Automating the Wheels of Commerce

Standardisation and dematerialisation of credit contracts and their online execution will speed up the processes under the Insolvency and Bankruptcy Code, 2016, while propelling business to the next level.

Wheel is the most influential invention of science in the history of mankind. It is the mother of almost every technological invention and one cannot think of the world without it. It undergoes continuous metamorphosis to meet every emerging need. Literally, there are wheels on wheels and wheels within wheels. Powered by automation, wheels are now extremely intelligent, potent and universal.

Contract is the wheel of commerce. It is the most influential innovation of commerce in the history of mankind. It is the foundation of every business and market innovation and one cannot think of the world without it. Literally, there are contracts on contracts, contracts within contracts and one contracts to contract to contract. It is under continuous metamorphosis to meet every business need.

The securities market undertakes transactions probably with the highest efficiency, speed and security, thanks to three institutional developments, namely, standardisation, dematerialisation and online execution of contracts, which are key components of contract automation. It trades in demat contracts; every trade is a contract executed online.

A share is the simplest contract traded in securities market. It is a contract between a shareholder and the company, subject to the Articles and the Statutes. It provides specific terms in respect of a class of shares of the company. The Articles of Association of a company provide generic terms in respect of all shares of the company. The specific statutes (the Companies Act, 2013), which enable issue of shares, provide the global terms in respect of all shares across companies. The general statutes (the Indian Contract Act, 1872) provide the universal terms in respect of all contracts across contracting parties.

On the bedrock formed by its Articles, the Companies Act, 2013, and the Indian Contract Act, 1872, a company issues a class of shares. Neither the company nor the prospective shareholders negotiate details of every term in case of each issue of shares. Nor do they prepare, sign and preserve bulky contracts. Even a transfer of shares from one person to another does not require a fresh contract between the company and the incoming shareholder.

The terms relating to shares have been standardised by the parties over centuries of transactions. Most of them have found place in course of time in the Articles, specific statutes and general statutes. Consequently, a share carries only a few terms and is sleek. This eliminates protracted negotiation by the parties, delay in conclusion of transactions, and the possibility of unfavourable terms for the weaker party. It facilitates development of jurisprudence around standard terms, and significantly reduces costs, avoids disputes, and promotes contract enforcement.

The securities market provides an electronic platform for online execution of contracts. The platform matches the interests of the parties and executes a standardised contract, online between them, with the least effort, cost and time. Once executed, the contract evidences unmistakable meeting of minds and irrefutable rights and obligations, and thereby avoids any concerns of contract enforcement.

Preparation, preservation and servicing of paper-based contracts are very costly, in addition to being susceptible to theft, forgery and mutilation. The securities market has addressed these concerns by dematerialising the contracts. A company issues demat shares; a depository holds demat shares; a stock exchange provides trading of demat shares; an investor deals in demat shares and the Government levies taxes on issue and trading of demat shares. This enables almost instantaneous transfer as well as consummation of contracts, while facilitating storage, retrieval, validation and authentication of contracts.

One would imagine that given the obvious advantages, the securities market must have embraced online execution as well as dematerialisation with open arms. There was, however, tough resistance to online trading of securities and dematerialisation of securities for years and both required considerable regulatory persuasion and fiat. In course of time, both turned out to be greatest stories of contagious success catapulting India's securities market to global benchmark. Many contracts such as lease agreements, wills, sale of goods, are now standardised and executed online. Many other contracts such as securities, kisan vikas patra, insurance plans, warehouse receipts, are now held and or transferred in demat form.

A debtor usually contracts with many creditors. It increases her capacity to raise debts and consequently the likelihood of default. When a default occurs, the sum of claims of individual creditors usually exceeds the value of assets of the debtor. The bankruptcy law steps in to satisfy the claims while preventing a run on the assets of the debtor. This requires perfect knowledge of every contract of credit.

The Insolvency and Bankruptcy Code, 2016 envisages the applicant to submit records of the default while initiating corporate insolvency resolution process. It envisages a creditor to submit claim along with proof of existence of debt. It expects that an information utility would make authentic record of debt and default available to the adjudicating authority and the resolution professional to facilitate timebound completion of processes. Automation of credit contracts would not only facilitate insolvency resolution and bankruptcy processes, but also yield similar benefits as have been realised in the securities market.

One occasionally argues that the credit market mostly uses bilateral, tailor-made contracts to provide terms of credit and that depending on the amount of credit, purpose of credit, nature of security, creditworthiness of the debtor, etc., each credit contract is unique. However, each contract has a finite number of terms and all possible terms in all possible contracts are also finite. It is possible to develop a lengthy template carrying all possible terms and the parties may fill up the template according to the terms they agree upon for a credit. Or, there can be 'n' templates to meet the needs of each class or sub-class of credit and the parties may pick up the template relevant to the purpose. The template may even provide flexibility to parties to modify or specify a special term to meet their requirements. It can be made sleek by parking common terms outside the contract. Many lenders today use a templated approach for a variety of credit contracts. Borrowing through credit cards is an example of a fully automated contract.

For credit contracts to enjoy the confidence of stakeholders and form the indisputable basis for initiation of processes under the Code and determination of claims of creditors, it is necessary to maintain the sanctity and integrity of the process of automation. An information utility or any other regulated third party created for the purpose may make standardised demat templates available on an electronic platform where parties can enter into credit contracts online. It may facilitate electronic stamping of such contracts, keep custody of all such contracts and make them available to parties and the entitled authorities for their legitimate uses.

Automation of contracts, irrespective of the business, would make contracting efficient, protect the weaker party and strengthen contract enforcement, and consequently improve ease of doing business. Like automation of wheels, it would propel the business to the next level, in a greener environment.

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