

Cancellation of the VVIP Helicopter Contract: Beginning of a Long haul?

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The terse press release of January 1, 2014 by the Ministry of Defence (MoD) concerning termination of the agreement for purchase of VVIP helicopters from Augusta Westland International Limited (AWIL)¹ makes two points. One, that the agreement has been terminated on the grounds of breach of the Pre-contract Integrity Pact (PCIP) and the Agreement by AWIL. Two, though integrity related issues are not subject to arbitration, MoD has nominated Hon'ble Justice BP Jeevan Reddy as its arbitrator with a view to safeguarding government's interest.

To put it laconically, PCIP requires the bidder/seller to commit that no corrupt practice had been adopted in procuring the contract and no such transgression will take place at any subsequent stage. The relevant clauses in the PCIP are very exhaustive and cover the whole range of transgressions involving bribery, gift, reward, favour, commission, fee, brokerage, etc. Any breach of these clauses or violation of any law enacted for the prevention of corruption entitles the buyer to take one or more of several actions mentioned in the PCIP. These actions include cancellation of contract, recovery of all sums paid and debarment of the bidder/seller from participating in future bids for a specified period.

What makes these clauses a very powerful tool in the hands of the buyer is the provision in the PCIP which says that 'the decision of the Buyer to the effect that a breach of provisions of this Integrity Pact has been committed by the Bidder shall be final and binding on the Bidder, however, the Bidder can approach the monitor(s) appointed for the purposes of this Pact'².

Viewed against this backdrop, MoD was, *prima facie*, within its rights to cancel the contract. However this action does not signify the end of the affair. Cancellation of the contract is one of the many actions that the PCIP empowers the buyer to take. The ministry will have to take a call on a number of other related issues. The first issue relates to debarment of the seller. Since

¹ Accessible at <http://pib.nic.in/newsite/pmreleases.aspx?mincode=33>, last accessed on January 2, 2014

² See Para 10.2 of the Defence Procurement Procedure (DPP) 2008 under which the Request for Proposal for the purchase of VVIP Helicopters was issued. The subsequent editions of the DPP issued in 2011 and 2013 also have this provision.

AgustaWestland is a wholly owned subsidiary of Finmeccanica and the latter has a stake in a number of other companies such as the Oto Melara and MBDA, which manufacture defence systems of interest to India, it will need to be decided whether debarment should be confined to AgustaWestland or extend to all companies in which Finmeccanica has a stake, as also the duration of such debarment.

While this is a larger issue and any decision taken in this regard will have a long-term impact, there is a second set of issues that would need to be addressed immediately. These issues relate to forfeiture of the Integrity Pact Bank Guarantee (IPBG) and the Performance-cum-Warranty Bond (PWB); recovery of the amount already paid (45 per cent of the contract value has already been paid) with interest; and, recovery of the sums paid by the seller in violation of the PCIP.

Forfeiture of the bank guarantees would have been a simple affair as the PCIP provides that these shall stand forfeited without the buyer having to assign any reason for that. The problem, however, is that according to the provisions of the PCIP the Guarantee/Bond could be forfeited either fully or partially. A call will have to be taken on this. Recovery of the amount already paid may also pose no problem as these payments are probably covered by bank guarantees but the seller could seek an interim injunction from the court against such an action. The same applies to recovery of the sums allegedly paid in violation of the PCIP, assuming that there is some way in which this amount could be recovered.

The third problem relates to the three helicopters that have already been received against the order for 12 helicopters. Assuming that all the money that has been paid to the seller is recovered, in addition to forfeiture of the bank guarantees and recovery of the sums paid by the seller in violation of the PCIP, it is doubtful if the ministry will have any claim on the three helicopters that have already been received as it would amount to holding them *gratis*. There are no policy guidelines which could help solve this imbroglio.

While there was perhaps no option for the MoD but to do what it has done, it would be naive to expect the seller to acquiesce in forfeiture of the bank guarantees, recovery of the sums allegedly paid in violation of the PCIP (assuming that it will be possible to recover this amount) and to simply take the three helicopters back without demur. The seller has indeed initiated the arbitration proceedings and after taking a rather legally untenable stand that there was no question of participating in the arbitration proceedings MoD has now nominated Hon'ble Mr Justice BP Jeevan Reddy as its arbitrator. Three points need to be made in this regard.

One, the arbitration clause in a contract (or, for that matter, a separate arbitration agreement) survives the cancellation of the contract to which it is related. Therefore, there is no way any party can get away from it by simply stating that there is no question of its participating in the arbitration proceedings. Two, the press release creates a somewhat wrong impression when it says that MoD

has nominated Hon'ble Justice BP Jeevan Reddy *as its arbitrator with a view to safeguarding government's interest*. An Arbitrator is required to serve the cause of justice and not to safeguard the interest of the party which nominates him. Under the Indian law of arbitration, the arbitrator is required to be impartial and independent³. In fact, under section 12 (3) (a) of the Arbitration and Conciliation Act, 1996, appointment of an arbitrator can be challenged if circumstances exist that give rise to justifiable doubts as to his independence or impartiality.

Three, section 9 of the aforesaid Act, provides for interim measures by the court even *before* the commencement of the arbitration proceedings. The Court exercises very wide powers under this section, which includes passing an order, *inter alia*, on (a) the preservation, interim custody or sale of any goods which are the subject-matter of the arbitration agreement; (b) securing the amount in dispute in the arbitration; and (c) such other interim measure of protection as may appear to the court to be just and convenient. Interim measures can be ordered by the arbitral tribunal also after commencement of the proceedings under section 17 of the aforesaid Act. The tribunal can order a party to take any interim measure of protection as considered necessary in respect of the subject matter of dispute.

While it is perhaps true that the integrity related issues are not subject to arbitration but that may not necessarily be the basis on which the matter is brought before arbitration tribunal by the seller. The charges against the company are yet to be established in a court of law. The Central Bureau of Investigation is yet to complete its investigation. In these circumstances, the process through which the MoD came to the conclusion that the PCIP had been violated could possibly be a ground for challenging the decision. In any case, the opaqueness of the process through which the buyer reaches the conclusion that the PCIP had been violated constitutes a grey area in the PCIP which would need to be addressed in the long run.

The present imbroglio seems to be poised for a long haul. Irrespective of how it plays out, there is a need to remove the ambiguities in the PCIP which have the potential of leading the MoD into blind alleys.

Views expressed are of the author and do not necessarily reflect the views of the IDSA or of the Government of India.

³ According to the standard arbitration clause in contracts involving foreign vendors, arbitration proceedings are to be conducted in India under the Indian Arbitration and Conciliation Act, 1996 and the awards of such Arbitration Tribunals shall be enforceable in the Indian courts only. See Defence Procurement Procedure.