explicit programmers. *Id.,* at 711, and n. 14. This is an indication that scrambling technology is not yet perfected. That is not to say, however, that scrambling is completely ineffective. Different cable systems use different scrambling systems, which vary in their dependability. "The severity of the problem varies from time to time and place to place, depending on the weather, the quality of the equipment, its installation, and maintenance." *Id.,* at 708. At even the good end of the spectrum a system might bleed to an extent sufficient to trigger the time-channeling requirement for a cautious cable operator. (The statute requires the signal to be "*fully* block[ed]." 47 U.S.C. § 561(a) (1994 ed., Supp. III) (emphasis added).) A rational cable operator, faced with the possibility of sanctions for intermittent bleeding, could well choose to time channel even if the bleeding is too momentary to pose any concern to most households. To affirm that the Government failed to prove the existence of a problem, while at the same time observing that the statute imposes a severe burden on speech, is consistent with the analysis our cases require. Here, there is no probative evidence in the record which differentiates among

the extent of bleed at individual households and no evidence which otherwise quantifies the signal bleed problem.

In addition, market-based solutions such as programmable televisions, VCR's, and mapping systems (which display a blue screen when tuned to a scrambled signal) may eliminate signal bleed at the consumer end of the cable. 30 F. Supp. 2d, at 708. Playboy made the point at trial that the Government's estimate failed to account for these factors. *Id.,* at 708—709. Without some sort of field survey, it is impossible to know how widespread the problem in fact is, and the only indicator in the record is a handful of complaints. Cf. *Turner Broadcasting System, Inc*. v. *FCC,* 520 U.S. 180, 187 (1997) (reviewing "'a record of tens of thousands of pages' of evidence" developed through "three years of pre-enactment hearings, … as well as additional expert submissions, sworn declarations and testimony, and industry documents" in support of complex must-carry provisions). If the number of children transfixed by even flickering pornographic television images in fact reached into the millions we, like the District Court, would have expected to be directed to more than a handful of complaints.

No support for the restriction can be found in the near barren legislative record relevant to this provision. Section 505 was added to the Act by floor amendment, accompanied by only brief statements, and without committee hearing or debate. See 141 Cong. Rec. 15586—15589 (1995). One of the measure's sponsors did indicate she considered time channeling to be superior to voluntary blocking, which "put[s] the burden of action on the subscriber, not the cable company." *Id*., at 15587 (statement of Sen. Feinstein). This sole conclusory statement, however, tells little about the relative efficacy of voluntary blocking versus time channeling, other than offering the unhelpful, self-evident generality that voluntary measures require voluntary action. The Court has declined to rely on similar evidence before. See *Sable Communications,* 492 U.S., at 129—130 ("[A]side from conclusory statements during the debates by proponents of the bill, … the congressional record presented to us contains no evidence as to *how* effective or ineffective the … regulations were or might prove to be" (footnote omitted)); *Reno,* 521 U.S., at 858, and n. 24, 875—876, n. 41 (same). This is not to suggest that a 10,000 page record must be compiled in every case or that the

Government must delay in acting to address a real problem; but the Government must present more than anecdote and supposition. The question is whether an actual problem has been proven in this case. We agree that the Government has failed to establish a pervasive, nationwide problem justifying its nationwide daytime speech ban.

Nor did the District Court err in its second conclusion. The Government also failed to prove §504 with adequate notice would be an ineffective alternative to §505. Once again, the District Court invited the Government to produce its proof. See 945 F. Supp., at 781 ("If the §504 blocking option is not being promoted, it cannot become a meaningful alternative to the provisions of §505. At the time of the permanent injunction hearing, further evidence of the actual and predicted impact and efficacy of §504 would be helpful to us"). Once again, the Government fell short. See 30 F. Supp. 2d, at 719 ("[The Government's argument that §504 is ineffective] is premised on adequate notice to subscribers. It is not clear, however, from the record that notices of the provisions of §504 have been adequate"). There is no evidence that a well-promoted voluntary blocking provision would not be capable at least of informing parents about signal bleed (if they are not yet aware of it) and about their rights to have the bleed blocked (if they consider it a problem and have not yet controlled it themselves).

The Government finds at least two problems with the conclusion of the three-judge District Court. First, the Government takes issue with the District Court's reliance, without proof, on a "hypothetical, enhanced version of Section 504." Brief for United States et al. 32. It was not the District Court's obligation, however, to predict the extent to which an improved notice scheme would improve §504. It was for the Government, presented with a plausible, less restrictive alternative, to prove the alternative to be ineffective, and §505 to be the least restrictive available means. Indeed, to the extent the District Court erred, it was only in attempting to implement the less restrictive alternative through judicial decree by requiring Playboy to provide for expanded notice in its cable service contracts. The appropriate remedy was not to repair the statute, it was to enjoin the speech restriction. Given the existence of a less restrictive means, if the Legislature wished to improve its statute, perhaps in the process giving careful consideration to other alternatives, it then could do so.

The Government also contends a publicized §504 will be just as restrictive as §505, on the theory that the cost of installing blocking devices will outstrip the revenues from distributing Playboy's programming and lead to its cancellation. See 30 F. Supp. 2d, at 713. This conclusion rests on the assumption that a sufficient percentage of households, informed of the potential for signal bleed, would consider it enough of a problem to order blocking devices–an assumption for which there is no support in the record. *Id.,* at 719. It should be noted, furthermore, that Playboy is willing to incur the costs of an effective §504. One might infer that Playboy believes an advertised §504 will be ineffective for its object, or one might infer the company believes the signal bleed problem is not widespread. In the absence of proof, it is not for the Court to assume the former.

It is no response that voluntary blocking requires a consumer to take action, or may be inconvenient, or may not go perfectly every time. A court should not assume a plausible, less restrictive alternative would be ineffective; and a court should not presume parents, given full information, will fail to act. If unresponsive operators are a concern, moreover, a notice statute could give cable operators ample incentive, through fines or other penalties for noncompliance, to respond to blocking requests in prompt and efficient fashion.

Having adduced no evidence in the District Court showing that an adequately advertised §504 would not be effective to aid desirous parents in keeping signal bleed out of their own households, the Government can now cite nothing in the record to support the point. The Government instead takes quite a different approach. After only an offhand suggestion that the success of a well-communicated §504 is "highly unlikely," the Government sets the point aside, arguing instead that society's independent interests will be unserved if parents fail to act on that information. Brief for United States et al. 32—33 ("[U]nder … an enhanced version of Section 504, parents who had strong feelings about the matter could see to it that their children did not view signal bleed–at least in their own homes"); *id.,* at 33 ("Even an enhanced version of Section 504 would succeed in blocking signal bleed only if, and after, parents affirmatively decided to avail themselves of the means offered them to do so. There would certainly be parents–perhaps a

large number of parents–who out of inertia, indifference, or distraction, simply would take no action to block signal bleed, even if fully informed of the problem and even if offered a relatively easy solution"); Reply Brief for United States et al. 12 ([Society's] interest would of course be served in instances … in which parents request blocking under an enhanced Section 504. But in cases in which parents fail to make use of an enhanced Section 504 procedure out of distraction, inertia, or indifference, Section 505 would be the only means to protect society's independent interest").

Even upon the assumption that the Government has an interest in substituting itself for informed and empowered parents, its interest is not sufficiently compelling to justify this widespread restriction on speech. The Government's argument stems from the idea that parents do not know their children are viewing the material on a scale or frequency to cause concern, or if so, that parents do not want to take affirmative steps to block it and their decisions are to be superseded. The assumptions have not been established; and in any event the assumptions apply only in a regime where the option of blocking has not been explained. The whole point of a publicized §504 would be to advise parents that indecent material may be shown and to afford them an opportunity to block it at all times, even when they are not at home and even after 10 p.m. Time channeling does not offer this assistance. The regulatory alternative of a publicized §504, which has the real possibility of promoting more open disclosure and the choice of an effective blocking system, would provide parents the information needed to engage in active supervision. The Government has not shown that this alternative, a regime of added communication and support, would be insufficient to secure its objective, or that any overriding harm justifies its intervention.

There can be little doubt, of course, that under a voluntary blocking regime, even with adequate notice, some children will be exposed to signal bleed; and we need not discount the possibility that a graphic image could have a negative impact on a young child. It must be remembered, however, that children will be exposed to signal bleed under time channeling as well. Time channeling, unlike blocking, does not eliminate signal bleed around the clock. Just as adolescents may be unsupervised outside of their own

households, it is hardly unknown for them to be unsupervised in front of the television set after 10 p.m. The record is silent as to the comparative effectiveness of the two alternatives.

Basic speech principles are at stake in this case. When the purpose and design of a statute is to regulate speech by reason of its content, special consideration or latitude is not accorded to the Government merely because the law can somehow be described as a burden rather than outright suppression. We cannot be influenced, moreover, by the perception that the regulation in question is not a major one because the speech is not very important. The history of the law of free expression is one of vindication in cases involving speech that many citizens may find shabby, offensive, or even ugly. It follows that all content-based restrictions on speech must give us more than a moment's pause. If television broadcasts can expose children to the real risk of harmful exposure to indecent materials, even in their own home and without parental consent, there is a problem the Government can address. It must do so, however, in a way consistent with First Amendment principles. Here the Government has not met the burden the First Amendment imposes.

The Government has failed to show that §505 is the least restrictive means for addressing a real problem; and the District Court did not err in holding the statute violative of the First Amendment. In light of our ruling, it is unnecessary to address the second question presented: whether the District Court was divested of jurisdiction to consider the Government's postjudgment motions after the Government filed a notice of appeal in this Court. The judgment of the District Court is affirmed. It is so ordered.

APPENDIX TO OPINION OF THE COURT

Section 505 of the Telecommunications Act of 1996, Pub. L. 104—104, 110 Stat. 136, 47 U.S.C. § 561 (1994 ed., Supp. III), provides in relevant part:

"(a) Requirement

"In providing sexually explicit adult programming or other programming that is indecent on any channel of its service primarily dedicated to

sexually-oriented programming, a multichannel video programming distributor shall fully scramble or otherwise fully block the video and audio portion of such channel so that one not a subscriber to such channel or programming does not receive it.

"(b) Implementation

"Until a multichannel video programming distributor complies with the requirement set forth in subsection (a) of this section, the distributor shall limit the access of children to the programming referred to in that subsection by not providing such programming during the hours of the day (as determined by the Commission) when a significant number of children are likely to view it.

"(c) 'Scramble' defined

"As used in this section, the term 'scramble' means to rearrange the content of the signal of the programming so that the programming cannot be viewed or heard in an understandable manner."

Section 504 of the Telecommunications Act of 1996, Pub. L. 104—104, 110 Stat. 136, 47 U.S.C. § 560 (1994 ed., Supp. III), provides in relevant part:

"(a) Subscriber request

"Upon request by a cable service subscriber, a cable operator shall, without charge, fully scramble or otherwise fully block the audio and video programming of each channel carrying such programming so that one not a subscriber does not receive it.

"(b) 'Scramble' defined

"As used in this section, the term 'scramble' means to rearrange the content of the signal of the programming so that the programming cannot be viewed or heard in an understandable manner."

UNITED STATES, PETITIONER v. *WINSTAR CORPORATION ET AL.*

On writ of certiorari to the united states court of appeals for the federal circuit [July 1, 1996]

Justice Souter announced the judgment of the Court and delivered an opinion, in which Justice Stevens and Justice Breyer join, and in which Justice O'Connor joins except as to Parts IV A and IV B.

The issue in this case is the enforceability of contracts between the Government and participants in a regulated industry, to accord them particular regulatory treatment in exchange for their assumption of liabilities that threatened to produce claims against the Government as insurer. Although Congress subsequently changed the relevant law, and thereby barred the Government from specifically honoring its agreements, we hold that the terms assigning the risk of regulatory change to the Government are enforceable, and that the Government is therefore liable in damages for breach.

We said in *Fahey* v. *Mallonee*, 332 U.S. 245, 250 (1947), that "[b]anking is one of the longest regulated and most closely supervised of public callings." That is particularly true of the savings and loan, or "thrift," industry, which has been described as "a federally conceived and assisted system to provide citizens with affordable housing funds." H. R. Rep. No. 101-54, pt. 1, p. 292 (1989). Because the contracts at issue in today's case arise out of the National Government's efforts over the last decade and a half to preserve that system from collapse, we begin with an overview of the history of federal savings and loan regulation.

The modern savings and loan industry traces its origins to the Great Depression, which brought default on 40 percent of the Nation's $20 billion in home mortgages and the failure of some 1700 of the nation's approximately 12,000 savings institutions. House Report, at 292-293. In the course of the debacle, Congress passed three statutes meant to stabilize the thrift industry. The Federal Home Loan Bank Act created the Federal Home Loan Bank Board (Bank Board), which was authorized to channel funds to thrifts for loans on houses and for preventing foreclosures on them. Ch. 522, 47 Stat. 725 (1932) (codified as amended at 12 U.S.C. §§ 1421-1449 (1988 ed.)); see also House Report, at 292. Next, the Home Owners' Loan Act of 1933 authorized the Bank Board to charter and regulate federal savings and loan associations. Ch. 64, 48 Stat. 128 (1933) (codified as amended at 12 U.S.C. §§ 1461-1468 (1988 ed.)). Finally, the National Housing Act created the Federal Savings and Loan Insurance Corporation (FSLIC), under the Bank Board's authority, with responsibility to insure thrift deposits and regulate all federally insured thrifts. Ch. 847, 48 Stat. 1246 (1934) (codified as amended at 12 U.S.C. §§ 1701-1750g (1988 ed.)).

The resulting regulatory regime worked reasonably well until the combination of high interest rates and inflation in the late 1970's and early 1980's brought about a second crisis in the thrift industry. Many thrifts found themselves holding long term, fixed rate mortgages created when interest rates were low; when market rates rose, those institutions had to raise the rates they paid to depositors in order to attract funds. See House Report, at 294-295. When the costs of short term deposits overtook the revenues from long term mortgages, some 435 thrifts failed between 1981 and 1983. House Report, at 296; see also General Accounting Office, Thrift Industry: Forbearance for Troubled Institutions 1982-1986, p. 9 (May 1987) (GAO, Forbearance for Troubled Institutions) (describing the origins of the crisis).

The first federal response to the rising tide of thrift failures was "extensive deregulation," including "a rapid expansion in the scope of permissible thrift investment powers and a similar expansion in a thrift's ability to compete for funds with other financial services providers." House Report, at 291; see also *id.*, at 295-297; Breeden, Thumbs on the Scale: The Role that Accounting Practices Played in the Savings and Loan Crisis, 59 Fordham L. Rev. S71, S72-S74 (1991) (describing legislation permitting nonresidential

real estate lending by thrifts and deregulating interest rates paid to thrift depositors). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN1[n.1] Along with this deregulation came moves to weaken the requirement that thrifts maintain adequate capital reserves as a cushion against losses, see 12 CFR § 563.13 (1981), a requirement that one commentator described as "the most powerful source of discipline for financial institutions." Breeden, *supra*, at S75. The result was a drop in capital reserves required by the Bank Board from five to four percent of assets in November 1980, see 45 Fed. Reg. 76111, and to three percent in January of 1982, see 47 Fed. Reg. 3543; at the same time, the Board developed new "regulatory accounting principles" (RAP) that in many instances replaced generally accepted accounting principles (GAAP) for purposes of determining compliance with its capital requirements. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN2[n.2] According to the House Banking Committee, "[t]he use of various accounting gimmicks and reduced capital standards masked the worsening financial condition of the industry, and the FSLIC, and enabled many weak institutions to continue operating with an increasingly inadequate cushion to absorb future losses." House Report, at 298. The reductions in required capital reserves, moreover, allowed thrifts to grow explosively without increasing their capital base, at the same time deregulation let them expand into new (and often riskier) fields of investment. See Note, Causes of the Savings and Loan Debacle, 59 Fordham L. Rev. S301, S311 (1991); Breeden, *supra*, at S74-S75.

While the regulators tried to mitigate the squeeze on the thrift industry generally through deregulation, the multitude of already failed savings and loans confronted FSLIC with deposit insurance liabilities that threatened to exhaust its insurance fund. See *Olympic Federal Savings and Loan Assn.* v. *Director, Office of Thrift Supervision*, 732 F. Supp. 1183, 1185 (DC 1990). According to the General Accounting Office, FSLIC's total reserves declined from $6.46 billion in 1980 to $4.55 billion in 1985, GAO, Forbearance for Troubled Institutions 12, when the Bank Board estimated that it would take $15.8 billion to close all institutions deemed insolvent under generally accepted accounting principles. General Accounting Office, Troubled Financial Institutions: Solutions to the Thrift Industry Problem 108 (Feb. 1989) (GAO, Solutions to the Thrift Industry Problem). By 1988, the year of the

last transaction involved in this case, FSLIC was itself insolvent by over $50 billion. House Report, at 304. And by early 1989, the GAO estimated that $85 billion would be needed to cover FSLIC's responsibilities and put it back on the road to fiscal health. GAO, Solutions to the Thrift Industry Problem 43. In the end, we now know, the cost was much more even than that. See, *e.g.*, Horowitz, The Continuing Thrift Bailout, Investor's Business Daily, Feb. 1, 1996, p. A1 (reporting an estimated $140 billion total public cost of the S&L crisis through 1995).

Realizing that FSLIC lacked the funds to liquidate all of the failing thrifts, the Bank Board chose to avoid the insurance liability by encouraging healthy thrifts and outside investors to take over ailing institutions in a series of "supervisory mergers." See GAO, Solutions to the Thrift Industry Problem 52; L. White, The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation 157 (1991) (White). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN3[n.3] Such transactions, in which the acquiring parties assumed the obligations of thrifts with liabilities that far outstripped their assets, were not intrinsically attractive to healthy institutions; nor did FSLIC have sufficient cash to promote such acquisitions through direct subsidies alone, although cash contributions from FSLIC were often part of a transaction. See M. Lowy, High Rollers: Inside the Savings and Loan Debacle 37 (1991) (Lowy). Instead, the principal inducement for these supervisory mergers was an understanding that the acquisitions would be subject to a particular accounting treatment that would help the acquiring institutions meet their reserve capital requirements imposed by federal regulations. See Investigation of Lincoln Savings & Loan Assn.: Hearing Before the House Committee on Banking, Finance, and Urban Affairs, 101st Cong., 1st Sess., pt. 5, p. 447 (1989) (testimony of M. Danny Wall, Director, Office of Thrift Supervision) (noting that acquirers of failing thrifts were allowed to use certain accounting methods "in lieu of [direct] federal financial assistance").

Under Generally Accepted Accounting Principles (GAAP) there are circumstances in which a business combination may be dealt with by the "purchase method" of accounting. See generally R. Kay & D. Searfoss, Handbook of Accounting and Auditing 23-21 to 23-40 (2d ed. 1989) (describing the purchase method); Accounting Principles Board Opinion No. 16 (1970) (establishing rules as to what method must be applied to

particular transactions). The critical aspect of that method for our purposes is that it permits the acquiring entity to designate the excess of the purchase price over the fair value of all identifiable assets acquired as an intangible asset called "goodwill." *Id.*, ¶11, p. 284; Kay & Searfoss, *supra*, at 23-38. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN4[n.4] In the ordinary case, the recognition of goodwill as an asset makes sense: a rational purchaser in a free market, after all, would not pay a price for a business in excess of the value of that business's assets unless there actually were some intangible "going concern" value that made up the difference. See Lowy 39. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN5[n.5] For that reason, the purchase method is frequently used to account for acquisitions, see A. Phillips, J. Butler, G. Thompson, & R. Whitman, Basic Accounting for Lawyers 121 (4th ed. 1988), and GAAP expressly contemplated its application to at least some transactions involving savings and loans. See Financial Accounting Standards Board Interpretation No. 9 (1976). Goodwill recognized under the purchase method as the result of an FSLIC sponsored supervisory merger was generally referred to as "supervisory goodwill."

Recognition of goodwill under the purchase method was essential to supervisory merger transactions of the type at issue in this case. Because FSLIC had insufficient funds to make up the difference between a failed thrift's liabilities and assets, the Bank Board had to offer a "cash substitute" to induce a healthy thrift to assume a failed thrift's obligations. Former Bank Board Chairman Richard Pratt put it this way in testifying before Congress:

"The Bank Board . . . . did not have sufficient resources to close all insolvent institutions, [but] at the same time, it had to consolidate the industry, move weaker institutions into stronger hands, and do everything possible to minimize losses during the transition period. Goodwill was an indispensable tool in performing this task." Savings and Loan Policies in the Late 1970's and 1980's: Hearings Before the House Committee on Banking, Finance, and Urban Affairs, 101st Cong., 2d Sess., No. 101-176, p. 227 (1990). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN6[n.6]

Supervisory goodwill was attractive to healthy thrifts for at least two reasons. First, thrift regulators let the acquiring institutions count supervisory

goodwill toward their reserve requirements under 12 CFR § 563.13 (1981). This treatment was, of course, critical to make the transaction possible in the first place, because in most cases the institution resulting from the transaction would immediately have been insolvent under federal standards if goodwill had not counted toward regulatory net worth. From the acquiring thrift's perspective, however, the treatment of supervisory goodwill as regulatory capital was attractive because it inflated the institution's reserves, thereby allowing the thrift to leverage more loans (and, it hoped, make more profits). See White 84; cf. Breeden, 59 Fordham L. Rev., at S75-S76 (explaining how loosening reserve requirements permits asset expansion).

A second and more complicated incentive arose from the decision by regulators to let acquiring institutions amortize the goodwill asset over long periods, up to the forty year maximum permitted by GAAP, see Accounting Principles Board Opinion No. 17, ¶29, p. 340 (1970). Amortization recognizes that intangible assets such as goodwill are useful for just so long; accordingly, a business must "write down" the value of the asset each year to reflect its waning worth. See Kay & Searfoss, *supra*, at 15-36 to 15-37; Accounting Principles Board Opinion No. 17, *supra*, ¶27, at 339-340. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN7[n.7] The amount of the write down is reflected on the business's income statement each year as an operating expense. See generally E. Faris, Accounting and Law in a Nutshell §12.2(q) (1984) (describing amortization of goodwill). At the same time that it amortizes its goodwill asset, however, an acquiring thrift must also account for changes in the value of its loans, which are its principal assets. The loans acquired as assets of the failed thrift in a supervisory merger were generally worth less than their face value, typically because they were issued at interest rates below the market rate at the time of the acquisition. See Black, Ending Our Forebearers' Forbearances: FIRREA and Supervisory Goodwill, 2 Stan. L. & Policy Rev. 102, 104-105 (1990). This differential or "discount," J. Rosenberg, Dictionary of Banking and Financial Services 233 (2d ed. 1985), appears on the balance sheet as a "contra asset" account, or a deduction from the loan's face value to reflect market valuation of the asset, R. Estes, Dictionary of Accounting 29 (1981). Because loans are ultimately repaid at face value, the magnitude of the discount declines over time as redemption approaches; this process, technically called

"accretion of discount," is reflected on a thrift's income statement as a series of capital gains. See Rosenberg, *supra*, at 9; Estes, *supra*, at 39-40.

The advantage in all this to an acquiring thrift depends upon the fact that accretion of discount is the mirror image of amortization of goodwill. In the typical case, a failed thrift's primary assets were long term mortgage loans that earned low rates of interest and therefore had declined in value to the point that the thrift's assets no longer exceeded its liabilities to depositors. In such a case, the disparity between assets and liabilities from which the accounting goodwill was derived was virtually equal to the value of the discount from face value of the thrift's outstanding loans. See Black, 2 Stan. L. & Policy Rev., at 104-105. Thrift regulators, however, typically agreed to supervisory merger terms that allowed acquiring thrifts to accrete the discount over the average life of the loans (approximately seven years), see *id.*, at 105, while permitting amortization of the goodwill asset over a much longer period. Given that goodwill and discount were substantially equal in overall values, the more rapid accrual of capital gain from accretion resulted in a net paper profit over the initial years following the acquisition. See *ibid.*; Lowy 39-40. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN8[n.8] The difference between amortization and accretion schedules thus allowed acquiring thrifts to seem more profitable than they in fact were.

Some transactions included yet a further inducement, described as a "capital credit." Such credits arose when FSLIC itself contributed cash to further a supervisory merger and permitted the acquiring institution to count the FSLIC contribution as a permanent credit to regulatory capital. By failing to require the thrift to subtract this FSLIC contribution from the amount of supervisory goodwill generated by the merger, regulators effectively permitted double counting of the cash as both a tangible and an intangible asset. See, *e.g.*, *Transohio Savings Bank* v. *Director, Office of Thrift Supervision*, 967 F. 2d 598, 604 (CADC 1992). Capital credits thus inflated the acquiring thrift's regulatory capital and permitted leveraging of more and more loans.

As we describe in more detail below, the accounting treatment to be accorded supervisory goodwill and capital credits was the subject of express arrangements between the regulators and the acquiring institutions. While

the extent to which these arrangements constituted a departure from prior norms is less clear, an acquiring institution would reasonably have wanted to bargain for such treatment. Although GAAP demonstrably permitted the use of the purchase method in acquiring a thrift suffering no distress, the relevant thrift regulations did not explicitly state that intangible goodwill assets created by that method could be counted toward regulatory capital. See 12 CFR § 563.13(a)(3) (1981) (permitting thrifts to count as reserves any "items listed in the definition of net worth"); 12 CFR § 561.13 (1981) (defining "net worth" as "the sum of all reserve accounts . . . , retained earnings, permanent stock, mutual capital certificates . . . , and any other non withdrawable accounts of an insured institution"). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN9[n.9] Indeed, the rationale for recognizing goodwill stands on its head in a supervisory merger: ordinarily, goodwill is recognized as valuable because a rational purchaser would not pay more than assets are worth; here, however, the purchase is rational only because of the accounting treatment for the shortfall. See Black, *supra*, at 104 ("GAAP's treatment of goodwill . . . assumes that buyers do not overpay when they purchase an S&L"). In the end, of course, such reasoning circumvented the whole purpose of the reserve requirements, which was to protect depositors and the deposit insurance fund. As some in Congress later recognized, "[g]oodwill is not cash. It is a concept, and a shadowy one at that. When the Federal Government liquidates a failed thrift, goodwill is simply no good. It is valueless. That means, quite simply, that the taxpayer picks up the tab for the shortfall." 135 Cong. Rec. 11795 (1989) (Rep. Barnard); see also White 84 (acknowledging that in some instances supervisory goodwill "involved the creation of an asset that did not have real value as protection for the FSLIC"). To those with the basic foresight to appreciate all this, then, it was not obvious that regulators would accept purchase accounting in determining compliance with regulatory criteria, and it was clearly prudent to get agreement on the matter.

The advantageous treatment of amortization schedules and capital credits in supervisory mergers amounted to more clear cut departures from GAAP and, hence, subjects worthy of agreement by those banking on such treatment. In 1983, the Financial Accounting Standards Board (the font of GAAP) promulgated Statement of Financial Accounting Standards No. 72,

which applied specifically to the acquisition of a savings and loan association. SFAS 72 provided that "[i]f, and to the extent that, the fair value of liabilities assumed exceeds the fair value of identifiable assets acquired in the acquisition of a banking or thrift institution, the unidentifiable intangible asset recognized generally shall be amortized to expense by the interest method over a period no longer than the discount on the long term interest bearing assets acquired is to be recognized as interest income." Accounting Standards, Original Pronouncements (July 1973-June 1, 1989), p. 725. In other words, SFAS 72 eliminated any doubt that the differential amortization periods on which acquiring thrifts relied to produce paper profits in supervisory mergers were inconsistent with GAAP. SFAS 72 also barred double counting of capital credits by requiring that financial assistance from regulatory authorities must be deducted from the cost of the acquisition before the amount of goodwill is determined. SFAS 72, ¶9. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN10[n.10] Thrift acquirers relying on such credits, then, had every reason for concern as to the continued availability of the RAP in effect at the time of these transactions.

Although the results of the forbearance policy, including the departures from GAAP, appear to have been mixed, see GAO, Forbearance for Troubled Institutions 4, it is relatively clear that the overall regulatory response of the early and mid 1980's was unsuccessful in resolving the crisis in the thrift industry. See, *e.g.*, *Transohio Savings Bank*, 967 F. 2d, at 602 (concluding that regulatory measures "actually aggravat[ed] the decline"). As a result, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183, with the objects of preventing the collapse of the industry, attacking the root causes of the crisis, and restoring public confidence.

FIRREA made enormous changes in the structure of federal thrift regulation by (1) abolishing FSLIC and transferring its functions to other agencies; (2) creating a new thrift deposit insurance fund under the Federal Deposit Insurance Corporation (FDIC); (3) replacing the Bank Board with the Office of Thrift Supervision (OTS), a Treasury Department office with responsibility for the regulation of all federally insured savings associations; and (4) establishing the Resolution Trust Corporation (RTC) to liquidate or

otherwise dispose of certain closed thrifts and their assets. See note following 12 U.S.C. § 1437 §§1441a, 1821. More importantly for the present case, FIRREA also obligated OTS to "prescribe and maintain uniformly applicable capital standards for savings associations" in accord with strict statutory requirements. 12 U.S.C. § 1464(t)(1)(A). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN11[n.11] In particular, the statute required thrifts to "maintain core capital in an amount not less than 3 percent of the savings association's total assets," 12 U.S.C. § 1464(t)(2)(A), and defined "core capital" to exclude "unidentifiable intangible assets," 12 U.S.C. § 1464(t)(9)(A), such as goodwill. Although the reform provided a "transition rule" permitting thrifts to count "qualifying supervisory goodwill" toward half the core capital requirement, this allowance was phased out by 1995. 12 U.S.C. § 1464(t)(3)(A). According to the House Report, these tougher capital requirements reflected a congressional judgment that "[t]o a considerable extent, the size of the thrift crisis resulted from the utilization of capital gimmicks that masked the inadequate capitalization of thrifts." House Report, at 310.

The impact of FIRREA's new capital requirements upon institutions that had acquired failed thrifts in exchange for supervisory goodwill was swift and severe. OTS promptly issued regulations implementing the new capital standards along with a bulletin noting that FIRREA "eliminates [capital and accounting] forbearances" previously granted to certain thrifts. Office of Thrift Supervision, Capital Adequacy: Guidance on the Status of Capital and Accounting Forbearances and Capital Instruments held by a Deposit Insurance Fund, Thrift Bulletin No. 38-2, Jan. 9, 1990. OTS accordingly directed that "[a]ll savings associations presently operating with these forbearances . . . should eliminate them in determining whether or not they comply with the new minimum regulatory capital standards." *Ibid*. Despite the statute's limited exception intended to moderate transitional pains, many institutions immediately fell out of compliance with regulatory capital requirements, making them subject to seizure by thrift regulators. See Black, 2 Stan. L. & Policy Rev., at 107 ("FIRREA's new capital mandates have caused over 500 S&Ls . . . to report that they have failed one or more of the three capital requirements").

ANNEXURE 2

This case is about the impact of FIRREA's tightened capital requirements on three thrift institutions created by way of supervisory mergers. Respondents Glendale Federal Bank, FSB, *Winstar* Corporation, and The Statesman Group, Inc. acquired failed thrifts in 1981, 1984, and 1988, respectively. After the passage of FIRREA, federal regulators seized and liquidated the *Winstar* and Statesman thrifts for failure to meet the new capital requirements. Although the Glendale thrift also fell out of regulatory capital compliance as a result of the new rules, it managed to avoid seizure through a massive private recapitalization. Believing that the Bank Board and FSLIC had promised them that the supervisory goodwill created in their merger transactions could be counted toward regulatory capital requirements, respondents each filed suit against the United States in the Court of Federal Claims, seeking monetary damages on both contractual and constitutional theories. That court granted respondents' motions for partial summary judgment on contract liability, finding in each case that the Government had breached contractual obligations to permit respondents to count supervisory goodwill and capital credits toward their regulatory capital requirements. See *Winstar Corp.* v. *United States*, 21 Cl. Ct. 112 (1990) *(Winstar I)* (finding an implied in fact contract but requesting further briefing on contract issues); 25 Cl. Ct. 541 (1992) *(Winstar II)* (finding contract breached and entering summary judgment on liability); *Statesman Savings Holding Corp.* v. *United States*, 26 Cl. Ct. 904 (1992) (granting summary judgment on liability to Statesman and Glendale). In so holding, the Court of Federal Claims rejected two central defenses asserted by the Government: that the Government could not be held to a promise to refrain from exercising its regulatory authority in the future unless that promise was unmistakably clear in the contract, *Winstar I*, 21 Cl. Ct., at 116; *Winstar II*, 25 Cl. Ct., at 544-549; *Statesman*, 26 Cl. Ct., at 919-920, and that the Government's alteration of the capital reserve requirements in FIRREA was a sovereign act that could not trigger contractual liability, *Winstar II*, 25 Cl. Ct., at 550-553; *Statesman*, 26 Cl. Ct., at 915-916. The Court of Federal Claims consolidated the three cases and certified its decisions for interlocutory appeal.

A divided panel of the Federal Circuit reversed, holding that the parties did not allocate to the Government, in an unmistakably clear manner, the

risk of a subsequent change in the regulatory capital requirements. *Winstar Corp.* v. *United States*, 994 F. 2d 797, 811-813 (1993). The full court, however, vacated this decision and agreed to rehear the case en banc. After rebriefing and reargument, the en banc court reversed the panel decision and affirmed the Court of Federal Claims' rulings on liability. *Winstar Corp.* v. *United States*, 64 F. 3d 1531 (CA Fed. 1995) (en banc). The Federal Circuit found that FSLIC had made express contracts with respondents, including a promise that supervisory goodwill and capital credits could be counted toward satisfaction of the regulatory capital requirements. *Id.*, at 1540, 1542-1543. The court rejected the Government's unmistakability argument, agreeing with the Court of Federal Claims that that doctrine had no application in a suit for money damages. *Id.*, at 1545-1548. Finally, the en banc majority found that FIRREA's new capital requirements "single[d] out supervisory goodwill for special treatment" and therefore could not be said to be a "public" and "general act" within the meaning of the sovereign acts doctrine. *Id.*, at 1548-1551. Judge Nies dissented, essentially repeating the arguments in her prior opinion for the panel majority, *id.*, at 1551-1552, and Judge Lourie also dissented on the ground that FIRREA was a public and general act, *id.*, at 1552-1553. We granted certiorari, 516 U.S. ___ (1996), and now affirm.

We took this case to consider the extent to which special rules, not generally applicable to private contracts, govern enforcement of the governmental contracts at issue here. We decide whether the Government may assert four special defenses to respondents' claims for breach: the canon of contract construction that surrenders of sovereign authority must appear in unmistakable terms, *Bowen* v. *Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52 (1986); the rule that an agent's authority to make such surrenders must be delegated in express terms, *Home Telephone & Telegraph Co.* v. *City of Los Angeles*, 211 U.S. 265 (1908); the doctrine that a government may not, in any event, contract to surrender certain reserved powers, *Stone* v. *Mississippi*, 101 U.S. 814 (1880); and, finally, the principle that a Government's sovereign acts do not give rise to a claim for breach of contract, *Horowitz* v. *United States*, 267 U.S. 458, 460 (1925).

The anterior question of whether there were contracts at all between the Government and respondents dealing with regulatory treatment of supervisory goodwill and capital credits, although briefed and argued by the parties in this Court, is not strictly before us. See *Yee* v. *Escondido*, 503 U.S. 519, 535 (1992) (noting that "we ordinarily do not consider questions outside those presented in the petition for certiorari"); Sup. Ct. Rule 14.1(a). And although we may review the Court of Federal Claims' grant of summary judgment *de novo*, *Eastman Kodak Co.* v. *Image Technical Services, Inc.*, 504 U.S. 451, 465, n. 10 (1992), we are in no better position than the Federal Circuit and the Court of Federal Claims to evaluate the documentary records of the transactions at issue. Our resolution of the legal issues raised by the petition for certiorari, however, does require some consideration of the nature of the underlying transactions.

The Federal Circuit found that "[t]he three plaintiff thrifts negotiated contracts with the bank regulatory agencies that allowed them to include supervisory goodwill (and capital credits) as assets for regulatory capital purposes and to amortize that supervisory goodwill over extended periods of time." 64 F. 3d, at 1545. Although each of these transactions was fundamentally similar, the relevant circumstances and documents vary somewhat from case to case.

In September 1981, Glendale was approached about a possible merger by the First Federal Savings and Loan Association of Broward County, which then had liabilities exceeding the fair value of its assets by over $734 million. At the time, Glendale's accountants estimated that FSLIC would have needed approximately $1.8 billion to liquidate Broward, only about $1 billion of which could be recouped through the sale of Broward's assets. Glendale, on the other hand, was both profitable and well capitalized, with a net worth of $277 million. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN12[n.12] After some preliminary negotiations with the regulators, Glendale submitted a merger proposal to the Bank Board, which had to approve all mergers involving savings and loan associations, see 12 U.S.C. § 1467a(e)(1)(A) and (B); 12 U.S.C. § 1817(j)(1); that proposal assumed the use of the purchase method of accounting to record supervisory goodwill arising from the transaction, with an amortization period of 40

years. The Bank Board ratified the merger, or "Supervisory Action Agreement" (SAA), on November 19, 1981.

The SAA itself said nothing about supervisory goodwill, but did contain the following integration clause:

"This Agreement . . . constitutes the entire agreement between the parties thereto and supersedes all prior agreements and understandings of the parties in connection herewith, excepting only the Agreement of Merger and any resolutions or letters issued contemporaneously herewith." App. 598-599.

The SAA thereby incorporated Bank Board Resolution No. 81-710, by which the Board had ratified the SAA. That Resolution referred to two additional documents: a letter to be furnished by Glendale's independent accountant identifying and supporting the use of any goodwill to be recorded on Glendale's books, as well as the resulting amortization periods; and "a stipulation that any goodwill arising from this transaction shall be determined and amortized in accordance with [Bank Board] Memorandum R 31b." *Id.*, at 607. Memorandum R 31b, finally, permitted Glendale to use the purchase method of accounting and to recognize goodwill as an asset subject to amortization. See *id.*, at 571-574.

The Government does not seriously contest this evidence that the parties understood that goodwill arising from these transactions would be treated as satisfying regulatory requirements; it insists, however, that these documents simply reflect statements of then current federal regulatory policy rather than contractual undertakings. Neither the Court of Federal Claims nor the Federal Circuit so read the record, however, and we agree with those courts that the Government's interpretation of the relevant documents is fundamentally implausible. The integration clause in Glendale's Supervisory Action Agreement (SAA) with FSLIC, which is similar in all relevant respects to the analogous provisions in the *Winstar* and Statesman contracts, provides that the SAA supersedes "all prior agreements and understandings . . . excepting only . . . any resolutions or letters issued contemporaneously" by the Board, *id.*, at 598-599; in other words, the SAA characterizes the Board's resolutions and letters not as statements of background rules, but as part of the "agreements and understandings" between the parties.

To the extent that the integration clause leaves any ambiguity, the other courts that construed the documents found that the realities of the transaction favored reading those documents as contractual commitments, not mere statements of policy, see Restatement (Second) of Contracts §202(1) (1981) ("Words and other conduct are interpreted in the light of all the circumstances, and if the principal purpose of the parties is ascertainable it is given great weight"), and we see no reason to disagree. As the Federal Circuit noted, "[i]t is not disputed that if supervisory goodwill had not been available for purposes of meeting regulatory capital requirements, the merged thrift would have been subject to regulatory noncompliance and penalties from the moment of its creation." 64 F. 3d, at 1542. Indeed, the assumption of Broward's liabilities would have rendered Glendale immediately insolvent by approximately $460 million, but for Glendale's right to count goodwill as regulatory capital. Although one can imagine cases in which the potential gain might induce a party to assume a substantial risk that the gain might be wiped out by a change in the law, it would have been irrational in this case for Glendale to stake its very existence upon continuation of current policies without seeking to embody those policies in some sort of contractual commitment. This conclusion is obvious from both the dollar amounts at stake and the regulators' proven propensity to make changes in the relevant requirements. See Brief for United States 26 ("[I]n light of the frequency with which federal capital requirements had changed in the past . . . , it would have been unreasonable for Glendale, FSLIC, or the Bank Board to expect or rely upon the fact that those requirements would remain unchanged"); see also *infra*, at 68-69. Under the circumstances, we have no doubt that the parties intended to settle regulatory treatment of these transactions as a condition of their agreement. See, *e.g.*, *The Binghamton Bridge*, 3 Wall. 51, 78 (1866) (refusing to construe charter in such a way that it would have been "madness" for private party to enter into it). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN13[n.13] We accordingly have no reason to question the Court of Appeals's conclusion that "the government had an express contractual obligation to permit Glendale to count the supervisory goodwill generated as a result of its merger with Broward as a capital asset for regulatory capital purposes." 64 F. 3d, at 1540.

In 1983, FSLIC solicited bids for the acquisition of Windom Federal Savings and Loan Association, a Minnesota based thrift in danger of failing.

At that time, the estimated cost to the Government of liquidating Windom was approximately $12 million. A group of private investors formed *Winstar* Corporation for the purpose of acquiring Windom and submitted a merger plan to FSLIC; it called for capital contributions of $2.8 million from *Winstar* and $5.6 million from FSLIC, as well as for recognition of supervisory goodwill to be amortized over a period of 35 years.

The Bank Board accepted the *Winstar* proposal and made an Assistance Agreement that incorporated, by an integration clause much like Glendale's, both the Board's resolution approving the merger and a forbearance letter issued on the date of the agreement. See App. 112. The forbearance letter provided that "[f]or purposes of reporting to the Board, the value of any intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by [*Winstar*] over a period not to exceed 35 years by the straight line method." *Id.*, at 123. Moreover, the Assistance Agreement itself contained an "Accounting Principles" section with the following provisions:

"Except as otherwise provided, any computations made for the purposes of this Agreement shall be governed by generally accepted accounting principles as applied on a going concern basis in the savings and loan industry, except that where such principles conflict with the terms of this Agreement, applicable regulations of the Bank Board or the [FSLIC], or any resolution or action of the Bank Board approving or adopted concurrently with this Agreement, then this Agreement, such regulations, or such resolution or action shall govern. . . . If there is a conflict between such regulations and the Bank Board's resolution or action, the Bank Board's resolution or action shall govern. For purposes of this section, the governing regulations and the accounting principles shall be those in effect on the Effective Date or as subsequently clarified, inter preted, or amended by the Bank Board or the Financial Accounting Standards Board ("FASB"), respectively, or any successor organization to either." *Id.*, at 108-109.

The Government emphasizes the last sentence of this clause, which provides that the relevant accounting principles may be "subsequently clarified . . . or amended," as barring any inference that the Government assumed the risk of regulatory change. Its argument, however, ignores the preceding

sentence providing that the Bank Board's resolutions and actions in connection with the merger must prevail over contrary regulations. If anything, then, the accounting principles clause tilts in favor of interpreting the contract to lock in the then current regulatory treatment of supervisory goodwill.

In any event, we do not doubt the soundness of the Federal Circuit's finding that the overall "documentation in the *Winstar* transaction establishes an express agreement allowing *Winstar* to proceed with the merger plan approved by the Bank Board, including the recording of supervisory goodwill as a capital asset for regulatory capital purposes to be amortized over 35 years." 64 F. 3d, at 1544. As in the Glendale transaction, the circumstances of the merger powerfully support this conclusion: The tangible net worth of the acquired institution was a negative $6.7 million, and the new *Winstar* thrift would have been out of compliance with regulatory capital standards from its very inception, without including goodwill in the relevant calculations. We thus accept the Court of Appeals's conclusion that "it was the intention of the parties to be bound by the accounting treatment for goodwill arising in the merger." *Ibid*.

Statesman, another nonthrift entity, approached FSLIC in 1987 about acquiring a subsidiary of First Federated Savings Bank, an insolvent Florida thrift. FSLIC responded that if Statesman wanted government assistance in the acquisition it would have to acquire all of First Federated as well as three shaky thrifts in Iowa. Statesman and FSLIC ultimately agreed on a complex plan for acquiring the four thrifts; the agreement involved application of the purchase method of accounting, a $21 million cash contribution from Statesman to be accompanied by $60 million from FSLIC, and (unlike the Glendale and *Winstar* plans) treatment of $26 million of FSLIC's contribution as a permanent capital credit to Statesman's regulatory capital.

The Assistance Agreement between Statesman and FSLIC included an "accounting principles" clause virtually identical to *Winstar*'s, see App. 402-403, as well as a specific provision for the capital credit:

"For the purposes of reports to the Bank Board . . . , $26 million of the contribution [made by FSLIC] shall be credited to [Statesman's] regulatory capital account and shall constitute regulatory capital (as defined in §561.13 of the Insurance Regulations)." *Id*., at 362a.

As with Glendale and *Winstar*, the Agreement had an integration clause incorporating contemporaneous resolutions and letters issued by the Board. *Id.*, at 407-408. The Board's Resolution explicitly acknowledged both the capital credits and the creation of supervisory goodwill to be amortized over 25 years, *id.*, at 458-459, and the Forbearance Letter likewise recognized the capital credit provided for in the Agreement. *Id.*, at 476. Finally, the parties executed a separate Regulatory Capital Maintenance Agreement stating that, "[i]n consideration of the mutual promises contained [t]herein," *id.*, at 418, Statesman would be obligated to maintain the regulatory capital of the acquired thrifts "at the level . . . required by §563.13(b) of the Insurance Regulations . . . or any successor regulation . . . ." The agreement further provided, however, that "[f]or purposes of this Agreement, any determination of [Statesman's] Required Regulatory Capital . . . shall include . . . amounts permitted by the FSLIC in the Assistance Agreement and in the forbearances issued in connection with the transactions discussed herein." *Id.*, at 418-419. Absent those forbearances, Statesman's thrift would have remained insolvent by almost $9 million despite the cash infusions provided by the parties to the transaction.

For the same reasons set out above with respect to the Glendale and *Winstar* transactions, we accept the Federal Circuit's conclusion that "the government was contractually obligated to recognize the capital credits and the supervisory goodwill generated by the merger as part of the Statesman's regulatory capital requirement and to permit such goodwill to be amortized on a straight line basis over 25 years." 64 F. 3d, at 1543. Indeed, the Government's position is even weaker in Statesman's case because the capital credits portion of the agreement contains an express commitment to include those credits in the calculation of regulatory capital. The Government asserts that the reference to §563.13 of FSLIC regulations, which at the time defined regulatory capital for thrift institutions, indicates that the Government's obligations could change along with the relevant regulations. But, just as in *Winstar*'s case, the Government would have us overlook the specific incorporation of the then current regulations as part of the agreement. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN14[n.14] The Government also cites a provision requiring Statesman to "comply in all material respects with all applicable statutes, regulations,

orders of, and restrictions imposed by the United States or . . . by any agency of [the United States]," App. 407, but this simply meant that Statesman was required to observe FIRREA's new capital requirements once they were promulgated. The clause was hardly necessary to oblige Statesman to obey the law, and nothing in it barred Statesman from asserting that passage of that law required the Government to take action itself or be in breach of its contract.

It is important to be clear about what these contracts did and did not require of the Government. Nothing in the documentation or the circumstances of these transactions purported to bar the Government from changing the way in which it regulated the thrift industry. Rather, what the Federal Circuit said of the Glendale transaction is true of the *Winstar* and Statesman deals as well: "the Bank Board and the FSLIC were contractually bound to recognize the supervisory goodwill and the amortization periods reflected" in the agreements between the parties. 64 F. 3d, at 1541-1542. We read this promise as the law of contracts has always treated promises to provide something beyond the promisor's absolute control, that is, as a promise to insure the promisee against loss arising from the promised condition's nonoccurrence. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN15[n.15] Holmes's example is famous: "[i]n the case of a binding promise that it shall rain to morrow, the immediate legal effect of what the promisor does is, that he takes the risk of the event, within certain defined limits, as between himself and the promisee." Holmes, The Common Law (1881), in 3 The Collected Works of Justice Holmes 268 (S. Novick ed. 1995). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN16[n.16] Contracts like this are especially appropriate in the world of regulated industries, where the risk that legal change will prevent the bargained for performance is always lurking in the shadows. The drafters of the Restatement attested to this when they explained that, "[w]ith the trend toward greater governmental regulation . . . parties are increasingly aware of such risks, and a party may undertake a duty that is not discharged by such supervening governmental actions . . . ." Restatement (Second) of Contracts §264, Comment *a*. "Such an agreement," according to the Restatement, "is usually interpreted as one to pay damages if performance is prevented rather than one to render a performance in violation of law." *Ibid*. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN17[n.17]

When the law as to capital requirements changed in the present instance, the Government was unable to perform its promise and, therefore, became liable for breach. We accept the Federal Circuit's conclusion that the Government breached these contracts when, pursuant to the new regulatory capital requirements imposed by FIRREA, 12 U.S.C. § 1464(t), the federal regulatory agencies limited the use of supervisory goodwill and capital credits in calculating respondents' net worth. 64 F. 3d, at 1545. In the case of *Winstar* and Statesman, the Government exacerbated its breach when it seized and liquidated respondents' thrifts for regulatory noncompliance. *Ibid.*

In evaluating the relevant documents and circumstances, we have, of course, followed the Federal Circuit in applying ordinary principles of contract construction and breach that would be applicable to any contract action between private parties. The Government's case, however, is that the Federal Circuit's decision to apply ordinary principles was error for a variety of reasons, each of which we consider, and reject, in the sections ahead.

The Government argues for reversal, first, on the principle that "contracts that limit the government's future exercises of regulatory authority are strongly disfavored; such contracts will be recognized only rarely, and then only when the limitation on future regulatory authority is expressed in unmistakable terms." Brief for United States 16. Hence, the Government says, the agreements between the Bank Board, FSLIC, and respondents should not be construed to waive Congress's authority to enact a subsequent bar to using supervisory goodwill and capital credits to meet regulatory capital requirements.

The argument mistakes the scope of the unmistakability doctrine. The thrifts do not claim that the Bank Board and FSLIC purported to bind Congress to ossify the law in conformity to the contracts; they seek no injunction against application of FIRREA's new capital requirements to them and no exemption from FIRREA's terms. They simply claim that the Government assumed the risk that subsequent changes in the law might prevent it from performing, and agreed to pay damages in the event that such failure to perform caused financial injury. The question, then, is not whether Congress could be constrained but whether the doctrine of unmistakability is applicable

to any contract claim against the Government for breach occasioned by a subsequent act of Congress. The answer to this question is no.

The unmistakability doctrine invoked by the Government was stated in *Bowen* v. *Public Agencies Opposed to Social Security Entrapment:* "`[S]overeign power . . . governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms.'" 477 U. S., at 52 (quoting *Merrion* v. *Jicarilla Apache Tribe*, 455 U.S. 130, 148 (1982)). This doctrine marks the point of intersection between two fundamental constitutional concepts, the one traceable to the theory of parliamentary sovereignty

made familiar by Blackstone, the other to the theory that legislative power may be limited, which became familiar to Americans through their experience under the colonial charters, see G. Wood, The Creation of the American Republic 1776-1787, pp. 268-271 (1969).

In his Commentaries, Blackstone stated the centuries old concept that one legislature may not bind the legislative authority of its successors:

"Acts of parliament derogatory from the power of subsequent parliaments bind not. . . . Because the legislature, being in truth the sovereign power, is always of equal, always of absolute authority: it acknowledges no superior upon earth, which the prior legislature must have been, if it's *[sic]* ordinances could bind the present parliament." 1 W. Blackstone, Commentaries on the Laws of England 90 (1765). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN18[n.18]

In England, of course, Parliament was historically supreme in the sense that no "higher law" limited the scope of legislative action or provided mechanisms for placing legally enforceable limits upon it in specific instances; the power of American legislative bodies, by contrast, is subject to the overriding dictates of the Constitution and the obligations that it authorizes. See Eule, Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity, 1987 Am. Bar Found. Research J. 379, 392-393 (observing that the English rationale for precluding a legislature from binding its successors does not apply in America). Hence, although we have recognized that "a general law . . . may be repealed, amended or disregarded by the

legislature which enacted it," and "is not binding upon any subsequent legislature," *Manigault* v. *Springs*, 199 U.S. 473, 487 (1905), http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN19[n.19] on this side of the Atlantic the principle has always lived in some tension with the constitutionally created potential for a legislature, under certain circumstances, to place effective limits on its successors, or to authorize executive action resulting in such a limitation.

The development of this latter, American doctrine in federal litigation began in cases applying limits on state sovereignty imposed by the National Constitution. Thus Chief Justice Marshall's exposition in *Fletcher* v. *Peck*, 6 Cranch 87 (1810), where the Court held that the Contract Clause, U. S. Const., Art. I, §10, cl. 1, barred the State of Georgia's effort to rescind land grants made by a prior state legislature. Marshall acknowledged "that one legislature is competent to repeal any act which a former legislature was competent to pass; and that one legislature cannot abridge the powers of a succeeding legislature." *Id.*, at 135. "The correctness of this principle, so far as respects general legislation," he said, "can never be controverted." *Ibid.* Marshall went on to qualify the principle, however, noting that "if an act be done under a law, a succeeding legislature cannot undo it. The past cannot be recalled by the most absolute power." *Ibid*. For Marshall, this was true for the two distinct reasons that the intrusion on vested rights by the Georgia legislature's act of repeal might well have gone beyond the limits of "the legislative power," and that Georgia's legislative sovereignty was limited by the Federal Constitution's bar against laws impairing the obligation of contracts. *Id.*, at 135-136.

The impetus for the modern unmistakability doctrine was thus Chief Justice Marshall's application of the Contract Clause to public contracts. Although that Clause made it possible for state legislatures to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments. Later decisions were accordingly less willing to recognize contractual restraints upon legislative freedom of action, and two distinct limitations developed to protect state regulatory powers. One came to be known as the "reserved powers" doctrine, which held that certain substantive powers of sovereignty could not be contracted away. See *West River Bridge*

Co. v. *Dix*, 6 How. 507 (1848) (holding that a State's contracts do not surrender its eminent domain power). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN20[n.20] The other, which surfaced somewhat earlier in *Providence Bank* v. *Billings*, 4 Pet. 514 (1830), and *Charles River Bridge* v. *Warren Bridge*, 11 Pet. 420 (1837), was a canon of construction disfavoring implied governmental obligations in public contracts. Under this rule that "[a]ll public grants are strictly construed," *The Delaware Railroad Tax*, 18 Wall. 206, 225 (1874), we have insisted that "[n]othing can be taken against the state by presumption or inference," *ibid.*, and that "neither the right of taxation, nor any other power of sovereignty, will be held . . . to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken." *Jefferson Branch Bank* v. *Skelly*, 1 Black 436, 446 (1862).

The posture of the Government in these early unmistakability cases is important. In each, a state or local government entity had made a contract granting a private party some concession (such as a tax exemption or a monopoly), and a subsequent governmental action had abrogated the contractual commitment. In each case, the private party was suing to invalidate the abrogating legislation under the Contract Clause. A requirement that the government's obligation unmistakably appear thus served the dual purposes of limiting contractual incursions on a State's sovereign powers and of avoiding difficult constitutional questions about the extent of State authority to limit the subsequent exercise of legislative power. Cf. *Edward J. DeBartolo Corp.* v. *Florida Gulf Coast Building & Constr. Trades Council*, 485 U.S. 568, 575 (1988) ("[W]here an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress"); *Ashwander* v. *TVA*, 297 U.S. 288, 348 (1936) (Brandeis, J., concurring) (same).

The same function of constitutional avoidance has marked the expansion of the unmistakability doctrine from its Contract Clause origins dealing with state grants and contracts to those of other governmental sovereigns, including the United States. See *Merrion* v. *Jicarilla Apache Tribe*, 455 U. S., at 148 (deriving the unmistakability principle from *St. Louis* v. *United Railways Co.*, 210 U.S. 266 (1908), a Contract Clause suit against a state government). http://supct.law.cornell.edu/supct/html/95-865.ZO.html -

FN21[n.21] Although the Contract Clause has no application to acts of the United States, *Pension Benefit Guaranty Corp.* v. *R. A. Gray & Co.*, 467 U.S. 717, 732, n. 9 (1984), it is clear that the National Government has some capacity to make agreements binding future Congresses by creating vested rights, see, *e.g.*, *Perry* v. *United States*, 294 U.S. 330 (1935); *Lynch* v. *United States*, 292 U.S. 571 (1934). The extent of that capacity, to be sure, remains somewhat obscure. Compare, *e.g.*, *United States Trust Co. of N.Y.* v. *New Jersey*, 431 U.S. 1, 26 (1977) (heightened Contract Clause scrutiny when States abrogate their own contractual obligations), with *Pension Benefit Guaranty Corp.*, *supra*, at 733 (contrasting less exacting due process standards governing federal economic legislation affecting private contracts). But the want of more developed law on limitations independent of the Contract Clause is in part the result of applying the unmistakability canon of construction to avoid this doctrinal thicket, as we have done in several cases involving alleged surrenders of sovereign prerogatives by the National Government and Indian tribes.

First, we applied the doctrine to protect a tribal sovereign in *Merrion* v. *Jicarilla Apache Tribe*, 455 U.S. 130 (1982), which held that long term oil and gas leases to private parties from an Indian tribe, providing for specific royalties to be paid to the tribe, did not limit the tribe's sovereign prerogative to tax the proceeds from the lessees' drilling activities. *Id.*, at 148. Because the lease made no reference to the tribe's taxing power, we held simply that a waiver of that power could not be "inferred . . . from silence," *ibid.*, since the taxing power of any government remains "unless it is has been specifically surrendered in terms which admit of no other reasonable interpretation." *Ibid.* (internal quotation marks and citation omitted).

In *Bowen* v. *Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986), this Court confronted a state claim that §103 of the Social Security Amendments Act of 1983, 97 Stat. 71, 42 U.S.C. § 418(g) (1982 ed., Supp. II), was unenforceable to the extent it was inconsistent with the terms of a prior agreement with the National Government. Under the law before 1983, a State could agree with the Secretary of Health and Human Services to cover the State's employees under the Social Security scheme subject to a right to withdraw them from coverage later. When the 1983 Act eliminated the right of withdrawal, the State of California and

related plaintiffs sought to enjoin application of the new law to them, or to obtain just compensation for loss of the withdrawal right (a remedy which the District Court interpreted as tantamount to the injunction, since it would mandate return of all otherwise required contributions, see 477 U. S., at 51). Although we were able to resolve the case by reading the terms of a state federal coverage agreement to reserve the Government's right to modify its terms by subsequent legislation, in the alternative we rested the decision on the more general principle that, absent an "unmistakable" provision to the contrary, "contractual arrangements, including those to which a sovereign itself is a party, `remain subject to subsequent legislation' by the sovereign." *Id.*, at 52 (quoting *Merrion*, *supra*, at 147). We thus rejected the proposal "to find that a `sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in' the contract," *Bowen*, *supra*, at 52 (quoting *Merrion*, *supra*, at 148), and held instead that unmistakability was needed for waiver, not reservation.

Most recently, in *United States* v. *Cherokee Nation of Oklahoma*, 480 U.S. 700 (1987), we refused to infer a waiver of federal sovereign power from silence. There, an Indian tribe with property rights in a river bed derived from a government treaty sued for just compensation for damage to its interests caused by the Government's navigational improvements to the Arkansas river. The claim for compensation presupposed, and was understood to presuppose, that the Government had conveyed to the tribe its easement to control navigation; absent that conveyance, the tribe's property included no right to be free from the Government's river bed improvements. *Id.*, at 704. We found, however, that the treaty said nothing about conveying the Government's navigational easement, see *id.*, at 706, which we saw as an aspect of sovereignty. This, we said, could be "`surrendered [only] in unmistakable terms,'" *id.*, at 707 (quoting *Bowen*, *supra*, at 52), if indeed it could be waived at all.

Merrion, *Bowen*, and *Cherokee Nation* thus announce no new rule distinct from the canon of construction adopted in *Providence Bank* and *Charles River Bridge*; their collective holding is that a contract with a sovereign government will not be read to include an unstated term exempting the other contracting party from the application of a subsequent sovereign act (including an act of Congress), nor will an ambiguous term of a grantor

contract be construed as a conveyance or surrender of sovereign power. The cases extending back into the 19th century thus stand for a rule that applies when the Government is subject either to a claim that its contract has surrendered a sovereign power http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN22[n.22] (*e.g.*, to tax or control navigation), or to a claim that cannot be recognized without creating an exemption from the exercise of such a power (*e.g.*, the equivalent of exemption from social security obligations). The application of the doctrine thus turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government.

Since the criterion looks to the effect of a contract's enforcement, the particular remedy sought is not dispositive and the doctrine is not rendered inapplicable by a request for damages, as distinct from specific performance. The respondents in *Cherokee Nation* sought nothing beyond damages, but the case still turned on the unmistakability doctrine because there could be no claim to harm unless the right to be free of the sovereign power to control navigation had been conveyed away by the Government. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN23[n.23] So, too, in *Bowen*: the sole relief sought was dollars and cents, but the award of damages as requested would have been the equivalent of exemption from the terms of the subsequent statute.

The application of the doctrine will therefore differ according to the different kinds of obligations the Government may assume and the consequences of enforcing them. At one end of the wide spectrum are claims for enforcement of contractual obligations that could not be recognized without effectively limiting sovereign authority, such as a claim for rebate under an agreement for a tax exemption. Granting a rebate, like enjoining enforcement, would simply block the exercise of the taxing power, cf. *Bowen*, 477 U. S., at 51, and the unmistakability doctrine would have to be satisfied. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN24[n.24] At the other end are contracts, say, to buy food for the army; no sovereign power is limited by the Government's promise to purchase and a claim for damages implies no such limitation. That is why no one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine. Between these extremes lies an

enormous variety of contracts including those under which performance will require exercise (or not) of a power peculiar to the Government. So long as such a contract is reasonably construed to include a risk shifting component that may be enforced without effectively barring the exercise of that power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it.

The Government argues that enforcement of the contracts in this case would implicate the unmistakability principle, with the consequence that *Merrion*, *Bowen*, and *Cherokee Nation* are good authorities for rejecting respondents' claims. The Government's position is mistaken, however, for the complementary reasons that the contracts have not been construed as binding the Government's exercise of authority to modify banking regulation or of any other sovereign power, and there has been no demonstration that awarding damages for breach would be tantamount to any such limitation.

As construed by each of the courts that considered these contracts before they reached us, the agreements do not purport to bind the Congress from enacting regulatory measures, and respondents do not ask the courts to infer from silence any such limit on sovereign power as would violate the holdings of *Merrion* and *Cherokee Nation*. The contracts have been read as solely risk shifting agreements and respondents seek nothing more than the benefit of promises by the Government to insure them against any losses arising from future regulatory change. They seek no injunction against application of the law to them, as the plaintiffs did in *Bowen* and *Merrion*, cf. *Reichelderfer* v. *Quinn*, 287 U.S. 315 (1932), and they acknowledge that the Bank Board and FSLIC could not bind Congress (and possibly could not even bind their future selves) not to change regulatory policy.

Nor do the damages respondents seek amount to exemption from the new law, in the manner of the compensation sought in *Bowen*, see *supra*, at 51. Once general jurisdiction to make an award against the Government is conceded, a requirement to pay money supposes no surrender of sovereign power by a sovereign with the power to contract. See, *e.g.*, *Amino Bros. Co.* v. *United States*, 178 Ct. Cl. 515, 525, 372 F. 2d 485, 491 ("The Government cannot make a binding contract that it will not exercise a sovereign power, but it can agree in a contract that if it does so, it will pay

the other contracting party the amount by which its costs are increased by the Government's sovereign act"), cert. denied, 389 U.S. 846 (1967). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN25[n.25] Even if the respondents were asking that the Government be required to make up any capital deficiency arising from the exclusion of goodwill and capital credits from the relevant calculations, such relief would hardly amount to an exemption from the capital requirements of FIRREA; after all, Glendale (the only respondent thrift still in operation) would still be required to maintain adequate tangible capital reserves under FIRREA, and the purpose of the statute, the protection of the insurance fund, would be served. Nor would such a damages award deprive the Government of money it would otherwise be entitled to receive (as a tax rebate would), since the capital requirements of FIRREA govern only the allocation of resources to a thrift and require no payments to the Government at all. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN26[n.26]

We recognize, of course, that while agreements to insure private parties against the costs of subsequent regulatory change do not directly impede the exercise of sovereign power, they may indirectly deter needed governmental regulation by raising its costs. But all regulations have their costs, and Congress itself expressed a willingness to bear the costs at issue here when it authorized FSLIC to "guarantee [acquiring thrifts] against loss" that might occur as a result of a supervisory merger. 12 U.S.C. § 1729(f)(2) (1988 ed.) (repealed 1989). Just as we have long recognized that the Constitution " `bar[s] Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole,' " *Dolan* v. *City of Tigard*, 512 U. S. ___, ___ (slip op., at 9) (quoting *Armstrong* v. *United States*, 364 U.S. 40, 49 (1960)), so we must reject the suggestion that the Government may simply shift costs of legislation onto its contractual partners who are adversely affected by the change in the law, when the Government has assumed the risk of such change.

The Government's position would not only thus represent a conceptual expansion of the unmistakability doctrine beyond its historical and practical warrant, but would place the doctrine at odds with the Government's own long run interest as a reliable contracting partner in the myriad workaday

transaction of its agencies. Consider the procurement contracts that can be affected by congressional or executive scale backs in federal regulatory or welfare activity; or contracts to substitute private service providers for the Government, which could be affected by a change in the official philosophy on privatization; or all the contracts to dispose of federal property, surplus or otherwise. If these contracts are made in reliance on the law of contract and without specific provision for default mechanisms, http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN27[n.27] should all the private contractors be denied a remedy in damages unless they satisfy the unmistakability doctrine? The answer is obviously no because neither constitutional avoidance nor any apparent need to protect the Government from the consequences of standard operations could conceivably justify applying the doctrine. Injecting the opportunity for unmistakability litigation into every common contract action would, however, produce the untoward result of compromising the Government's practical capacity to make contracts, which we have held to be "of the essence of sovereignty" itself. *United States* v. *Bekins*, 304 U.S. 27, 51-52 (1938). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN28[n.28] From a practical standpoint, it would make an inroad on this power, by expanding the Government's opportunities for contractual abrogation, with the certain result of undermining the Government's credibility at the bargaining table and increasing the cost of its engagements. As Justice Brandeis recognized, "[p]unctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors." *Lynch* v. *United States*, 292 U. S., at 580. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN29[n.29]

The dissent's only answer to our concern is to recognize that "Congress may not simply abrogate a statutory provision obligating performance without breaching the contract and rendering itself liable for damages." *Post*, at 6 (citing *Lynch*, *supra*, at 580). Yet the only grounds that statement suggests for distinguishing *Lynch* from the present case is that there the contractual obligation was embodied in a statute. Putting aside the question why this distinction should make any difference, we note that the dissent seemingly does not deny that its view would apply the unmistakability doctrine to the vast majority of governmental contracts, which would be subject to abrogation

arguments based on subsequent sovereign acts. Indeed, the dissent goes so far as to argue that our conclusion that damages are available for breach even where the parties did not specify a remedy in the contract depends upon "reading of additional terms into the contract." *Post*, at 7. That, of course, is not the law; damages are always the default remedy for breach of contract. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN30[n.30] And we suspect that most government contractors would be quite surprised by the dissent's conclusion that, where they have failed to require an express provision that damages will be available for breach, that remedy must be "implied in law" and therefore unavailable under the Tucker Act, *post*, at 7-8.

Nor can the dissenting view be confined to those contracts that are "regulatory" in nature. Such a distinction would raise enormous analytical difficulties; one could ask in this case whether the Government as contractor was regulating or insuring. The dissent understandably does not advocate such a distinction, but its failure to advance any limiting principle at all would effectively compromise the Government's capacity as a reliable, straightforward contractor whenever the subject matter of a contract might be subject to subsequent regulation, which is most if not all of the time. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN31[n.31] Since the facts of the present case demonstrate that Government may wish to further its regulatory goals through contract, we are unwilling to adopt any rule of construction that would weaken the Government's capacity to do business by converting every contract it makes into an arena for unmistakability litigation.

In any event, we think the dissent goes fundamentally wrong when it concludes that "the issue of remedy for . . . breach" can arise only "[i]f the sovereign did surrender its power unequivocally." *Post*, at 6. This view ignores the other, less remarkable possibility actually found by both courts that construed these contracts: that the Government agreed to do something that did not implicate its sovereign powers at all, that is, to indemnify its contracting partners against financial losses arising from regulatory change. We accordingly hold that the Federal Circuit correctly refused to apply the unmistakability doctrine here. See 64 F. 3d, at 1548. There being no need for an unmistakably clear "second promise" not to change the capital

requirements, it is sufficient that the Government undertook an obligation that it subsequently found itself unable to perform. This conclusion does not, of course, foreclose the assertion of a defense that the contracts were *ultra vires* or that the Government's obligation should be discharged under the common law doctrine of impossibility, see *infra*, at 49-52, 52-72, but nothing in the nature of the contracts themselves raises a bar to respondents' claims for breach. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN32[n.32]

The answer to the Government's unmistakability argument also meets its two related contentions on the score of *ultra vires*: that the Bank Board and FSLIC had no authority to bargain away Congress's power to change the law in the future, and that we should in any event find no such authority conferred without an express delegation to that effect. The first of these positions rests on the reserved powers doctrine, developed in the course of litigating claims that States had violated the Contract Clause. See *supra*, at 34. It holds that a state government may not contract away "an essential attribute of its sovereignty," *United States Trust*, 431 U. S., at 23, with the classic example of its limitation on the scope of the Contract Clause being found in *Stone* v. *Mississippi*, 101 U.S. 814 (1880). There a corporation bargained for and received a state legislative charter to conduct lotteries, only to have them outlawed by statute a year later. This Court rejected the argument that the charter immunized the corporation from the operation of the statute, holding that "the legislature cannot bargain away the police power of a State." *Id.*, at 817. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN33[n.33]

The Government says that "[t]he logic of the doctrine . . . applies equally to contracts alleged to have been made by the federal government." Brief for United States 38. This may be so but is also beside the point, for the reason that the Government's ability to set capital requirements is not limited by the Bank Board's and FSLIC's promises to make good any losses arising from subsequent regulatory changes. See *supra*, at 41-43. The answer to the Government's contention that the State cannot barter away certain elements of its sovereign power is that a contract to adjust the risk of

subsequent legislative change does not strip the Government of its legislative sovereignty. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN34[n.34]

The same response answers the Government's demand for express delegation of any purported authority to fetter the exercise of sovereign power. It is true, of course, that in *Home Telephone & Telegraph Co.* v. *City of Los Angeles*, 211 U. S., at 273, we said that "[t]he surrender, by contract, of a power of government, though in certain well defined cases it may be made by legislative authority, is a very grave act, and the surrender itself, as well as the authority to make it, must be closely scrutinized." Hence, where "a contract has the effect of extinguishing *pro tanto* an undoubted power of government," we have insisted that "both [the contract's] existence and the authority to make it must clearly and unmistakably appear, and all doubts must be resolved in favor of the continuance of the power." *Ibid.* But *Home Telephone & Telegraph* simply has no application to the present case, because there were no contracts to surrender the Government's sovereign power to regulate. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN35[n.35]

There is no question, conversely, that the Bank Board and FSLIC had ample statutory authority to do what the Court of Federal Claims and the Federal Circuit found they did do, that is, promise to permit respondents to count supervisory goodwill and capital credits toward regulatory capital and to pay respondents' damages if that performance became impossible. The organic statute creating FSLIC as an arm of the Bank Board, 12 U.S.C. § 1725(c) (1988 ed.) (repealed 1989), generally empowered it "[t]o make contracts," http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN36[n.36] and §1729(f)(2), enacted in 1978, delegated more specific powers in the context of supervisory mergers:

"Whenever an insured institution is in default or, in the judgment of the Corporation, is in danger of default, the Corporation may, in order to facilitate a merger or consolidation of such insured institution with another insured institution . . . guarantee such other insured institution against loss by reason of its merging or consolidating with or assuming the liabilities and purchasing the assets of such insured institution in or in danger of default." 12 U.S.C. § 1729(f)(2) (1976 ed. Supp. V) (repealed 1989).

Nor is there any reason to suppose that the breadth of this authority was not meant to extend to contracts governing treatment of regulatory capital. Congress specifically recognized FSLIC's authority to permit thrifts to count goodwill toward capital requirements when it modified the National Housing Act in 1987:

"No provision of this section shall affect the authority of the [FSLIC] to authorize insured institutions to utilize subordinated debt and goodwill in meeting reserve and other regulatory requirements." 12 U.S.C. § 1730h(d) (1988 ed.) (repealed 1989).

See also S. Rep. No. 100-19, p. 55 (1987) ("It is expected that the [Bank Board] will retain its own authority to determine . . . the components and level of capital to be required of FSLIC insured institutions"); *NLRB* v. *Bell Aerospace Co.*, 416 U.S. 267, 275 (1974) ("[S]ubsequent legislation declaring the intent of an earlier statute is entitled to significant weight"). There is no serious question that FSLIC (and the Bank Board acting through it) was authorized to make the contracts in issue.

The Government's final line of defense is the sovereign acts doctrine, to the effect that " `[w]hatever acts the government may do, be they legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons.' " *Horowitz* v. *United States*, 267 U. S., at 461 (quoting *Jones* v. *United States*, 1 Ct. Cl. 383, 384 (1865)). Because FIRREA's alteration of the regulatory capital requirements was a "public and general act," the Government says, that act could not amount to a breach of the Government's contract with respondents.

The Government's position cannot prevail, however, for two independent reasons. The facts of this case do not warrant application of the doctrine, and even if that were otherwise the doctrine would not suffice to excuse liability under this governmental contract allocating risks of regulatory change in a highly regulated industry.

In *Horowitz*, the plaintiff sued to recover damages for breach of a contract to purchase silk from the Ordnance Department. The agreement included a promise by the Department to ship the silk within a certain time, although

the manner of shipment does not appear to have been a subject of the contract. Shipment was delayed because the United States Railroad Administration placed an embargo on shipments of silk by freight, and by the time the silk reached Horowitz the price had fallen, rendering the deal unprofitable. This Court barred any damages award for the delay, noting that "[i]t has long been held by the Court of Claims that the United States when sued as a contractor cannot be held liable for an obstruction to the performance of the particular contract resulting from its public and general acts as a sovereign." 267 U. S., at 461. This statement was not, however, meant to be read as broadly as the Government urges, and the key to its proper scope is found in that portion of our opinion explaining that the essential point was to put the Government in the same position that it would have enjoyed as a private contractor:

" `The two characters which the government possesses as a contractor and as a sovereign cannot be thus fused; nor can the United States while sued in the one character be made liable in damages for their acts done in the other. Whatever acts the government may do, be they legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons. . . . In this court the United States appear simply as contractors; and they are to be held liable only within the same limits that any other defendant would be in any other court. Though their sovereign acts performed for the general good may work injury to some private contractors, such parties gain nothing by having the United States as their defendants.' " *Ibid.* (quoting *Jones* v. *United States*, *supra*, at 384).

The early Court of Claims cases upon which *Horowitz* relied anticipated the Court's emphasis on the Government's dual and distinguishable capacities and on the need to treat the government as contractor the same as a private party. In *Deming* v. *United States*, 1 Ct. Cl. 190 (1865), the Court of Claims rejected a suit by a supplier of army rations whose costs increased as a result of Congress's passage of the Legal Tender Act. The *Deming* court thought it "grave error" to suppose that "general enactments of Congress are to be construed as evasions of [the plaintiff's] particular contract." *Id.*, at 191. "The United States as a contractor are not responsible for the United States as a lawgiver," the court said. "In this court the United

States can be held to no greater liability than other contractors in other courts." *Ibid*. Similarly, *Jones* v. *United States*, *supra* refused a suit by surveyors employed by the Commissioner of Indian Affairs, whose performance had been hindered by the United States's withdrawal of troops from Indian country. "The United States as a contractor," the Claims Court concluded, "cannot be held liable directly or indirectly for the public acts of the United States as a sovereign." *Id*., at 385.

The Government argues that "[t]he relevant question [under these cases] is whether the impact [of governmental action] . . . is caused by a law enacted to govern regulatory policy and to advance the general welfare." Brief for United States 45. This understanding assumes that the dual characters of Government as contractor and legislator are never "fused" (within the meaning of *Horowitz*) so long as the object of the statute is regulatory and meant to accomplish some public good. That is, on the Government's reading, a regulatory object is proof against treating the legislature as having acted to avoid the Government's contractual obligations, in which event the sovereign acts defense would not be applicable. But the Government's position is open to serious objection.

As an initial matter, we have already expressed our doubt that a workable line can be drawn between the Government's "regulatory" and "nonregulatory" capacities. In the present case, the Government chose to regulate capital reserves to protect FSLIC's insurance fund, much as any insurer might impose restrictions on an insured as a condition of the policy. The regulation thus protected the Government in its capacity analogous to a private insurer, the same capacity in which it entered into supervisory merger agreements to convert some of its financial insurance obligations into responsibilities of private entrepreneurs. In this respect, the supervisory mergers bear some analogy to private contracts for reinsurance. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN37[n.37] On the other hand, there is no question that thrift regulation is, in fact, regulation, and that both the supervisory mergers of the 1980's and the subsequent passage of FIRREA were meant to advance a broader public interest. The inescapable conclusion from all of this is that the Government's "regulatory" and "nonregulatory" capacities were fused in the instances under consideration, and we suspect that such fusion will be so common in the modern regulatory

state as to leave a criterion of "regulation" without much use in defining the scope of the sovereign acts doctrine. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN38[n.38]

An even more serious objection is that allowing the Government to avoid contractual liability merely by passing any "regulatory statute," would flaunt the general principle that, "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Lynch* v. *United States*, 292 U. S., at 579. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN39[n.39] Careful attention to the cases shows that the sovereign acts doctrine was meant to serve this principle, not undermine it. In *Horowitz*, for example, if the defendant had been a private shipper, it would have been entitled to assert the common law defense of impossibility of performance against Horowitz's claim for breach. Although that defense is traditionally unavailable where the barrier to performance arises from the act of the party seeking discharge, see Restatement (Second) of Contracts §261; 2 E. Farnsworth, Farnsworth on Contracts §9.6, p. 551 (1990); cf. *W. R. Grace & Co.* v. *Rubber Workers*, 461 U.S. 757, 767-768, n. 10 (1983), *Horowitz* held that the "public and general" acts of the sovereign are not attributable to the Government as contractor so as to bar the Government's right to discharge. The sovereign acts doctrine thus balances the Government's need for freedom to legislate with its obligation to honor its contracts by asking whether the sovereign act is properly attributable to the Government as contractor. If the answer is no, the Government's defense to liability depends on the answer to the further question, whether that act would otherwise release the Government from liability under ordinary principles of contract law. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN40[n.40] Neither question can be answered in the Government's favor here.

If the Government is to be treated like other contractors, some line has to be drawn in situations like the one before us between regulatory legislation that is relatively free of government self interest and therefore cognizable for the purpose of a legal impossibility defense and, on the other hand, statutes tainted by a governmental object of self relief. Such an object is not necessarily inconsistent with a public purpose, of course, and when we

speak of governmental "self interest," we simply mean to identify instances in which the Government seeks to shift the costs of meeting its legitimate public responsibilities to private parties. Cf. *Armstrong* v. *United States*, 364 U. S., at 49 (The Government may not "forc[e] some people alone to bear public burdens which . . . should be borne by the public as a whole"). Hence, while the Government might legitimately conclude that a given contractual commitment was no longer in the public interest, a government seeking relief from such commitments through legislation would obviously not be in a position comparable to that of the private contractor who willy nilly was barred by law from performance. There would be, then, good reason in such circumstance to find the regulatory and contractual characters of the Government fused together, in *Horowitz*'s terms, so that the Government should not have the benefit of the defense. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN41[n.41]

Horowitz's criterion of "public and general act" thus reflects the traditional "rule of law" assumption that generality in the terms by which the use of power is authorized will tend to guard against its misuse to burden or benefit the few unjustifiably. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN42[n.42] See, *e.g.*, *Hurtado* v. *California*, 110 U.S. 516, 535-536 (1884) ("Law . . . must be not a special rule for a particular person or a particular case, but . . . `[t]he general law . . .' so `that every citizen shall hold his life, liberty, property and immunities under the protection of the general rules which govern society' ") (citation omitted). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN43[n.43] Hence, governmental action will not be held against the Government for purposes of the impossibility defense so long as the action's impact upon public contracts is, as in *Horowitz*, merely incidental to the accomplishment of a broader governmental objective. See *O'Neill* v. *United States*, 231 Ct. Cl. 823, 926 (1982) (noting that the sovereign acts doctrine recognizes that "the Government's actions, otherwise legal, will occasionally incidentally impair the performance of contracts"). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN44[n.44] The greater the Government's self interest, however, the more suspect becomes the claim that its private contracting partners ought to bear the financial burden of the Government's own improvidence, and where a substantial part of the impact of the Government's

action rendering performance impossible falls on its own contractual obligations, the defense will be unavailable. Cf. *Sun Oil Co.* v. *United States*, 215 Ct. Cl. 716, 768, 572 F. 2d 786, 817 (1978) (rejecting sovereign acts defense where the Secretary of the Interior's actions were "`directed principally and primarily at plaintiffs' contractual right'"). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN45[n.45]

The dissent would adopt a different rule that the Government's dual roles of contractor and sovereign may never be treated as fused, relying upon *Deming*'s pronouncement that "[t]he United States as a contractor are not responsible for the United States as a lawgiver." *Post*, at 9 (quoting 1 Ct. Cl., at 191). But that view would simply eliminate the "public and general" requirement, which presupposes that the Government's capacities must be treated as fused when the Government acts in a non general way. *Deming* itself twice refers to the "general" quality of the enactment at issue, 1 Ct. Cl., at 191, and notes that "[t]he statute bears upon [the governmental contract] as it bears upon all similar contracts between citizens, and affects it in no other way." *Ibid*. At the other extreme, of course, it is clear that any benefit at all to the Government will not disqualify an act as "public and general"; the silk embargo in *Horowitz*, for example, had the incidental effect of releasing the Government from its contractual obligation to transport Mr. Horowitz's shipment. Our holding that a governmental act will not be public and general if it has the substantial effect of releasing the Government from its contractual obligations strikes a middle course between these two extremes. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN46[n.46]

In the present case, it is impossible to attribute the exculpatory "public and general" character to FIRREA. Although we have not been told the dollar value of the relief the Government would obtain if insulated from liability under contracts such as these, the attention given to the regulatory contracts prior to passage of FIRREA shows that a substantial effect on governmental contracts is certain. The statute not only had the purpose of eliminating the very accounting gimmicks that acquiring thrifts had been promised, but the specific object of abrogating enough of the acquisition contracts as to make that consequence of the legislation a focal point of the congressional debate. http://supct.law.cornell.edu/supct/html/95-

865.ZO.html - FN47[n.47] Opponents of FIRREA's new capital requirements complained that "[i]n its present form, [FIRREA] would abrogate written agreements made by the U. S. government to thrifts that acquired failing institutions by changing the rules in the middle of the game." 135 Cong. Rec. H2783 (June 15, 1989) (Statement of Rep. Ackerman). Several congressmen observed that, "[s]imply put, [Congress] has reneged on the agreements that the government entered into concerning supervisory goodwill." House Report, at 498 (additional views of Reps. Annunzio, Kanjorski, and Flake). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN48[n.48] A similar focus on the supervisory merger contracts is evident among proponents of the legislation; Representative Rostenkowski, for example, insisted that "the Federal Government should be able to change requirements when they have proven to be disastrous and contrary to the public interest. The contracts between the savings and loan owners when they acquired failing institutions in the early 1980's are not contracts written in stone." 135 Cong. Rec., at H2717 (June 15, 1989). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN49[n.49]

This evidence of intense concern with contracts like the ones before us suffices to show that FIRREA had the substantial effect of releasing the Government from its own contractual obligations. Congress obviously expected FIRREA to have such an effect, and in the absence of any evidence to the contrary we accept its factual judgment that this would be so. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN50[n.50] Nor is Congress's own judgment neutralized by the fact, emphasized by the Government, that FIRREA did not formally target particular transactions. Legislation can almost always be written in a formally general way, and the want of an identified target is not much security when a measure's impact nonetheless falls substantially upon the Government's contracting partners. For like reason, it does not answer the legislative record to insist, as the Government does, that the congressional focus is irrelevant because the broad purpose of FIRREA was to "advance the general welfare." Brief for United States 45. We assume nothing less of all congressional action, with the result that an intent to benefit the public can no more serve as a criterion of a "public and general" sovereign act than its regulatory character can. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN51[n.51] While

our limited enquiry into the background and evolution of the thrift crisis leaves us with the understanding that Congress acted to protect the public in the FIRREA legislation, the extent to which this reform relieved the Government of its own contractual obligations precludes a finding that the statute is a "public and general" act for purposes of the sovereign acts defense. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN52[n.52]

Even if FIRREA were to qualify as "public and general," however, other fundamental reasons would leave the sovereign acts doctrine inadequate to excuse the Government's breach of these contracts. As *Horowitz* makes clear, that defense simply relieves the Government as contractor from the traditional blanket rule that a contracting party may not obtain discharge if its own act rendered performance impossible. But even if the Government stands in the place of a private party with respect to "public and general" sovereign acts, it does not follow that discharge will always be available, for the common law doctrine of impossibility imposes additional requirements before a party may avoid liability for breach. As the Restatement puts it,

> "[w]here, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary." Restatement (Second) of Contracts §261.

See also 2 Farnsworth on Contracts §9.6, at 543-544 (listing four elements of the impossibility defense). Thus, since the object of the sovereign acts defense is to place the Government as contractor on par with a private contractor in the same circumstances, *Horowitz*, 267 U. S., at 461, the Government, like any other defending party in a contract action, must show that the passage of the statute rendering its performance impossible was an event contrary to the basic assumptions on which the parties agreed, and must ultimately show that the language or circumstances do not indicate that the Government should be liable in any case. While we do not say that these conditions can never be satisfied when the Government contracts with participants in a regulated industry for particular regulatory treatment,

we find that the Government as such a contractor has not satisfied the conditions for discharge in the present case.

For a successful impossibility defense the Government would have to show that the nonoccurrence of regulatory amendment was a basic assumption of these contracts. See, *e.g.*, Restatement (Second) of Contracts §261; 2 Farnsworth, *supra*, §9.6, at 549-550. The premise of this requirement is that the parties will have bargained with respect to any risks that are both within their contemplation and central to the substance of the contract; as Justice Traynor said, "[i]f [the risk] was foreseeable there should have been provision for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed." *Lloyd* v. *Murphy*, 25 Cal. 2d 48, 54, 153 P.2d 47, 50 (1944). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN53[n.53] That inference is particularly compelling, where, as here, the contract provides for particular regulatory treatment (and, *a fortiori*, allocates the risk of regulatory change). Such an agreement reflects the inescapable recognition that regulated industries in the modern world do not live under the law of the Medes and the Persians, and the very fact that such a contract is made at all is at odds with any assumption of regulatory stasis. In this particular case, whether or not the reach of the FIRREA reforms was anticipated by the parties, there is no doubt that some changes in the regulatory structure governing thrift capital reserves were both foreseeable and likely when these parties contracted with the Government, as even the Government agrees. It says in its brief to this Court that "in light of the frequency with which federal capital requirements had changed in the past . . . , it would have been unreasonable for Glendale, FSLIC, or the Bank Board to expect or rely upon the fact that those requirements would remain unchanged." Brief for United States 26; see also *id.*, at 3, n. 1 (listing the changes). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN54[n.54] The Federal Circuit panel in this case likewise found that the regulatory capital requirements "have been the subject of numerous statutory and regulatory changes over the years," and "changed three times in 1982 alone." 994 F. 2d, at 801. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN55[n.55] Given these fluctuations, and given the fact that a single modification of the applicable regulations could, and ultimately did, eliminate virtually all of the

consideration provided by the Government in these transactions, it would be absurd to say that the nonoccurrence of a change in the regulatory capital rules was a basic assumption upon which these contracts were made. See, *e.g.*, *Moncrief* v. Williston *Basin Interstate Pipeline Co.*, 880 F. Supp. 1495, 1508 (DWyo. 1995); *Vollmar* v. *CSX Transportation, Inc.*, 705 F. Supp. 1154, 1176 (EDVa. 1989), aff'd, 898 F. 2d 413 (CA4 1990).

Finally, any governmental contract that not only deals with regulatory change but allocates the risk of its occurrence will, by definition, fail the further condition of a successful impossibility defense, for it will indeed indicate that the parties' agreement was not meant to be rendered nugatory by a change in the regulatory law. See Restatement (Second) of Contracts §261 (no impossibility defense where the "language or the circumstances" indicate allocation of the risk to the party seeking discharge). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN56[n.56] The mere fact that the Government's contracting agencies (like the Bank Board and FSLIC) could not themselves preclude Congress from changing the regulatory rules does not, of course, stand in the way of concluding that those agencies assumed the risk of such change, for determining the consequences of legal change was the point of the agreements. It is, after all, not uncommon for a contracting party to assume the risk of an event he cannot control, http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN57[n.57] even when that party is an agent of the Government. As the Federal Circuit has recognized, "[government] contracts routinely include provisions shifting financial responsibility to the Government for events which might occur in the future. That some of these events may be triggered by sovereign government action does not render the relevant contractual provisions any less binding than those which contemplate third party acts, inclement weather and other *force majeure*." *Hughes Communications Galaxy, Inc.* v. *United States*, 998 F. 2d 953, 958-959 (CA Fed. 1993). http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FN58[n.58]

As to each of the contracts before us, our agreement with the conclusions of the Court of Federal Claims and the Federal Circuit forecloses any defense of legal impossibility, for those courts found that the Bank Board resolutions, Forbearance Letters, and other documents setting forth the accounting

treatment to be accorded supervisory goodwill generated by the transactions were not mere statements of then current regulatory policy, but in each instance were terms in an allocation of risk of regulatory change that was essential to the contract between the parties. See *supra*, at 21-23. Given that the parties went to considerable lengths in procuring necessary documents and drafting broad integration clauses to incorporate their terms into the contract itself, the Government's suggestion that the parties meant to say only that the regulatory treatment laid out in these documents would apply as an initial matter, subject to later change at the Government's election, is unconvincing. See *ibid.* It would, indeed, have been madness for respondents to have engaged in these transactions with no more protection than the Government's reading would have given them, for the very existence of their institutions would then have been in jeopardy from the moment their agreements were signed.

* * *

We affirm the Federal Circuit's ruling that the United States is liable to respondents for breach of contract. Because the Court of Federal Claims has not yet determined the appropriate measure or amount of damages in this case, we remand for further proceedings consistent with our opinion.

It is so ordered.

Notes

1. http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC11 The easing of federal regulatory requirements was accompanied by similar initiatives on the state level, especially in California, Florida, and Texas. The impact of these changes was substantial, since as of 1980 over 50 percent of federally insured thrifts were chartered by the States. See House Report, at 297.

   http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC22 "Regulatory and statutory accounting gimmicks included permitting thrifts to defer losses from the sale of assets with below market yields; permitting the use of income capital certificates, authorized by Congress, in place of real capital; letting qualifying mutual capital

certificates be included as RAP capital; allowing FSLIC members to exclude from liabilities in computing net worth, certain contra asset accounts, including loans in process, unearned discounts, and deferred fees and credits; and permitting the inclusion of net worth certificates, qualifying subordinated debentures and appraised equity capital as RAP net worth." House Report, at 298. The result of these practices was that "[b]y 1984, the difference between RAP and GAAP net worth at S&L's stood at $9 billion," which meant "that the industry's capital position, or . . . its cushion to absorb losses was overstated by $9 billion." *Ibid.*

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC33 See also *ibid.* (noting that "[t]he FSLIC developed lists of prospective acquirers, made presentations, held seminars, and generally tried to promote the acquisitions of these insolvents"); Grant, The FSLIC: Protection through Professionalism, 14 Federal Home Loan Bank Board Journal 9-10 (Feb. 1981) (describing the pros and cons of various default prevention techniques from FSLIC's perspective). Over 300 such mergers occurred between 1980 and 1986, as opposed to only 48 liquidations. GAO, Forbearance for Troubled Institutions 13. There is disagreement as to whether the government actually saved money by pursuing this course rather than simply liquidating the insolvent thrifts. Compare, *e.g.*, Brief for Franklin Financial Group, Inc., et al. as *Amicus Curiae* 7, quoting Remarks by H. Brent Beasley, Director of FSLIC, before the California Savings and Loan League Management Conference (Sept. 9, 1982) (concluding that FSLIC assisted mergers have "`[h]istorically . . . cost about 70% of [the] cost of liquidation' "), with GAO, Solutions to the Thrift Industry Problem 52 ("FSLIC's cost analyses may . . . understat[e] the cost of mergers to the government").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC44 See also Accounting Principles Board Opinion No. 17, ¶26, p. 339 (1970) (providing that "[i]ntangible assets acquired . . . as part of an acquired company should . . . be recorded at cost," which for unidentifiable intangible assets like goodwill is "measured by the difference between the cost of the . . . enterprise acquired and the sum of the assigned costs of individual tangible and identifiable intangible assets acquired less liabilities assumed").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC55 See *Newark Morning Ledger Co.* v. *United States*, 507 U.S. 546, 556 (1993) (describing "goodwill" as "the total of all the imponderable qualities that attract customers to the business"). Justice Story defined "good will" somewhat more elaborately as "the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances, or necessities, or even from ancient partialities, or prejudices." J. Story, Law of Partnership §99, p. 139 (1841).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC66 See also 135 Cong. Rec. H2703 (daily ed. June 16, 1989) (statement of Rep. Hyde) (observing that FSLIC used goodwill as "an inducement to the healthy savings and loans to merge with the sick ones"); Brief of Franklin Financial Group, Inc., et al. as *Amicus Curiae* 9, quoting Deposition of Thurman Connell, former official at the Atlanta Federal Home Loan Bank, in *Charter Federal Savings Bank* v. *Office of Thrift Supervision*, Joint Appendix Nos. 91-2647, 91-2708 (CA4), p. 224 (recognizing that treating supervisory goodwill as regulatory capital was "`a very important aspect of [the acquiring thrifts'] willingness to enter into these agreements,'" and concluding that the regulators "`looked at [supervisory goodwill] as kind of the engine that made this transaction go. Because without it, there wouldn't have been any train pulling out of the station, so to speak'").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC77 In this context, "amortization" of an intangible asset is equivalent to depreciation of tangible assets. See *Newark Morning Ledger Co.* v. *United States*, 507 U. S., at 571, n. 1 (1993) (Souter, J., dissenting); Gregorcich, Amortization of Intangibles: A Reassessment of the Tax Treatment of Purchased Goodwill, 28 Tax Lawyer 251, 253 (1975). Both the majority opinion and dissent in *Newark Morning Ledger* agreed that "goodwill" was not subject to depreciation (or amortization)

for federal tax purposes, see 507 U. S., at 565, n. 13; *id.*, at 573 (Souter, J., dissenting), although we disagreed as to whether one could accurately estimate the useful life of certain elements of goodwill and, if so, permit depreciation of those elements under Internal Revenue Service regulations. *Id.*, at 566-567; *id.*, at 576-577 (Souter, J., dissenting). Neither of the *Newark Morning Ledger* opinions, however, denied the power of another federal agency, such as the Bank Board or FSLIC, to decide that goodwill is of transitory value and impose a particular amortization period to be used for its own regulatory purposes.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC88 See also National Commission on Financial Institution Reform, Recovery and Enforcement, Origins and Causes of the S&L Debacle: A Blueprint for Reform, A Report to the President and Congress of the United States 38-39 (July 1993) (explaining the advantages of different amortization and accretion schedules to an acquiring thrift). The downside of a faster accretion schedule, of course, was that it exhausted the discount long before the goodwill asset had been fully amortized. As a result, this treatment resulted in a net drag on earnings over the medium and long terms. See Lowy 40-41; Black, Ending Our Forebearers' Forbearances: FIRREA and Supervisory Goodwill, 2 Stan. L. & Policy Rev. 102, 104-105 (1990). Many thrift managers were apparently willing to take the short term gain, see Lowy 40-41, and others sought to stave off the inevitable losses by pursuing further acquisitions, see Black, *supra*, at 105.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC99 The 1981 regulations quoted above were in effect at the time of the Glendale transaction. The 1984 regulations relevant to the *Winstar* transaction were identical in all material respects, and although substantial changes had been introduced into §563.13 by the time of the Statesman merger in 1988, they do not appear to resolve the basic ambiguity as to whether goodwill could qualify as regulatory capital. See 12 CFR § 563.13 (1988). Section 563.13 has since been superseded by the Financial Institutions Reform, Recovery, and Enforcement Act.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1010 Although the Glendale transaction in this case occurred before the promulgation of SFAS 72 in 1983, the proper amortization period for goodwill under GAAP was uncertain prior to that time. According to one observer, "when the accounting profession designed the purchase accounting rules in the early 1970s, they didn't anticipate the case of insolvent thrift institutions . . . . The rules for that situation were simply unclear until September 1982," when the SFAS 72 rules were first aired. Lowy 39-40.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1111 See 135 Cong. Rec. 18863 (1989) (Sen. Riegle) (emphasizing that these capital requirements were at the "heart" of the legislative reform); *id.*, at 18860 (Sen. Chafee) (describing capital standards as FIRREA's "strongest and most critical requirement" and "the backbone of the legislation"); *id.*, at 18853 (Sen. Dole) (describing the "[t]ough new capital standards [as] perhaps the most important provisions in this bill").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1212 Glendale's premerger net worth amounted to 5.45 percent of its total assets, which comfortably exceeded the 4 percent capital/asset ratio, or net worth requirement, then in effect. See 12 CFR § 563.13(a)(2) (1981).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1313 See also *Appleby* v. *Delaney*, 271 U.S. 403, 413 (1926) ("It is not reasonable to suppose that the grantees would pay $12,000 . . . and leave to the city authorities the absolute right completely to nullify the chief consideration for seeking this property, . . . or that the parties then took that view of the transaction").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1414 As part of the contract, the Government's promise to count supervisory goodwill and capital credits toward regulatory capital was alterable only by written agreement of the parties. See App. 408. This was also true of the Glendale and *Winstar* transactions. See *id.*, at 112, 600.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1515 To be sure, each side could have eliminated any serious contest about the correctness of their interpretive positions by using clearer language. See, *e.g.*, *Guaranty Financial Services, Inc.* v. *Ryan*, 928 F. 2d 994, 999-1000 (CA11 1991) (finding, based on very different contract language, that the Government had expressly reserved the right to change the capital requirements without any responsibility to the acquiring thrift). The failure to be even more explicit is perhaps more surprising here, given the size and complexity of these transactions. But few contract cases would be in court if contract language had articulated the parties' postbreach positions as clearly as might have been done, and the failure to specify remedies in the contract is no reason to find that the parties intended no remedy at all. The Court of Claims and Federal Circuit were thus left with the familiar task of determining which party's interpretation was more nearly supported by the evidence.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1616 See also *Day* v. *United States*, 245 U.S. 159, 161 (1917) (Holmes, J.) ("One who makes a contract never can be absolutely certain that he will be able to perform it when the time comes, and the very essence of it is that he takes the risk within the limits of his undertaking").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1717 See, *e.g.*, *Hughes Communications Galaxy, Inc.* v. *United States*, 998 F. 2d 953, 957-959 (CA Fed. 1993) (interpreting contractual incorporation of then current government policy on space shuttle launches not as a promise not to change that policy, but as a promise "to bear the cost of changes in launch priority and scheduling resulting from the revised policy"); *Hills Materials Co.* v. *Rice*, 982 F. 2d 514, 516-517 (CA Fed. 1992) (interpreting contract to incorporate safety regulations extant when contract was signed and to shift responsibility for costs incurred as a result of new safety regulations to the Government); see generally 18 W. Jaeger, Williston on Contracts §1934, at 19-21 (3d ed. 1978) ("Although a warranty in effect is a promise to pay damages if the facts are not as warranted, in terms it

is an undertaking that the facts exist. And in spite of occasional statements that an agreement impossible in law is void there seems no greater difficulty in warranting the legal possibility of a performance than its possibility in fact . . . . [T]here seems no reason of policy forbidding a contract to perform a certain act legal at the time of the contract if it remains legal at the time of performance, and if not legal, to indemnify the promisee for non performance" (footnotes omitted)); 5A A. Corbin, Corbin on Contracts §1170, p. 254 (1964) (noting that in some cases where subsequent legal change renders contract performance illegal, "damages are still available as a remedy, either because the promisor assumed the risk or for other reasons," but specific performance will not be required).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1818 See also H. L. A. Hart, The Concept of Law 145 (1961) (recognizing that Parliament is "sovereign, in the sense that it is free, at every moment of its existence as a continuing body, not only from legal limitations imposed *ab extra*, but also from its own prior legislation").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC1919 See also *Reichelderfer* v. *Quinn*, 287 U.S. 315, 318 (1932) ("[T]he will of a particular Congress . . . does not impose itself upon those to follow in succeeding years"); Black, Amending the Constitution: A Letter to a Congressman, 82 Yale L. J. 189, 191 (1972) (characterizing this "most familiar and fundamental principl[e]" as "so obvious as rarely to be stated").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2020 See also *Stone* v. *Mississippi*, 101 U.S. 814 (1880) (State may not contract away its police power); *Butchers' Union Slaughter House & Livestock Landing Co.* v. *Crescent City Livestock Landing & Slaughterhouse Co.*, 111 U.S. 746 (1884) (same); see generally Griffith, Local Government Contracts: Escaping from the Governmental/Proprietary Maze, 75 Iowa L. Rev. 277, 290-299 (1990) (recounting the early development of the reserved powers doctrine). We discuss the application of the reserved powers doctrine to this case *infra*, at 49-50.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2121 *United Railways* is in the line of cases stretching back to *Providence Bank* v. *Billings*, 4 Pet. 514 (1830), and *Charles River Bridge* v. *Warren Bridge*, 11 Pet. 420 (1837). Justice Day's opinion in *United Railways* relied heavily upon *New Orleans City & Lake R. Co.* v. *New Orleans*, 143 U.S. 192 (1892), which in turn relied upon classic Contract Clause unmistakability cases like *Vicksburg S. & P. R. Co.* v. *Dennis*, 116 U.S. 665 (1886), *Memphis Gas Light Co.* v. *Taxing Dist. of Shelby Cty.*, 109 U.S. 398 (1883), and *Piqua Branch of State Bank of Ohio* v. *Knoop*, 16 How. 369 (1854). And *Home Building & Loan Assn.* v. *Blaisdell*, 290 U.S. 398 (1934), upon which *Merrion* also relied, cites *Charles River Bridge* directly. See 290 U. S., at 435; see also Note, Forbearance Agreements: Invalid Contracts for the Surrender of Sovereignty, 92 Colum. L. Rev. 426, 453 (1992) (linking the unmistakability principle applied in *Bowen* v. *Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986), to the *Charles River Bridge/Providence Bank* line of cases).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2222 "Sovereign power" as used here must be understood as a power that could otherwise affect the Government's obligation under the contract. The Government could not, for example, abrogate one of its contracts by a statute abrogating the legal enforceability of that contract, government contracts of a class including that one, or simply all government contracts. No such legislation would provide the Government with a defense under the sovereign acts doctrine, see *infra*, at 52-61.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2323 The Government's right to take the tribe's property upon payment of compensation, of course, did not depend upon the navigational servitude; where it applies, however, the navigational easement generally obviates the obligation to pay compensation at all. See, *e.g.*, *United States* v. *Kansas City Ins. Co.*, 339 U.S. 799, 808 (1950) ("When the Government exercises [the navigational] servitude, it is exercising its paramount power in the interest of navigation, rather than taking the private property of anyone"); *Scranton*

v. Wheeler, 179 U.S. 141, 163 (1900) ("Whatever the nature of the interest of a riparian owner in the submerged lands in front of his upland bordering on a public navigable water, his title is not as full and complete as his title to fast land which has no direct connection with the navigation of such water. It is a qualified title . . . to be held at all times subordinate to such use of the submerged lands and of the waters flowing over them as may be consistent with or demanded by the public right of condemnation"). Because an order to pay compensation would have placed the Government in the same position as if the navigational easement had been surrendered altogether, the holding of *Cherokee Nation* is on all fours with the approach we describe today.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2424 The dissent is mistaken in suggesting there is question begging in speaking of what a government contract provides without first applying the unmistakability doctrine, see *post*, at 6. A contract may reasonably be read under normal rules of construction to contain a provision that does not satisfy the more demanding standard of unmistakable clarity. If an alleged term could not be discovered under normal standards, there would be no need for an unmistakability doctrine. It would, of course, make good sense to apply the unmistakability rule if it was clear from the start that a contract plaintiff could not obtain the relief sought without effectively barring exercise of a sovereign power, as in the example of the promisee of the tax exemption who claims a rebate.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2525 See also *Hughes Communications Galaxy, Inc.* v. *United States*, 998 F. 2d, at 958 (finding the unmistakability doctrine inapplicable to "the question of how liability for certain contingencies was allocated by the contract"); *Sunswick Corp.* v. *United States*, 109 Ct. Cl. 772, 798, 775 F. Supp. 221, 228 ("We know of no reason why the Government may not by the terms of its contract bind itself for the consequences of some act on its behalf which, but for the contract, would be nonactionable as an act of the sovereign. As shown in

Bostwick v. *United States*, 94 U.S. 53, 69 [(1877)], the liability of the Government in such circumstances rests upon the contract and not upon the act of the Government in its sovereign capacity"), cert. denied, 334 U.S. 827 (1948); see generally Eule, Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity, 1987 Am. Bar Found. Research J. 379, 424 (observing that limiting the Government's obligation to "compensating for the financial losses its repudiations engender . . . . affords the current legislature the freedom to respond to constituents' needs, while at the same time protecting those whose contractual interests are impaired"); Note, A Procedural Approach to the Contract Clause, 93 Yale L. J. 918, 928-929 (1984) ("A damage remedy is superior to an injunction because damages provide the states with the flexibility to impair contracts retroactively when the benefits exceed the costs. So long as the victims of contract impairments are made whole through compensation, there is little reason to grant those victims an injunctive remedy").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2626 This point underscores the likelihood that damage awards will have the same effect as an injunction only in cases, like *Bowen*, where a private party seeks the return of payments to the Government. The classic examples, of course, are tax cases like *St. Louis* v. *United Railways Co.*, 210 U.S. 266 (1908). Because a request for rebate damages in that case would effectively have exempted the plaintiffs from the law by forcing the reimbursement of their tax payments, the dissent is quite wrong to suggest, see *post*, at 5-6, that the plaintiffs could have altered the outcome by pleading their case differently.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2727 See Posner & Rosenfield, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6 J. Leg. Stud. 83, 88-89 (1977) (noting that parties generally rely on contract law "to reduce the costs of contract negotiation by supplying contract terms that the parties would probably have adopted explicitly had they negotiated over them").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2828 See also *Bowen* v. *Public Agencies Opposed to Social*

Security Entrapment, 477 U. S., at 52 ("[T]he Federal Government, as sovereign, has the power to enter contracts that confer vested rights, and the concomitant duty to honor those rights . . ."); *Perry* v. *United States*, 294 U.S. 330, 353 (1935) ("[T]he right to make binding obligations is a competence attaching to sovereignty"); cf. H. L. A. Hart, The Concept of Law 145-146 (1961) (noting that the ability to limit a body's future authority is itself one aspect of sovereignty).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC2929 See also Logue, Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment, 94 Mich. L. Rev. 1129, 1146 (1996) ("If we allowed the government to break its contractual promises without having to pay compensation, such a policy would come at a high cost in terms of increased default premiums in future government contracts and increased disenchantment with the government generally").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3030 See, *e.g.*, Restatement (Second) of Contracts §346, cmt. a ("Every breach of contract gives the injured party a right to damages against the party in breach" unless "[t]he parties . . . by agreement vary the rules"); 3 Farnsworth on Contracts §12.8, at 185 (1990) ("The award of damages is the common form of relief for breach of contract. Virtually any breach gives the injured party a claim for damages").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3131 The dissent justifies its all devouring view of unmistakability not by articulating any limit, but simply by reminding us that "Men must turn square corners when they deal with the Government." *Post*, at 14-15 (quoting *Rock Island, A. & L.R. Co.* v. *United States*, 254 U.S. 141, 143 (1920) (Holmes, J.)). We have also recognized, however, that " `[i]t is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their government.' " *Heckler* v. *Community Health Services of Crawford County, Inc.*, 467 U.S. 51, 61 n. 13 (1984) (quoting *St. Regis Paper Co.* v. *United*

States, 368 U.S. 208, 229 (1961) (Black, J., dissenting). See also *Federal Crop Insurance Corp.* v. *Merrill*, 332 U.S. 380, 387-388 (1947) (Jackson, J., dissenting) ("It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners should constitute a one way street").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3232 Justice Scalia offers his own theory of unmistakability, see *post*, at 1-5, which would apply in a wide range of cases and so create some tension with the general principle that the Government is ordinarily treated just like a private party in its contractual dealings, see, *e.g.*, *Perry* v. *United States*, 294 U.S. 330, 352 (1935), but which would be satisfied by an inference of fact and therefore offer a only a low barrier to litigation of constitutional issues if a party should, in fact, prove a governmental promise not to change the law. Justice Scalia seeks to minimize the latter concern by quoting Holmes's pronouncement on damages as the exclusive remedy at law for breach of contract, see *post*, at 2, but this ignores the availability of specific performance in a non trivial number of cases, see, *e.g.*, Restatement (Second) of Contracts §§357-359, including the Contract Clause cases in which the unmistakability doctrine itself originated. See, *e.g.*, *Carter* v. *Greenhow*, 114 U.S. 317, 322 (1885) (stating that "the only right secured" by the Contract Clause is "to have a judicial determination, declaring the nullity of the attempt to impair [the contract's] obligation"); Zigler, Takings Law and the Contract Clause: A Takings Law Approach to Legislative Modifications of Public Contracts, 36 Stan. L. Rev. 1447, 1462 (1984) (suggesting that "analysis under the contract clause is limited to declaring the statute unconstitutional. The provision does not authorize the courts to award damages in lieu of requiring the state to adhere to the original terms of the contract"); cf. C. Fried, Contract as Promise 117-118 (1981) (arguing that "Holmes's celebrated dictum . . . goes too far, is too simple"). Finally, we have no need to consider the close relationship that Justice Scalia sees between the unmistakability and sovereign acts doctrines, see *post*, at 6, because, even considered separately, neither one favors the Government in this case.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3333 See also *Atlantic Coast Line R. Co.* v. *Goldsboro*, 232 U.S. 548, 558 (1914) ("[T]he power of the State to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community . . . can neither be abdicated nor bargained away, and is inalienable even by express grant"); *West River Bridge Co.* v. *Dix*, 6 How. 507 (1848) (State's contracts do not relinquish its eminent domain power).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3434 To the extent that Justice Scalia finds the reserved powers doctrine inapplicable because "the private party to the contract does not seek to stay the exercise of sovereign authority, but merely requests damages for breach of contract," *post*, at 5, he appears to adopt a distinction between contracts of indemnity and contracts not to change the law similar to the unmistakability analysis he rejects. He also suggests that the present case falls outside the "core governmental powers" that cannot be surrendered under the reserved powers doctrine, but this suggestion is inconsistent with our precedents. See *Stone* v. *Mississippi*, 101 U.S. 814, 817 (1880) ("[T]he legislature cannot bargain away the police power of a State"); *Veix* v. *Sixth Ward Building & Loan Assn. of Newark*, 310 U.S. 32, 38 (1940) (recognizing that thrift regulation is within the police power).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3535 See Speidel, Implied Duties of Cooperation and the Defense of Sovereign Acts in Government Contracts, 51 Geo. L. J. 516, 542 (1963) ("[W]hile the contracting officers of Agency X cannot guarantee that the United States will not perform future acts of effective government, they can agree to compensate the contractor for damages resulting from justifiable acts of the United States in its `sovereign capacity' " (footnotes omitted)).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3636 See also 1 R. Nash & J. Cibinic, Federal Procurement Law 5 (3d ed. 1977) ("The authority of the executive to use contracts in carrying out authorized programs is . . . generally assumed in the absence of express statutory prohibitions or limitations").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3737 Nor is there any substance to the claim that these were contracts that only the Government could make. The regulatory capital or net worth requirements at issue applied only to thrifts choosing to carry federal deposit insurance, see Federal Home Loan Bank System, A Guide to the Federal Home Loan Bank System 69 (5th ed. 1987), and institutions choosing to self insure or to seek private insurance elsewhere would have been free to make similar agreements with private insurers.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3838 Moreover, if the dissent were correct that the sovereign acts doctrine permits the Government to abrogate its contractual commitments in "regulatory" cases even where it simply sought to avoid contracts it had come to regret, then the Government's sovereign contracting power would be of very little use in this broad sphere of public activity. We rejected a virtually identical argument in *Perry* v. *United States*, 294 U.S. 330 (1935), in which Congress had passed a resolution regulating the payment of obligations in gold. We held that the law could not be applied to the Government's own obligations, noting that "the right to make binding obligations is a competence attaching to sovereignty." *Id.*, at 353.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC3939 See also *Clearfield Trust Co.* v. *United States*, 318 U.S. 363, 369 (1943) ("`The United States does business on business terms'") (quoting *United States* v. *National Exchange Bank of Baltimore*, 270 U.S. 527, 534 (1926)); *Perry* v. *United States*, *supra*, at 352 (1935) ("When the United States, with constitutional authority, makes contracts, it has rights and incurs responsibilities similar to those of individuals who are parties to such instruments. There is no difference . . . except that the United States cannot be sued without its consent") (citation omitted); *United States* v. *Bostwick*, 94 U.S. 53, 66 (1877) ("The United States, when they contract with their citizens, are controlled by the same laws that govern the citizen in that behalf"); *Cooke* v. *United States*, 91 U.S. 389, 398 (1875) (explaining that when the United States "comes down from its position of sovereignty, and enters

the domain of commerce, it submits itself to the same laws that govern individuals there").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4040 See *Jones*, 1 Cl. Ct., at 85 ("Wherever the public and private acts of the government seem to commingle, a citizen or corporate body must by supposition be substituted in its place, and then the question be determined whether the action will lie against the supposed defendant"); *O'Neill* v. *United States*, 231 Ct. Cl. 823, 826 (1982) (sovereign acts doctrine applies where, "[w]ere [the] contracts exclusively between private parties, the party hurt by such governing action could not claim compensation from the other party for the governing action"). The dissent ignores these statements (including the statement from *Jones*, from which case *Horowitz* drew its reasoning literally verbatim), when it says, *post*, at [7], that the sovereign acts cases do not emphasize the need to treat the government as contractor the same as a private party.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4141 Our Contract Clause cases have demonstrated a similar concern with governmental self interest by recognizing that "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self interest is at stake." *United States Trust Co. of N. Y. v. New Jersey*, 431 U.S. 1, 26 (1977); see also *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 412-413, and n. 14 (1983) (noting that a stricter level of scrutiny applies under the Contract Clause when a State alters its own contractual obligations); cf. *Perry*, *supra*, at 350-351 (drawing a "clear distinction" between Congress's power over private contracts and "the power of the Congress to alter or repudiate the substance of its own engagements").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4242 The generality requirement will almost always be met where, as in *Deming*, the governmental action "bears upon [the government's contract] as it bears upon all similar contracts between citizens." *Deming* v. *United States*, 1 Ct. Cl. 190, 191 (1865). *Deming*

is less helpful, however, in cases where, as here, the public contracts at issue have no obvious private analogs.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4343 The dissent accuses us of transplanting this due process principle into alien soil, see *post*, at 9. But this Court did not even wait until the term following *Hurtado* before applying its principle of generality to a case that, like this one, involved the deprivation of property rights. See *Hagar* v. *Reclamation Dist. No. 108*, 111 U.S. 701, 708 (1884). More importantly, it would be surprising indeed if the sovereign acts doctrine, resting on the inherent nature of sovereignty, were not shaped by fundamental principles about how sovereigns ought to behave.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4444 See also Speidel, 51 Geo. L. J., at 539-540 (observing that "the commonly expressed conditions to the availability of the sovereign acts defense" are not only that "the act . . . must have been `public and general,' " but also that "the damage to the contractor must have been caused indirectly"); cf. *Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 191-192 (1983) (distinguishing between direct and incidental impairments under the Contract Clause).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4545 Cf. also *Resolution Trust Corp.* v. *Federal Savings and Loan Insurance Corp.*, 25 F.3d 1493, 1501 (CA10 1994) ("The limits of this immunity [for sovereign acts] are defined by the extent to which the government's failure to perform is the result of legislation targeting a class of contracts to which it is a party"); *South Louisiana Grain Services, Inc.* v. *United States*, 1 Cl. Ct. 281, 287, n. 6 (1982) (rejecting sovereign acts defense where the government agency's actions "were directed specifically at plaintiff's alleged contract performance"). Despite the dissent's predictions, the sun is not, in fact, likely to set on the sovereign acts doctrine. While an increase in regulation by contract will produce examples of the "fusion" that bars the defense, we may expect that other sovereign activity will continue to occasion the sovereign acts defense in cases of incidental effect.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4646 A different intermediate position would be possible, at least in theory. One might say that a governmental action was not "public and general" under *Horowitz* if its predominant purpose or effect was avoidance of the Government's contractual commitments. The difficulty, however, of ascertaining the relative intended or resulting impacts on governmental and purely private contracts persuades us that this test would prove very difficult to apply.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4747 We note that whether or not Congress intended to abrogate supervisory merger agreements providing that supervisory goodwill would count toward regulatory capital requirements has been the subject of extensive litigation in the Courts of Appeals, and that every Circuit to consider the issue has concluded that Congress did so intend. See *Transohio Sav. Bank* v. *Director, Office of Thrift Supervision*, 967 F. 2d 598, 617 (CADC 1992); *Carteret Sav. Bank* v. *Office of Thrift Supervision*, 963 F. 2d 567, 581-582 (CA3 1992); *Security Sav. & Loan* v. *Director, Office of Thrift Supervision*, 960 F. 2d 1318, 1322 (CA5 1992); *Far West Federal Bank* v. *Director, Office of Thrift Supervision*, 951 F. 2d 1093, 1098 (CA9 1991); *Guaranty Financial Services, Inc.* v. *Ryan*, 928 F. 2d 994, 1006 (CA11 1991); *Franklin Federal Sav. Bank* v. *Director, Office of Thrift Supervision*, 927 F. 2d 1332, 1341 (CA6), cert. denied, 502 U.S. 937 (1991); cf. *Resolution Trust Corp.* v. *FSLIC*, 25 F. 3d 1493, 1502 (CA10 1994) (observing that "FIRREA's structure leaves little doubt that Congress well knew the crippling effects strengthened capital requirements would have on mergers that relied on supervisory goodwill," but concluding that Congress sought to mitigate the impact by giving OTS authority to exempt thrifts until 1991); *Charter Federal Sav. Bank* v. *Office of Thrift Supervision*, 976 F. 2d 203, 210 (CA4 1992) (accepting the conclusions of the other Circuits in dictum), cert. denied, 507 U.S. 1004 (1993).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4848 See also House Report, at 534 (additional views of Reps. Hiler, Ridge, Bartlett, Dreier, McCandless, Saiki, Baker, and Paxon)

("For the institutions with substantial supervisory goodwill, the bill radically changes the terms of previously negotiated transactions"); *id.*, at 507-508 (additional views of Rep. LaFalce) ("Those institutions which carry intangible assets on their books do so generally under written agreements they have entered into with the U. S. government, agreements which generally state that they cannot be superseded by subsequent regulations"); *id.*, pt. 5, at 27 (additional views of Rep. Hyde) ("[Thrifts] were told that they would be able to carry this goodwill on their books as capital for substantial periods of time. . . . The courts could well construe these agreements as formal contracts. Now, . . . Congress is telling these same thrifts that they cannot count this goodwill toward meeting the new capital standards"); 135 Cong. Rec. H2706 (June 15, 1989) (statement of Rep. Crane) (FIRREA "would require these S&Ls to write off this goodwill in a scant 5 years. This legislation violates the present agreements that these institutions made with the Federal Government"). Although there was less of a focus on the impact of FIRREA on supervisory goodwill in the Senate, at least two senators noted that the new capital requirements would have the effect of abrogating government contracts. See *id.*, at S5533 (May 17, 1989) (statement of Sen. Hatfield) ("The new tangible capital standards in the legislation specifically exclude supervisory goodwill, and in doing so effectively abrogate agreements made between the Federal Home Loan Bank Board, on behalf of the U. S. Government, and certain healthy thrift institutions"); *id.*, at S10213 (Aug. 4, 1989) (statement of Sen. D'Amato) (asking "whether any future transactions involving failed or failing institutions will be possible after this bill sanctions a wholesale reneging of Federal agency agreements").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC4949 See also House Report, at 545 (Supplemental Views of Reps. Schumer, Morrison, Roukema, Gonzalez, Vento, McMillen and Hoagland) ("[A]n overriding public policy would be jeopardized by the continued adherence to arrangements which were blithely entered into by the FSLIC"); 135 Cong. Rec. H2705 (June 15, 1989) (statement of Rep. Gonzalez) ("[I]n blunt terms, the Bank Board and FSLIC insurance fund managers entered into bad deals—I might even call

them steals"); *id.*, at H2565 (June 14, 1989) (statement of Rep. Saxton) ("In short[,] goodwill agreements were a mistake and as the saying goes . . . `Two wrongs don't make a right' "). These proponents defeated two amendments to FIRREA, proposed by Reps. Quillen and Hyde, which would have given thrifts that had received capital forbearances from thrift regulators varying degrees of protection from the new rules. See *Transohio Sav. Bank* v. *Director, Office of Thrift Supervision*, *supra*, at 616-617; see also 135 Cong. Rec. H2710 (June 15, 1989) (statement of Rep. Price) ("[T]he proponents of [the Hyde] amendment say a `Deal is a Deal' . . . . But to claim that Congress can never change a regulator's decision . . . in the future is simply not tenable"); *Franklin Federal Savings Bank* v. *Director, Office of Thrift Supervision*, *supra,* at 1340-1341 (reviewing the House debate and concluding that "*[n]obody* expressed the view that FIRREA did not abrogate forbearance agreements regarding supervisory goodwill") (emphasis in original).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5050 Despite the claims of the dissent, our test does not turn upon "some sort of legislative intent," *post*, at 10. Rather, we view Congress's expectation that the Government's own obligations would be heavily affected simply as good evidence that this was, indeed, the case.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5151 We have, indeed, had to reject a variant of this argument before. See *Lynch* v. *United States*, 292 U.S. 571, 580 (1934) (acknowledging a public need for governmental economy, but holding that "[t]o abrogate contracts, in the attempt to lessen governmental expenditure, would be not the practice of economy, but an act of repudiation"); see also Speidel, 51 Geo. L.J., at 522 (noting that even when "the Government's acts are motivated or required by public necessity . . . [t]he few decisions on point seem to reject public convenience or necessity as a defense, particularly where [the Government's action] directly alters the terms of the contract").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5252 The dissent contends that FIRREA must be a "public and

general" act because it "occupies 372 pages in the Statutes at Large, and under 12 substantive titles contains more than 150 numbered sections." *Post*, at 11. But any act of repudiation can be buried in a larger piece of legislation, and if that is enough to save it then the Government's contracting power will not count for much. To the extent that The Chief Justice relies on the fact that FIRREA's core capital requirements applied to all thrift institutions, we note that neither he nor the Government has provided any indication of the relative incidence of the new statute in requiring capital increases for thrifts subject to regulatory agreements affecting capital and those not so subject.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5353 See also *Transatlantic Financing Corp.* v. *United States*, 363 F. 2d 312, 315 (CADC 1966) (requiring that the contingency rendering performance impossible be "`something' unexpected"); *Companhia de Navegacao Lloyd Brasiliero* v. *C. G. Blake Co.*, 34 F. 2d 616, 619 (CA2 1929) (L. Hand, J.) (asking "how unexpected at the time [the contract was made] was the event which prevented performance"); see also *Kel Kim Corp.* v. *Central Markets, Inc.*, 70 N. Y. 2d 900, 902, 524 N. E. 2d 295, 296 (1987) ("[T]he impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract"); *Barbarossa and Sons, Inc.* v. *Iten Chevrolet, Inc.*, 265 N. W. 2d 655, 659 (Minn. 1978) (asking "whether the risk of the given contingency was so unusual or unforeseen and would have such severe consequences that to require performance would be to grant the promisee an advantage for which he could not be said to have bargained in making the contract"); *Mishara Construction Co.* v. *Transit Mixed Concrete Corp.*, 365 Mass. 122, 129, 310 N. E. 2d 363, 367 (1974) ("The question is . . . Was the contingency which developed one which the parties could reasonably be thought to have foreseen as a real possibility which could affect performance?"); *Krell* v. *Henry*, 2 K. B. 740, 752 (1903) ("The test seems to be whether the event which causes the impossibility was or might have been anticipated and guarded against"); 18 W. Jaeger, Williston on Contracts §1931, p. 8 (3d ed. 1978) ("The

important question is whether an unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of both parties when they entered into the contract. If so, the risk should not fairly be thrown upon the promisor"). Although foreseeability is generally a relevant, but not dispositive, factor, see 2 E. Farnsworth, Farnsworth on Contracts §9.6, pp. 555-556 (1990); *Opera Company of Boston, Inc.* v. *Wolf Trap Foundation for the Performing Arts*, 817 F. 2d 1094, 1101 (CA4 1987), there is no reason to look further where, as here, the risk was foreseen to be more than minimally likely, went to the central purpose of the contract, and could easily have been allocated in a different manner had the parties chosen to do so, see *id.*, at 1099-1102; 18 Williston on Contracts, *supra*, §1953, at 119.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5454 The Government confirmed this point at oral argument. When asked whether FIRREA's tightening of the regulatory capital standards was "exactly the event that the parties assumed might happen when they made their contracts," the Government responded "Exactly. Congress had changed capital standards many times over the years." Tr. of Oral Arg. 9.

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5555 See, *e.g.*, Garn St Germain Depository Institutions Act of 1982, Pub. L. 97-320, 96 Stat. 1469 (eliminating any fixed limits to Bank Board discretion in setting reserve requirements); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132, 160 (conferring discretionary authority on the Bank Board to set reserve requirements between 3% and 6%); 47 Fed. Reg. 3543 (lowering the reserve ratio from 4% to 3%); *id.*, at 31859 (excluding certain "contra asset" accounts from reserve calculations); *id.*, at 52961 (permitting thrifts to count appraised equity capital toward reserves); see also *Charter Federal Sav. Bank* v. *Office of Thrift Supervision*, 976 F. 2d, at 212 (noting that because "[c]apital requirements have been an evolving part of the regulatory scheme since its inception," the Bank Board "would have expected changes in statutory requirements, including capital requirements"); *Carteret Sav.*

Bank v. *Office of Thrift Supervision*, 963 F. 2d, at 581 (observing that "[i]n the massively regulated banking industry, . . . the rules of the game change with some regularity").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5656 See also *Hughes Communications Galaxy, Inc.* v. *United States*, 998 F. 2d, at 957-959 (rejecting sovereign acts defense where contract was interpreted as expressly allocating the risk of change in governmental policy); Posner & Rosenfield, 6 J. Leg. Stud., at 98 (noting that, subject to certain constraints, "[t]he contracting parties' chosen allocation of risk" should always be honored as the most efficient one possible).

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5757 See, *e.g.*, *Chicago, Milwaukee & St. Paul R. Co.* v. *Hoyt*, 149 U.S. 1, 14-15 (1893) ("There can be no question that a party may by an absolute contract bind himself or itself to perform things which subsequently become impossible, or to pay damages for the nonperformance"). This is no less true where the event that renders performance impossible is a change in the governing law. See, *e.g.*, 4 R. Anderson, Anderson on the Uniform Commercial Code §2-615:34, p. 286 (3d ed. 1983) ("Often in regard to impossibility due to change of law . . . there would be no difficulty in a promisor's assuming the risk of the legal possibility of his promise"); 6 A. Corbin, Corbin on Contracts §1346, p. 432 (1962) ("Just as in other cases of alleged impossibility, the risk of prevention by courts and administrative officers can be thrown upon a contractor by a provision in the contract itself or by reason of established custom and general understanding").

http://supct.law.cornell.edu/supct/html/95-865.ZO.html - FNSRC5858 See generally *Hills Materials Co.* v. *Rice*, 982 F. 2d 514, 516, n. 2 (CA Fed. 1992) ("[T]he [sovereign acts] doctrine certainly does not prevent the government as contractor from affirmatively assuming responsibility for specific sovereign acts"); *D & L Construction Co.* v. *United States*, 185 Ct. Cl. 736, 752, 402 F. 2d 990, 999 (1968) ("It has long been established that while the United States cannot be held liable directly or indirectly for public acts which it

performs as a sovereign, the Government can agree in a contract that if it does exercise a sovereign power, it will pay the other contracting party the amount by which its costs are increased by the Government's sovereign act, and that this agreement can be implied as well as expressed"); *Amino Brothers Co.* v. *United States*, 178 Ct. Cl. 515, 525, 372 F. 2d 485, 491 (1967) (same), cert. denied, 389 U.S. 846 (1967); *Gerhardt F. Meyne Co.* v. *United States*, 110 Ct. Cl. 527, 550, 76 F. Supp. 811, 815 (1948) (same). A common example of such an agreement is mandated by Federal Acquisition Regulation 52.222-43, which requires government entities entering into certain fixed price service contracts to include a price adjustment clause shifting to the Government responsibility for cost increases resulting from compliance with Department of Labor wage and fringe benefit determinations. 48 CFR § 52.222-43 (1995).

ANNEXURE 3

INFORMATION TECHNOLOGY ACT 2000

KEY DEFINITIONS

THE INFORMATION TECHNOLOGY ACT, 2000

(No. 21 OF 2000) [9th June,2000]

An Act to provide legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as "electronic commerce", which involve the use of alternatives to paper-based methods of communication and storage of information, to facilitateelectronic filing of documents with the Government agencies and further to amend the Indian Penal Code, the Indian Evidence Act, 1872, the Bankers' Books

Evidence Act, 1891 and the Reserve Bank of India Act, 1934 and for matters connected therewith or incidental thereto.

WHEREAS the General Assembly of the United Nations by resolution A/RES/51/162, dated the 30th January, 1997 has adopted the Model Law on Electronic Commerce adopted by the United Nations Commission on International Trade Law;

AND WHEREAS the said resolution recommends inter alia that all States give favourable consideration to the said Model Law when they enact or revise their laws, in view of the need for uniformity of the law applicable to alternatives to paper-cased methods of communication and storage of information;

AND WHEREAS

it is considered necessary to give effect to the said resolution and to promote efficient delivery of Government services by means of reliable electronic records.

BE

it enacted by Parliament in the Fifty-first Year of the Republic of India as follows:-

CHAPTER I

PRELIMINARY

1. Short title, extent, commencement and application

(1) This Act may be called the Information Technology Act, 2000.

(2) It shall extend to the whole of India and, save as otherwise provided in this Act, it applies also to any offence or contravention thereunder committed outside India by any person.

(3) It shall come into force on such date as the Central Government may, by notification, appoint and different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the commencement of that provision.

(4) Nothing in this Act shall apply to, -

a) a negotiable instrument as defined in section 13 of the Negotiable Instruments Act, 1881;

(b) a power-of-attorney as defined in section 1A of the Powers-of-Attorney Act, 1882;

(c) a trust as defined in section 3 of the Indian Trusts Act, 1882;

(d) a will as defined in clause

(h) of section 2 of the Indian Succession Act, 1925 including any other testamentary disposition by whatever name called;

(e) any contract for the sale or conveyance of immovable property or any interest in such property;

(f) any such class of documents or transactions as may be notified by the Central Government in the Official Gazette.

2. Definitions

(1) In this Act, unless the context otherwise requires, -

(a) "access" with its grammatical variations and cognate expressions means gaining entry into, instructing or communicating with the logical, arithmetical, or memory function resources of a computer, computer system or computer network;

(b) "addressee" means a person who is intended by the originator to receive the lectronic record but does not include any intermediary;

c) "adjudicating officer" means an adjudicating officer appointed under subsection (1) of section 46;

(d) "affixing digital signature" with its grammatical variations and cognate expressions means adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of digital signature;

e) "appropriate Government" means as respects any matter,-

(i) Enumerated in List II of the Seventh Schedule to the Constitution;

ii) relating to any State law enacted under List III of the Seventh Schedule to the Constitution, the State Government and in any other case, the Central Government;

(f) "asymmetric crypto system" means a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature;

(g) "Certifying Authority" means a person who has been granted a licence to issue a Digital Signature Certificate under section 24;

(h) "certification practice statement" means a statement issued by a Certifying Authority to specify the practices that the Certifying Authority employs in issuing Digital Signature Certificates;

(i) "computer" means any electronic magnetic, optical or other high-speed data processing device or system which performs logical, arithmetic, and memory functions by manipulations of electronic,

magnetic or optical impulses, and includes all input, output, processing, storage, computer software, or communication facilities which are connected or related to the computer in a computer system or computer network;

(j) "computer network" means the interconnection of one or more computers through-

(i) the use of satellite, microwave, terrestrial line or other communication media; and

ii) terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained;

(k) "computer resource" means computer, computer system, computer network, data,computer data base or software;

(l) "computer system" means a device or collection of devices, including input and output support devices and excluding calculators which are not programmable and capable of being used in conjunction with external files, which contain computer programmes, electronic instructions, input data and output data, that performs logic, arithmetic, data storage and retrieval, communication control and other functions;

(m) "Controller" means the Controller of Certifying Authorities appointed under sub-section (l) of section 17;

(n) "Cyber Appellate Tribunal" means the Cyber Regulations Appellate Tribunal established under sub-section (1) of section 48;

(o) "data" means a representation of information, knowledge, facts, concepts or instructions which are being prepared or have been prepared in a formalised manner, and is intended to be processed, is being processed or has been processed in a computer system or computer network, and may be in any form (including computer printouts magnetic or optical storage media, punched cards, punched tapes) or stored internally in the memory of the computer;

(p) "digital signature" means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section 3;

(q) "Digital Signature Certificate" means a Digital Signature Certificate issued under sub- section (4) of section 35;

(r) "electronic form" with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device;

(s) "Electronic Gazette" means the Official Gazette published in the electronic form;

(t) "electronic record" means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche;

(u) "function", in relation to a computer, includes logic, control arithmetical process, deletion, storage and retrieval and communication or telecommunication from or within a computer;

(v) "information" includes data, text, images, sound, voice, codes, computer programmes, software and databases or micro film or computer generated micro fiche:

(w) "intermediary" with respect to any particular electronic message means any person who on behalf of another person receives, stores or transmits that message or provides any service with respect to that message;

(x) "key pair", in an asymmetric crypto system, means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key;

(y) "law" includes any Act of Parliament or of a State Legislature, Ordinances promulgated by the President or a Governor, as the case may be. Regulations made bythe President under article 240, Bills enacted as President's Act under sub-clause (a) of clause

(1) of article 357 of the Constitution and includes rules, regulations, bye- laws and orders issued or made thereunder;

(z) "licence" means a licence granted to a Certifying Authority under section 24;

(za) "originator" means a person who sends, generates, stores or transmits any electronic message or causes any electronic message to be sent, generated, stored or transmitted to any other person but does not include an intermediary;

(zb) "prescribed" means prescribed by rules made under this Act;

(zc) "private key" means the key of a key pair used to create a digital signature;

(zd) "public key" means the key of a key pair used to verify a digital signature and listed in the Digital Signature Certificate;

(ze) "secure system" means computer hardware, software, and procedure that-

   (a) are reasonably secure from unauthorised access and misuse;

   (b) provide a reasonable level of reliability and correct operation;

   (c) are reasonably suited to performing the intended functions; and

   (d) adhere to generally accepted security procedures;

(zf) "security procedure" means the security procedure prescribed under section 16 by the Central Government;

(zg) "subscriber" means a person in whose name the Digital Signature Certificate is issued;

(zh) "verify" in relation to a digital signature, electronic record or public key, with its grammatical variations and cognate expressions means to determine whether-

   (a) the initial electronic record was affixed with the digital signature by the use of private key corresponding to the public key of the subscriber;

(b) the initial electronic record is retained intact or has been altered since such electronic record was so affixed with the digital signature.

(2) Any reference in this Act to any enactment or any provision thereof shall, in relation to an area in which such enactment or such provision is not in force, be construed as a reference to the corresponding law or the relevant provision of the corresponding law, if any, in force in that area.

Note - The complete act is available in the Website www.nalsarpro.org or can be found at the websit of Ministry of Information Technology, Government of India.