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UPENDING THE ARBITRATION REGIME FOR GOVERNMENT PROCUREMENTS

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MAYURI TIWARI
ADITYA AGARWAL
YUGA KANE
Anagram Partners

mayuri.ta@anagrampartners.in
aditya.a@anagrampartners.in
yuga.k@anagrampartners.in

If you have any questions regarding the matters discussed in this publication, please contact the attorney(s) listed above or call your regular contact at Anagram.

On June 3, 2024, the Ministry of Finance, Government of India, issued the Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement ("Guidelines").[1]

The Guidelines recommend that arbitration should *not* be "*routinely or automatically included in procurement contracts/ tenders*", especially in "*large contracts*". Specifically, arbitration may only be opted in instances where the value of the dispute in procurement contracts involving the Government of India ("**Government**") is less than INR 100 million (approximately USD 1.2 million). It is a separate matter, that the Guidelines, issued by Ministry of Finance (and not the Ministry of Law) on a legal matter, do not explain how the "*value of the dispute*" is to be determined at the time of entering into the contract. The Guidelines advocate for resolution of disputes through mediation and recommend the constitution of a "*high level committee*" for resolution of "*high value matters*". This effectively means that all disputes which have a value in excess of the threshold amount of INR 100 million would be submitted to court litigation.

The Guidelines come almost a month after the Supreme Court of India set aside an approximately USD 1 billion award against the Delhi Metro Rail Corporation (discussed here)[2] and in our view are an irrational response against the increasing number of adverse arbitral awards involving the Government and its entities and agencies (including Central Public Sector Enterprises ("**CPSE**"), Public Sector Banks ("**PSB**") etc., and Government companies. The Guidelines, if implemented, would pose challenges for the dispute resolution process in procurement dealings with the Government. The application of the Guidelines to "procurements" could bring within its ambit an array of contracts, including those in the infrastructure sector and if so done, their implementation could have the potential to upend private sector participation in Government-sponsored infrastructure projects.

Key Features

Whilst the Guidelines intend to promote mediation and not arbitration as the preferred method of dispute resolution as the "*norm*", especially in "*large contracts*" or matters of "*high*

1 Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement, Ministry of Finance, 3rd June 2024 (**Guidelines**).

2 *Delhi Metro Rail Corporation Ltd. v. Delhi Airport Metro Express Pvt. Ltd.*, (2024) 6 SCC 357.

value", surely it cannot be lost on the Government that any mediation exercise under the Mediation Act, 2023 would require a voluntary and consensual dispute resolution. In essence, the mandatory default mechanism for dispute resolution can never be mediation. The Guidelines ignore the fact that it would be impossible to measure the value of the dispute at the time of entering the contract. It is one thing to suggest that the Guidelines should apply to contracts below a certain value i.e., INR 100 million, but it is something quite unexplainable for the Guidelines to expect counterparties to apply arbitration linked to the value of the dispute. It further provides that if the dispute value is more than INR 100 million, and a government department or public undertaking wishes to opt for arbitration, they are required to: (i) record the reasons for opting for arbitration upon "*careful application of mind*"; and (ii) seek approval from the relevant authorities[3] who have the power to make "*general or case-specific modification in the application of the guidelines*".[4]

In the best case, if the Guidelines are implemented in the current form, the parties would not have any clarity on the dispute resolution method at the time of entering into the contract, as its applicability will come into play only once a dispute arises and its dispute value is crystalized and in the worst case, the Guidelines, if implemented, would make the arbitration clause unworkable.

The Government justifies its drastic approach in the Guidelines based on *first*, its own purported experience of arbitration which, it states, has been unsatisfactory due to excessive delays, "*reduced formality*" in the process leading to awards being rendered on the basis of improper application of law, impropriety on part of arbitrators as they are apparently not subject to "*high standards of selection*" as the judiciary and constant challenges mounted against unfavorable awards leading to further litigation; and *second*, peculiar nature of the way the Government functions, leading to multiple levels of scrutiny, difficulty in accepting adverse awards without exhausting all judicial avenues and the existence of an arbitration clause acting as a disincentive to finding amicable solutions.[5]

Interestingly, this is not the first instance of the Government avoiding arbitration in favour of other dispute resolute mechanisms. The former Finance Minister, in the budget speech of 2015-16, had committed to introduce the Public Contracts (Resolution of Disputes) Bill to streamline the institutional arrangements for resolution of such disputes.[6] While the said Bill went through public consultation, no progress was made to give effect to it. Further, the Vijay Kelkar Committee on "*Revisiting and Revitalizing Public Private Partnership Model of Infrastructure*" had mooted the idea of establishing a dedicated tribunal for adjudication of infrastructure sector disputes.[7] Accordingly, model concession agreements across infrastructure sectors were modified to include an overriding provision for referring disputes to a specialized infrastructure tribunal, as and when such tribunals are established. However, as of date, no such tribunal has been established.

3 Guidelines, at paragraph 7(iii) mandate the approval of the Secretary of the concerned Ministry or any other officer who has been delegated authority by the Secretary (not below the level of Joint Secretary for Government Ministries or Departments and of the Managing Director for the CPSEs, PSBs or Financial Institutions.

4 Guidelines, at paragraph 7.

5 Guidelines, at paragraphs 4, 5.

6 Budget Speech (2015-16) by Hon'ble Finance Minister Arun Jaitley (available at link, last accessed July 26, 2024)

7 Report of the Committee on Revisiting and Revitalising Public Private Partnership Model of Infrastructure (available at link, last accessed on July 23, 2024).

Applicability

The import of the Guidelines can only be examined if the scope of the terms 'domestic' and 'procurement' is deciphered. The term 'domestic' has not been explained in the Guidelines. It remains to be seen whether it refers to a contract with a 'domestic' counter party or one for 'domestic' supply within India, irrespective of the nationality of the counterparty.

Moreover, there is no specific statute in India that governs procurement by the Government. Generally, 'public procurement' is regulated by Article 299 of the Constitution of India read with (i) the General Financial Rules, 2017[8] ("**GFR**"), and (ii) Manual for Procurement of: (A) 'Goods'[9], (B) 'Works'[10], and (C) 'Consultancy and Other Services'[11], ((A) to (C) collectively referred to as the "**Procurement Manuals**" – which are general guidelines for procurement). The term procurement has been consistently defined under the Procurement Manuals in a broad manner to include "*acquisition by way of purchase, lease, license or otherwise, either using public funds or any other source of funds (e.g. grant, loans, gifts, private investment etc.) of goods, works or services or any combination thereof, including award of Public Private Partnership*[12] *projects...*"[13]

The terms 'goods', 'consultancy services' and 'other services' have also been broadly defined in the Procurement Manuals and the term 'works' has been ascribed the following meaning:

> *"any activity, sufficient in itself to fulfil an economic or technical function, involving construction, ...*
>
> *The term "Works" includes (i) civil works for the purposes of roads, railway, airports, shipping-ports, bridges, buildings, irrigation systems, water supply, sewerage facilities, dams, tunnels and earthworks; and so on* ..."[14]

Given the wide import of the term "*procurement*", the Guidelines may bring within its purview procurement contracts entered by the Government, including power purchase agreements, concession agreements for development of highways, ports, airports, turnkey contracts, operation & maintenance agreements, etc. This would mean that going forward, several infrastructure contracts where the value of dispute is in excess of INR 100 million (which it is in most cases) and where the Government (its entity, agency, instrumentality) is a party, would not be submitted to arbitration. However, one cannot rule out the possibility of the Government applying these rules selectively, for a smaller subset of procurement contracts. Though the Guidelines

8 General Financial Rules, 2017 (available at link, last accessed on July 23, 2024).

9 Manual for Procurement of Goods, Department of Expenditure, Ministry of Finance (available at link, last accessed on July 23, 2024).

10 Manual for Procurement of Works, Department of Expenditure, Ministry of Finance (available at link, last accessed on July 23, 2024).

11 Manual for Procurement of Consultancy and Other Services, Department of Expenditure, Ministry of Finance, (available at link, last accessed on July 23, 2024).

12 Public Private Partnership (or PPP) has been consistently defined in the Procurement Manuals to mean *"an arrangement between the central, a statutory entity or any other Government-owned entity, on one side, and a private sector entity, on the other, for the provision of public assets or public services... through investments being made or management being undertaken by the private sector entity, for a specified period of time, where there is predefined allocation of risk between the private sector and the public entity.."* See, *supra* note 6 at (xxxi); *supra* note 7 at (xxxv); supra note 8 at (xxxiii).

13 See *supra* note 6 at (xxiv); *supra* note 7 at (xxviii); *supra* note 8 at (xxvi).

14 See *supra* note 6 at (xxxviii); *supra* note 7 at (xl); *supra* note 8 at (xl).

have not specifically stipulated a "*start date*", it appears that the Guidelines will apply prospectively to contracts which are yet to be executed by parties and not to subsisting contracts.[15]

Impact

The Government's push for mediation as a dispute resolution mechanism is noteworthy. That said, there are three main concerns it ignores: (i) mediation, if made compulsory or where the parties are unwilling to mediate leads to denial of justice;[16] (ii) mediation (unless it results in a memorandum of settlement accepted by both parties) remains non-binding;[17] and (iii) parties are at liberty to opt out of the proceedings at their will.[18] Practically, this will result in high value disputes in infrastructure sector being relegated to courts and will be antithetical to the objective the Government is trying to attain.

The Guidelines are also likely to have a larger impact on the infrastructure industry:

- Adverse impact on investor confidence— Arbitration provides multiple benefits such as confidentiality, speed and flexibility, which in turn, gives greater comfort to investors regarding enforceability of their contractual rights. The Guidelines are likely to upend the progress achieved in recent times and have an adverse impact on attracting/sustaining foreign investment in India.

- Narrow pool of adjudicators— The nature of disputes in the infrastructure sector is highly technical and requires adjudication by experts who have a command of the technical know-how of the infrastructure sector. These technical experts are unlikely to be trained mediators and therefore will deprive parties of the choice to appoint them as adjudicators.

- Increased Delays— The delays and cost overruns are a key cause of disputes in the infrastructure sector. Insistence on court adjudication is likely to elongate the time for dispute resolution and consequently, delay the completion of such infrastructure projects on time and within the estimated costs. This position was also echoed by the Economic Survey 2023-24[19] which identified "*inadequate arrangements for dispute resolution and arbitration, leading to prolonged litigation*" as one of the key impediments for greater private sector participation in the infrastructure sector.

- Ambiguities leading to uncertainty— *First*, the Guidelines intend to limit their application only to 'domestic' procurement contracts without explanation on the import of the term 'domestic'. *Second*, the applicability is based on the dispute value (which is usually the sum of the claim, counterclaim minus any set-off), as opposed to contract value. The Guidelines also compel parties to quantify the dispute value right at the stage of reference to arbitration, which may be a difficult exercise. This could push the decision making on choice of the dispute

15 Guidelines, at paragraph 7(i)-(iii).

16 Department-Related Parliamentary Standing Committee on Personnel, Public Grievances, Law and Justice, "*One Hundred Seventeenth Report on The Mediation Bill, 2021*", available at link (Volume 1, July 13, 2022) at page 83.

17 Mediation Act, 2023, Section 24.

18 *Id*.

19 See, Economic Survey 2023-24, page 441 (available at link, last accessed on July 24, 2024)

resolution method not to the contract drafting stage but post the dispute having arisen (especially when parties have little consensus). It also makes it a breeding ground for litigation tactics by recalcitrant opponents who want to avoid arbitration and elongate the dispute timeline even where dispute value is small.

- The implementation of the Guidelines will also deprive the industry of the benefit afforded in arbitration proceedings through the decision of Cabinet Committee on Economic Affairs[20] which mandated Government entities to pay 75% of the principal amount in the award to the concessionaire before challenging the arbitral award, or the "*Vivad se Vishwas -II*" scheme.[21]

CONCLUSION

In our view the Guidelines could adversely affect the investor confidence as long gestation periods of infrastructure projects require a secure and predictable dispute resolution framework. Given that the Government is a counterparty in infrastructure projects or public procurement contracts, submitting the dispute to national courts (in case of failed mediation) would threaten investor confidence in enforcement of contracts or resolution of their claims in a fair and unbiased manner, thereby making the overall investment 'high-risk'.

While it is undeniable that the arbitration process in India has several failings, the concerns expressed in the Government's Guidelines overplay the shortcomings. Ultimately, the Guidelines, if implemented, would increase adjudication through the courts with protracted timelines. A better approach would have been to address the shortcomings in the arbitral process by encouraging incorporation of fast-track arbitration in relevant cases, mandating strict adherence to timelines under Section 29A of the Arbitration and Conciliation Act, 1996 and compulsory adoption of institutional arbitration for increased accountability of the overall arbitral process.[22]

20 See, CCEA "*Cabinet approves Initiatives to revive the Construction Sector the Office Memorandum*" (available at link, last accessed on July 24, 2024)

21 See, '*Vivad se Vishwas II (Contractual Disputes)*' (available at link, last accessed on July 23, 2024).

22 Guidelines, at paragraph 7(iv) in fact recommend that institutional arbitration be given preference in matters where arbitration is to be resorted to.

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