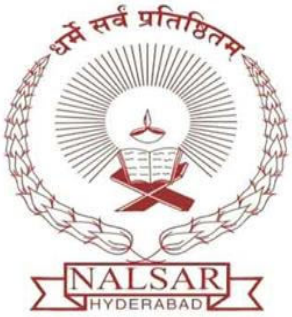

Centre for Aerospace & Defence Laws (CADL)
Directorate of Distance Education
NALSAR University of Law, Hyderabad

Course Material

M.A. (SECURITY AND DEFENCE LAWS)

1.2.6. DEFENCE CONTRACTS AND TENDERS

Compiled by:
Prof. (Dr.) V. Balakista Reddy
Ms. Ruchi Jain

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MODULE-I

FUNDAMENTALS OF LAW OF CONTRACTS

INDIAN CONTRACT ACT, 1872

Prior to the Indian Contract Act, English law of contract was followed in India. Indian Contract Act has XI chapter. Law of contract creates jus in personem and not in jus in rem. The Indian Contract Act consists of the following two parts: (a) General principles of the Law of Contract. (b) Special kinds of contracts. The general principals of the Law of Contract are contained in Sections 1 to 75 of the Indian Contract Act. These principles apply to all kinds of contracts irrespective of their nature. Special contracts are contained in Sections 124 to 238 of the Indian Contract Act. These special contracts are Indemnity, Guarantee, Bailment, pledge and Agency.

Contracts as Defined by Eminent Jurists

1. "Every agreement and promise enforceable at law is a contract." – Pollock
2. "A Contract is an agreement between two or more persons which is intended to be enforceable at law and is contracted by the acceptance by one party of an offer made to him by the other party to do or abstain from doing some act." – Halsbury
3. "A contract is an agreement creating and defining obligation between the parties" – Salmond

Some Important Definitions under Indian Contract Act, 1872

1. Offer(i.e. Proposal) [section 2(a)]:-When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other person either to such act or abstinence, he is said to make a proposal.
2. Acceptance 2(b):- When the person to whom the proposal is made, signifies his assent there to , the proposal is said to be accepted.
3. Promise 2(b) :- A Proposal when accepted becomes a promise. In simple words, when an offer is accepted it becomes promise.
4. Promisor and promise 2(c) :- When the proposal is accepted, the person making the proposal is called as promisor and the person accepting the proposal is called as promisee.
5. Consideration 2(d):- When at the desire of the promisor, the promisee or any other person has done or abstained from doing something or does or abstains from doing something or promises to do or abstain from doing something, such act or abstinence or promise is called a consideration for the promise. ™ Price paid by the one party for the promise of the other Technical word meaning QUIDPRO-QUO i.e. something in return.
6. Agreement 2(e) :- Every promise and set of promises forming the consideration for each other. In short, agreement = offer + acceptance.
7. Contract 2(h) :- An agreement enforceable by Law is a contract.

8. Void agreement 2(g):- An agreement not enforceable by law is void.
9. Voidable contract 2(i):- An agreement is a voidable contract if it is enforceable by Law at the option of one or more of the parties there to (i.e. the aggrieved party), and it is not enforceable by Law at the option of the other or others.
10. Void contract: - A contract which ceases to be enforceable by Law becomes void when it ceases to be enforceable.

ESSENTIALS OF A VALID CONTRACT

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

1. Proper offer and proper acceptance with intention to create legal relationship. Cases;- A and B agree to go to a movie on coming Sunday. A does not turn in resulting in loss of B's time B cannot claim any damages from B since the agreement to watch a movie is a domestic agreement which does not result in a contract.
    - In case of social agreement there is no intention to create legal relationship and there the is no contract (Balfour v. Balfour)
    - In case of commercial agreements, the law presume that the parties had the intention to create legal relations.
    - [an agreement of a purely domestic or social nature is not a contract]
2. Lawful consideration :- consideration must not be unlawful, immoral or opposed to the public policy.
3. Capacity:- The parties to a contract must have capacity (legal ability) to make valid contract. Section 11:- of the Indian contract Act specify that every person is competent to contract provided.
    (i) Is of the age of majority according to the Law which he is subject, and
    (ii) Who is of sound mind and
    (iii) Is not disqualified from contracting by any law to which he is subject.
        - Person of unsound mind can enter into a contract during his lucid interval.
        - An alien enemy, foreign sovereigns and accredited representative of a foreign state. Insolvents and convicts are not competent to contract.
4. Free consent :- consent of the parties must be genuine consent means agreed upon samething in the same sense i.e. there should be consensus – ad – idem. A consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake.
5. Lawful object
    - The object of agreement should be lawful and legal.
    - Two persons cannot enter into an agreement to do a criminal act.
    - Consideration or object of an agreement is unlawful if it

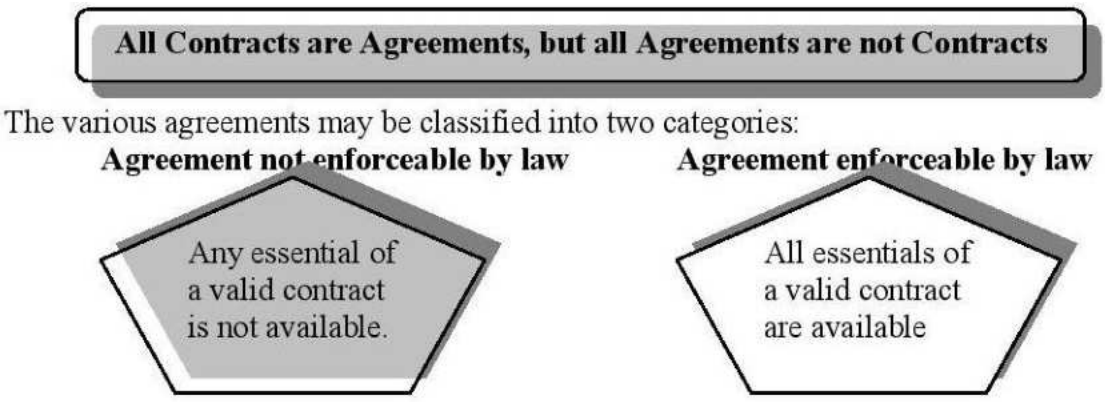
(a) is forbidden by law; or
(b) is of such nature that, if permitted, would defeat the provisions of any law; or
(c) is fraudulent; or
(d) Involves or implies, injury to person or property of another; or
(e) Court regards it as immoral, or opposed to public policy.

6. Possibility of performance:
   - The terms of the agreement should be capable of performance.
   - An agreements to do act, impossible in itself cannot be enforced.

   Example : A agrees to B to discover treasure by magic. The agreement is void because the act in itself is impossible to be performed from the very beginning.
7. The terms of the agreements are certain or are capable of being made certain [29] Example : A agreed to pay Rs.5 lakh to B for ultra-modern decoration of his drawing room. The agreement is void because the meaning of the term " ultra – modern" is not certain.
8. Not declared Void
   - The agreement should be such that it should be capable or being enforced by law.
   - Certain agreements have been expressly declared illegal or void by the law.
9. Necessary legal formalities
   - A contract may be oral or in writing.
   - Where a particular type of contract is required by law to be in writing and registered, it must comply with necessary formalities as to writing, registration and attestation.
   - If legal formalities are not carried out then the contract is not enforceable by law.

   Example : A promise to pay a time. Barred debt must be in writing.

Agreement is a wider term than contract whereas all contracts are agreements. All agreements are not contracts.



Thus we see that an agreement may be or may not be enforceable by law, and so all agreement are not contract. Only those agreements are contracts, which are enforceable by law, In short.

Contracts = Agreement + Enforceability by Law

Hence, we can conclude "All contracts are agreement, but all agreements are not contracts."

Distinction between Contract & Agreement

Basis	Contract	Agreement
1. Section :	Sec. 2(h)	Sec. 2(e)
2. Definition :	A contract is an agreement enforceable by law.	Every promise or every set of promises forming consideration for each other is an agreements.
3. Enforceability :	Every contract is enforceable	Every promise is not enforceable.
4. Interrelationship	A contract includes an agreement.	An agreement does not include a contract.
5. Scope :	The scope of a contract is limited, as it includes only commercial agreements.	Its scope is relatively wider, as it includes both social agreement and commercial agreements.
6. Validity :	Only legal agreements are called contracts.	An agreement may be both legal and illegal.
7. Legal Obligation :	Every contract contains a legal obligation.	It is not necessary for every agreement to have legal obligation.

Types of contracts :-

(1) On the Basis of creation

a. Express contract
b. Implied contract
c. Tacit contract
d. Quasi contract
e. E contract

(2) On the Basis of Validity

a. Valid contract
b. Void contract
c. Voidable contrac
d. Unenforceable contract
e. Illegal contract

(3) On the Basis of execution

a. Executed contract
b. Executed contract
c. Partly executed and party executory

(4) On the Basis of Liability

a. Bilateral contract
b. Unilateral contract

On the Basis of Creation

(a) Express contract :- A contract made by word spoken or written. According to sec 9 in so for as the proposal or acceptance of any promise is made in words, the promise is said to be express. Example : A says to B 'will you purchase my bike for Rs.20,000?" B says to A "Yes".

(b) Implied contract:- A contract inferred by ™ The conduct of person or ™ The circumstances of the case. By implies contract means implied by law (i.e.) the law implied a contract through parties never intended. According to sec 9 in so for as such

proposed or acceptance is made otherwise than in words, the promise is said to be implied. Example: A stops a taxi by waving his hand and takes his seat. There is an implied contract that A will pay the prescribed fare.

(c) Tacit contract: - A contract is said to be tacit when it has to be inferred from the conduct of the parties. Example obtaining cash through automatic teller machine, sale by fall hammer of an auction sale.

(d) Quasi Contracts are contracts which are created –

- Neither by word spoken
- Nor written
- Nor by the conduct of the parties.
- But these are created by the law.

Example: If Mr. A leaves his goods at Mr. B's shop by mistake, then it is for Mr. B to return the goods or to compensate the price. In fact, these contracts depend on the principle that nobody will be allowed to become rich at the expenses of the other.

(a) e – Contract: An e – contract is one, which is entered into between two parties via the internet.

On the basis of Validity

(a) Valid contract:- An agreement which satisfies all the requirements prescribed by law On the basis of creation

(b) Void contract (2(j)):- a contract which ceases to be enforceable by law because void when of ceased to be enforceable When both parties to an agreement are:- Under a mistake of facts [20] Consideration or object of an agreement is unlawful [23] Agreement made without consideration [25] Agreement in restrain of marriage [26] Restraint of trade [27] Restrain legal proceeding [28]. Agreement by wage of wager [30]

(c) Voidable contract 2(i):- an agreement which is enforceable by law at the option of one or more the parties but not at the option of the other or others is a voidable contract. Result of coercion, undue influence, fraud and misrepresentation.

(d) Unenforceable contract: - where a contract is good in substance but because of some technical defect i.e. absence in writing barred by imitation etc. one or both the parties cannot sue upon but is described as unenforceable contract. Example: Writing registration or stamping. Example: An agreement which is required to be stamped will be unenforceable if the same is not stamped at all or is under stamped.

(e) Illegal contract:- It is a contract which the law forbids to be made. All illegal agreements are void but all void agreements or contracts are not necessary illegal. Contract that is immoral or opposed to public policy are illegal in nature. Unlike illegal agreements there is no punishment to the parties to a void agreement. Illegal agreements are void from the very beginning agreements are void from the very beginning but sometimes valid contracts may subsequently become void.

On the basis of execution

(a) Executed contract :- A contract in which both the parties have fulfilled their obligations under the contract. Example: A contracts to buy a car from B by paying cash, B instantly delivers his car.
(b) Executory contract:- A contract in which both the parties have still to fulfilled their obligations. Example : D agrees to buy V's cycle by promising to pay cash on 15th July. V agrees to deliver the cycle on 20th July.
(c) Partly executed and partly executory:- A contract in which one of the parties has fulfilled his obligation but the other party is yet to fulfill his obligation. Example : A sells his car to B and A has delivered the car but B is yet to pay the price. For A, it is excuted contract whereas it is executory contract on the part of B since the price is yet to be paid.

On the basis of Liability

(a) Bilateral contract:- A contract in which both the parties commit to perform their respective promises is called a bilateral contract. Example : A offers to sell his fiat car to B for Rs.1,00,000 on acceptance of A's offer by B, there is a promise by A to Sell the car and there is a promise by B to purchase the car there are two promise.
(b) Unilateral contract:- A unilateral contract is a one sided contract in which only one party has to perform his promise or obligation party has to perform his promise or obligation to do or forbear.
Example :- A wants to get his room painted. He offers Rs.500 to B for this purpose B says to A " if I have spare time on next Sunday I will paint your room". There is a promise by A to pay Rs 500 to B. If B is able to spare time to paint A's room. However there is no promise by B to Paint the house. There is only one promise.

OFFER OR PROPOSAL

Offer(i.e. Proposal) [section 2(a)]:-When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other person either to such act or abstinence, he is said to make a proposal.

To form an agreement, there must be at least two elements – one offer and the other acceptance. Thus offer is the foundation of any agreement. "When one person signifies to another his willingness –

- to do or to abstain from doing anything,
- with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal."

The person who makes an offer is called "Offeror" or " Promisor" and the person to whom the offer is made is called the Offeree" or "Promisee".

Example Mr. A says to Mr. B, "Will you purchase my car for Rs.1,00,000?" In this case, Mr. A is making an offer to Mr. B. Here A is the offeror and B is the offeree.

Essentials elements of an offer:-

1. There must be two parties.
2. The offer must be communicated to the offeree.
3. The offer must show the willingness of offeror. Mere telling the plan is not offer.
4. The offer must be made with a view to obtaining the assent of the offeree.
5. A statement made jokingly does not amount to an offer.
6. An offer may involve a positive act or abstinence by the offeree.
7. Mere expression of willingness does not constitute an offer. A tells B' that be desires to marry by the end of 2008, if does not constitute an offer of marriage by A' to B' A further adds will you marry me. Then it become offer.

Legal Rules as to valid offer:-

1. Offer must be communicated to the offeree: The offer is completed only when it has been communicated to the offeree. Until the offer is communicated, it cannot be accepted. Thus, an offer accepted without its knowledge, does not confer any legal rights on the acceptor. Example: A's nephew has absconded from his home. He sent his servant to trace his missing nephew. When he servant had left, A then announced that anybody who discovered the missing boy, would be given the reward of Rs.500. The servant discovered the missing boy without knowing the reward. When the servant came to know about the reward, he brought an action against A to recover the same. But his action failed. It was held that the servant was not entitled to the reward because he did not know about the offer when the discovered the missing boy. [Lalman Shukla v. Gauri Datt (1913) All LJ 489]
2. The offer must be certain definite and not vague unambiguous and certain. Example: A offered to sell to B. 'a hundred tons of oil'. The offer is uncertain as there is nothing to show what kind of oil is intended to be sold.
3. The offer must be capable of creating legal relation. A social invitation is not create legal relation. Example: A invited B to a dinner and B accepted the invitation. It is a mere social invitation. And A will not be liable if he fails to provide dinner to B.
4. Offer may be express and implied The offer may be express or implied; An offer may be express as well as implied. An offer which is expressed by words, written or spoken, is called an express offer. The offer which is expressed by conduct, is called an implied offer [Section 9].

5. Communication of complete offer Example: A offered to sell his pen to B for Rs.1,000. B replied, “I am ready to pay Rs.950”. On A’s refusal to sell at this price, B agreed to pay Rs.1,000. held, there was not contract at the acceptance to buy it for Rs.950 was a counter offer, i.e. rejection of the offer of A. Subsequent acceptance to pay Rs.1,000 is a fresh offer from B to which A was not bound go give his acceptance.
6. Counter offer – A counter offer amounts to rejection of the original offer
7. Cross offer do not conclude a contract
8. An offer must not thrust the burden of acceptance on the offeree. Example: A made a contract with B and promised that if he was satisfied as a customer he would favorably consider his case for the renewal of the contract. The promise is too vague to create a legal relationship. ¾ The acceptance cannot be presumed from silence. ¾ Acceptance is valid only if it is communicated to the offeror.
9. Offer must be distinguished from invitation to offer. Example: Menu card of restaurant is an invitation to put an offer. Example ; Price – tags attached with the goods displayed in any showroom or supermarket is also an invitation to proposal. If the salesman or the cashier does not accept the price, the or the cashier does not accept the price, the interested buyer cannot compel him to sell, if he wants to buy it, he must make a proposal. Example: Job or tender advertisement inviting applications for a job or inviting tenders is an invitation to an offer. Example: An advertisement for auction sale is merely an invitation to make an offer and not an offer for sale. Therefore, an advertisement of an auction can be withdrawn without any notice. The persons going to the auction cannot claim for loss of time and expenses if the advertisement for auction is withdrawn.
10. Offeror should have an intention to obtain the consent of the offeree.
11. An answer to a question is not a offer.

Offer	Invitation to offer
➢ Show his readiness to enter into a contract, it is called as an offer ➢ Purpose of entering contract ➢ Results in a contract **Example** Application filled in by a prospective applicable to the Institution, a student seeking admission in educational Institution.	➢ Person invites offer to make an offer to him. ➢ Purpose of enter offer ➢ Results in offer. **Example** Issue of prospectus by a Company, an education Institution.

I. Express offer - When the offeror expressly communication the offer the offer is said to be an express offer the express communication of the offer may be made by Spoken word Written word

II. Implied offer – when the offer is not communicate expressly. An offer may be implied from:- The conduct of the parties or The circumstances of the case

III. Specific:- It means an offer made in (a) a particular person or (b) a group of person: It can be accepted only by that person to whom it is made communication of acceptance is necessary in case of specific offer.

IV. General offer: - It means on offer which is made to the public in general.

- General offer can be accepted by anyone.
- If offeree fulfill the term and condition which is given in offer then offer is accepted.
- Communication of acceptance is not necessary is case of general offer

Example Company advertised that a reward of Rs.100 would be given to any person who would suffer from influenza after using the medicine (Smoke balls) made by the company according to the printed directions. One lady, Mrs, Carlill, purchased and used the medicine according to the printed directions of the company but suffered from influenza, She filed a suit to recover the reward of Rs.100. The court held that there was a contract as she had accepted a general offer by using the medicine in the prescribed manner and as such as entitled to recover the reward from the company. Carlill v Carbilic Smoke Ball Co. 1893

V. Cross offer:- When two parties exchange identical offers in ignorance at the time of each other's offer the offer's are called cross offer. Two cross offer does not conclude

a contract. Two offer are said to be cross offer if 1. They are made by the same parties to one another 2. Each offer made in ignorance of the offer made by the 3. The terms and conditions contained in both the offers' are same. Example : A offers by a letter to sell 100 tons of steel at Rs.1,000 per ton. On the same day, B also writes to A offering to buy 100 tons of steel at Rs.1,000 per ton. When does a contract come into existence: - A contract comes into existence when any of the parties, accept the cross offer made by the other party.

VI. Counter offer :- when the offeree give qualified acceptance of the offer subject to modified and variations in the terms of original offer. Counter offer amounts to rejection of the original offer. Legal effect of counter offer:- (1) Rejection of original offer (2) The original offer is lapsed (3) A counter offer result is a new offer. In other words an offer made by the offeree in return of the original offer is called as a counter offer. Example: A offered to sell his pen to B for Rs.1,000. B replied, " I am ready to pay Rs.950." On A's refusal to sell at this price, B agreed to pay Rs.1,000. Held, there was not contract as the acceptance to buy it for Rs.950 was a counter offer, i.e. rejection of the offer of A. Subsequent acceptance to pay Rs.1,000 is a fresh offer from B to which A was not bound to give his acceptance.

VII. Standing, open and continuous offer:- An offer is allowed to remain open for acceptance over a period of time is known as standing, open or continually offer. Tender for supply of goods is a kind of standing offer. Example: When we ask the newspaper vendor to supply the newspaper daily. In such case, we do not repeat our offer daily and the newspaper vendor supplies the newspaper to us daily. The offers of such types are called Standing Offer.

Lapse of an Offer

An offer should be accepted before it lapses (i.e. comes to an end). An offer may come to an end in any of the following ways stated in Section 6 of the Indian Contract Act:

1. By communication of notice of revocation: An offer may come to an end by communication of notice of revocation by the offeror. It may be noted that an offer can be revoked only before its acceptance is complete for the offeror. In other words, an offeror can revoke his offer at any time before he becomes before bound by it. Thus, the communication of revocation of offer should reach the offeree before the acceptance is communicated.
2. By lapse of time; Where time is fixed for the acceptance of the offer, and it is not acceptance within the fixed time, the offer comes to an end automatically on the expiry of fixed time. Where no time for acceptance is prescribed, the offer has to be accepted within reasonable time. The offer lapses if it is not accepted within that time. The term 'reasonable time' will depend upon the facts and circumstances of each case.

3. By failure to accept condition precedent: Where, the offer requires that some condition must, be fulfilled before the acceptance of the offer, the offer lapses, if it is accepted without fulfilling the condition.
4. By the death or insanity of the offeror: Where, the offeror dies or becomes, insane, the offer comes to an end if the fact of his death or insanity comes to the knowledge of the acceptor before he makes his acceptance. But if the offer is accepted in ignorance of the fact of death or insanity of the offeror, the acceptance is valied. This will result in a valid contract, and legal representatives of the deceased offeror shall be bound by the contract. On the death of offeree before acceptance, the offer also comes to an end by operation of law.
5. By counter – offer by the offeree: Where, a counter – offer is made by the offeree, and then the original offer automatically comes to an end, as the counter – offer amounts to rejections of the original offer.
6. By not accepting the offer, according to the prescribed or usual mode: Where some manner of acceptance is prescribed in the offer, the offeror can revoke the offer if it is not accepted according to the prescribed manner.
7. By rejection of offer by the offeree: Where, the offeree rejects the offer, the offer comes to an end. Once the offeree rejects the offer, he cannot revive the offer by subsequently attempting to accept it. The rejection of offer may be express or implied.
8. By change in law: Sometimes, there is a change in law which makes the offer illegal or incapable of performance. In such cases also, the offer comes to an end.

ACCEPTANCE

Acceptance 2(b):- When the person to whom the proposal is made, signifies his assent there to , the proposal is said to be accepted.

Legal Rules for the Acceptance

1. Acceptance must be absolute and unqualified Example: A offers to sell his house to B for Rs. two lakhs. B accepts the offer and promises to pay the price in four installments. This is not pay the acceptance as the acceptance is with variation in the terms of the offer.
2. Acceptance must be communicated: Mere mental acceptance is no acceptance, But there is no requirement of communication of acceptance of general offer. Example The manager of Railway Company received a draft agreement relating to the supply of coal. The manager marked the draft with the words “Approved” and put the same in the drawer of his table and forgot all about it. Held, there was no contract between the parties as the acceptance was not communicated. It may however, be pointed out that the Court

construed a conduct to parties as railway company was accepting the supplies of coal from time to time.

3. Manner of acceptance General rule say that it must be as per the manner prescribed by offeror. If no mode is prescribed in which it can be accepted, then it must be in some usual and reasonable manner.
4. If there is deviation in communication of an acceptance of offer, offeror may reject such acceptance by sending notice within reasonable time. If the offeror doesn't send notice or rejection, he accepted acceptance of offer. Example: A offers B and indicates that the acceptance be given by telegram. B sends his acceptance by ordinary post. It is a valid acceptance unless A insists for acceptance in the prescribed manner.
5. Acceptance of offer must be made by offeror. Example : A applied for the headmastership of a school. He was selected by the appointing authority but the decision was not communicated to him. However, one of members in his individual capacity informed him about the selection. Subsequently, the appointing authority cancelled its decision. A sued the school for breach of contract. The Court rejected the A's action and held that there was no notice of acceptance. "Information by unauthorized person is as insufficient as overhearing from behind the door".
6. Acceptance must be communicated to offeror
7. Time limit for acceptance • If the offer prescribes the time limit, it must be accepted within specified time. • If the offer does not prescribe the time limit, it must be accepted within reasonable time. Example : A applied (offered) for shares in a company in early June. The allotment (Acceptance) was made in late November. A refused to take the shares. Held, A was entitled to do so as the reasonable time for acceptance had elapsed.
8. Acceptance of offer may be expressly (by words spoken or written); or impliedly (by acceptance of consideration); or by performance of conditions (e.g.in case of a general offer)
9. Mere silence is not acceptance of the offer Example A offers to B to buy his house for Rs.5 lakhs and writes "If I hear no more about it within a week, I shall presume the house is mine for Rs.5 lakhs. "B does not respond. Here, no contract is concluded between A and B.
10. However, following are the two exceptions to the above rule. It means silence amounts as acceptance of offer. • Where offeree agrees that non – refusal by him within specified time shall amount to acceptance of offer. • When there is custom or usage of trade which specified that silence shall amount to acceptance.
11. Acceptance subject to the contract is no acceptance If the acceptance has been given 'subject to the contract" or subject to approval by certain persons, it has not effect at all. Such an acceptance will not create binding contract until a formal contract is prepared and signed by all the parties.

General Rules as to Communication of Acceptance

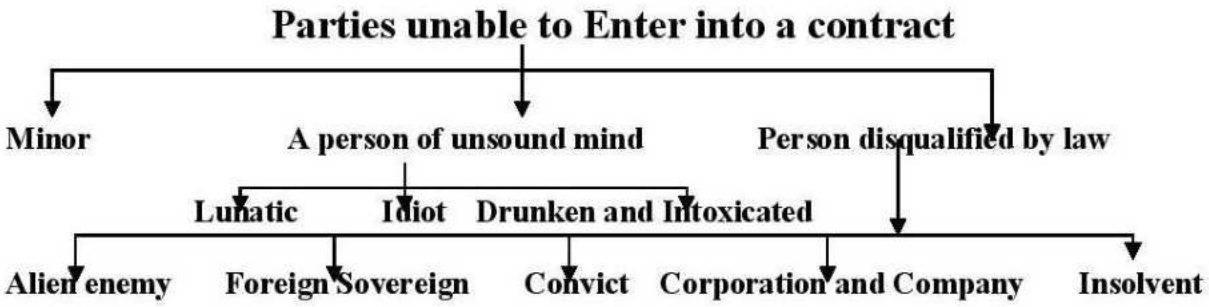
1. In case of acceptance by post: Where the acceptance is given by post, the communication of acceptance is complete as against the proposer when the letter of acceptance is posted. Thus, mere posting of letter of acceptance is sufficient to conclude a contract. However, the letter must be properly addressed and stamped.
2. Delayed or no delivery of letter Where the letter of acceptance is posted by the acceptor but it never reaches the offeror, or it is delayed in transit, it will not affect the validity of acceptance. The offeror is bound by the acceptance.
3. Acceptance by telephones telex or tax If the communication of an acceptance is made by telephone, tele-printer, telex, fax machines, etc, it completes when the acceptance is received by the offeror. The contract is concluded as soon as the offeror receives not hears the acceptance.
4. The place of Contract In case of acceptance by the post, the place where the letter is posted is the place of contract. Where the acceptance is given by instantaneous means of communication (telephone, fax, tele-printer, telex etc.), the contract is made at the place where the acceptance is received,
5. The time of Contract In case of acceptance by post, the time of posting the letter of acceptance to the time of contract. But in case of acceptance by instantaneous means of communication, the time of contract is the time when the offeror gets the communication, the time of contract is the time when offeror gets the communication of acceptance.
6. Communication of acceptance in case of an agent. Where the offer has been made through an agent, the communication of acceptance is completed when the acceptance is given either to the agent or to the principal. In such a case, if the agent fails to convey the acceptance received from offeree, still the principal is bound by the acceptance.
7. Acceptance on loudspeakers Acceptance given on loudspeaker is not a valid a acceptance.

Particulars	Offer	Acceptance
When Communication is complete [Sec.4]	• Communication of a proposal is complete when it comes to the knowledge of the person to whom it is made. • **Example :** A proposes by letter, to sell his Tonga to B at Rs.10,000. Communication of the proposal is complete when B receives the letter.	• **As against the offerer/ 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 Offeree/Acceptor**: When it comes to the knowledge of the Proposer. (See separate question above)
When Revocation can be made [Sec.5]	• Offer/proposal may be revoked at any time before the communication of its acceptance is complete, as against the proposer, but not afterwards. • **Example:** U sends a letter to Y proposing to sell his land. Y sends his acceptance by post. U can revoke the offer at any time before or at the moment when Y posts his letter of acceptance, but not afterwards.	• Acceptance may be revoked at any time before the communication of acceptor, but not afterwards. • **Example:** T sends to S by post, an offer to sell his cycle. S sends his acceptance via post, S could revoke his acceptance, upto any time before or at the moment when he posts his letter of acceptance, but not afterwards.
When communication of revocation is complete [Sec.4]	• **As against the offeror**: 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. • **Example :** S proposes to H by letter. H sends his acceptance by letter. Suddenly, S sends a telegram revoking his offer. Revocation is complete as against S when the telegram is dispatched; H's revocation of acceptance is complete when S receives such telegram.	• **As against the Offeree**: When it comes to his knowledge. • **Example :** Communication of revocation is complete only when H receives the telegram. • When H revokes his acceptance, it is complete when he dispatches the telegram.

Accepted is lighted match, while offer is a train of gun powder

Sir willian Anson.

CAPACITY TO CONTRACT



Section 11. Every person is competent to contract who is of age of majority according to the Law to which he is subject, who is of sound mind and not is disqualified from contracting by any Law to which he is subject.

Age of majority:- According to section 3 of Indian majority Act-1875 every person domiciled in Indian attains majority on the completion of 18 years of age.

Exception: - 21 years- in the following cases.

(a) Where a guardian of a minor's person or property is appointed under the Guardian and wards Act, 1890.
(b) Where minor's property has passed under the superintendence of the court of words.

Position of Agreements by Minor:-

1. Validity: - An agreement with a minor is void-ab-initio [Mohoribibee v. Dharmodas Ghose] Example : Mr. D, a minor, mortgaged his house for Rs.20000 to a money – lender, but the mortgagee, i.e. the money – lender, paid him a sum of Rs.8000. Subsequently, the minor sued for setting aside the mortgage. Held that the contract was void, as Mr. D was minor and therefore he is not liable to pay anything to the lender.
2. A minor's has received any benefit under a void contract, he cannot be asked to return the same.
3. If a minor has received any benefit under a void contract, he cannot be asked to return the same.
4. Fraudulent representation by a minor- no difference in the status of agreement. The contract remains void.
5. A minor with the consent of all the partners, be admitted to the benefits of an existing partnership.
6. Contracts entered into by minors are void-ab-initio. Hence no specific performance can be enforced for such contracts.
7. Minor's parent/guardians are not liable to a minor's creditor for the breach of contract by the minor.

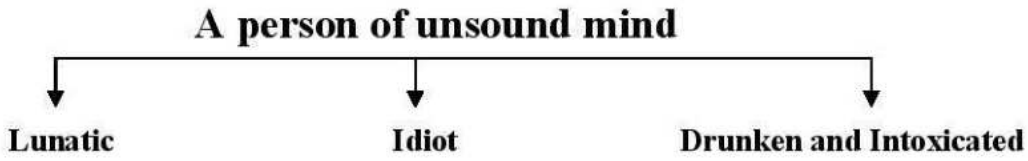
8. A minor can act as an agent but not personally liable. But he cannot be principal.
9. A minor cannot become shareholder of a the company except when the shares are fully paid up and transfer by share.
10. A minor cannot be adjudicated as insolvent.
11. Can enter into contracts of Apprenticeship, Services, Education, etc: (a) A minor can enter into contract of apprenticeship, or for training or instruction in a special art, education, etc. (b) These are allowed because it generates benefits to the Minor.
12. Guarantee for and by minor A contract of guarantee in favour of a minor is valid. However, a minor cannot be a surety in a contract of guarantee. This is because, the surety is ultimately liable under a contract of guarantee whereas a minor can never be held personally liable.
13. Minor as a trade union member Any person who has attained the age of fifteen years may be a member for registered trade union, provided the rules of the trade union allow so. Such a member will enjoy all the rights of a member.

EXCEPTION

- Contract for the benefit of a minor.
- Contract by Guardian Benefit of a minor by his guardian or manager of his estate. a. within the scope of the authority of the guardian. b. Is for the benefit of the minor.
- Contract for supply of Necessaries. Example : Food, clothes, bed, shelter, shoes, medicines and similar other things required for the maintenance of his life or for the life of his dependents, expenses for instruction in grade or arts; expenses for moral religions or intellectual education, funeral expenses of his deceased family members, marriage expenses of a dependent female member in the family; expenses incurred in the protection of his property or personal liberty, Diwali pooja expenses, etc. have been held by courts to be necessaries of life. However, the things like earrings for a male, spectacles for a blind person or a wild animal cannot be considered as necessaries.
- Liability for tort: A minor is liable for a tort, i.e., civil wrong committed by him. Example : A, a 14 – year – old boy drives a car carelessly and injures B. He is liable for the accident i.e., tort.

Person of Unsound Mind

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



- At time of entering into a contract, a person must be sound mind. Law presumes that every person is of sound mind unless otherwise it is proved before court. An agreement by a person of unsound mind is void. The following are categories of a person considered as person of a unsound mind.
- An idiot An idiot is a person who is congenital (by birth) unsound mind. His incapacity is permanent and therefore he can never understand contract and make a rational judgment as to its effects upon his interest. Consequently, the agreement of an idiot is absolutely void ab initio. He is not personally liable even for the payment of necessaries of life supplied to him.
- Delirious persons A person delirious from fever is also not capable of understanding the nature and implications of an agreement. Therefore, he cannot enter into a contract so long as delirium lasts.
- Hypnotized persons Hypnotism produces temporary incapacity till a person is under the effect of artificial induced sleep.
- Mental decay There may be mental decay or senile mind or old age or poor health. When such person is not capable of understanding the contract and its effect upon his interest, he cannot enter into contract.
- Lunatic is not permanently of unsound mined. He can enter into contract during lucid intervals i.e., during period when he is of sound mind.
- Drunken person An agreement made by intoxicated person is void.

Person Disqualified by Law

- Body corporate or company or corporation Contractual capacity of company is determined by object clause of its memorandum of association. Any act done in excess of power given is ultra – virus and hence void.
- Alien enemy • An ‘alien’ is a person who is a foreigner to the land. He may be either an ‘alien friend’ or an ‘alien enemy. If the sovereign or state of the alien is at peace with the country of his stay, he is an alien friend. An if a war is declared between the

two countries he is termed as an alien enemy. • During the war, contract can be entered into with alien enemy with the permission of central government.

- Convict can't enter into a contract while he is undergoing imprisonment. But he can enter into a contract with permission of central government while undergoing imprisonment. After the imprisonment is over, be becomes capable of entering into contract. Thus the incapacity is only during the period of sentence.
- Insolvent When any person is declared as an insolvent, his property vests in receiver and therefore, he can't enter into contract relating to his property. Again he becomes capable to enter into contract when he is discharged by court.
- Foreign sovereigns, diplomatic staff and representative of foreign staff can enter into valid contract. However, a suit cannot be filed against them, in the Indian counts without the prior sanction of the central Government.

Third party to a contract cannot sue or a stranger to a contract cannot sue.

Only those persons, who are parties to a contract, can sue and be sued upon the contract. This Rule is called "Doctrine of privities of contract."

Exception

i. Trust:- In case of trust a beneficiary can sue upon the contract. Example: A transferred certain properties to B to be held by him in trust for the benefit of C. In this case, C although not a party to the trust, can sue for the benefits available to him under the trust. This exception to the rule of Privity of contract has been recognised in a well known case of khwaja Mohd. Khan v. Hussaini Begum (1910) 32 All 410.

ii. Family settlement / Marriage contract:- In case of family settlement members who were not originally party to the contract can also sue upon it. A female members cone force a provision for marriage expenses made on partition of HUF. Example: H sued her father – in – law K to recover Rs.15,000 being arrears of allowance called Pin money payable to her by K under an agreement between K and H's father, consideration being H's marriage to K's son D. Both H and D were minors at the time of marriage. Held, the promise can be made enforceable by H. Provision of marriage expenses of female members of a Joint Hindu Family, entitles the female member to sue for such expenses on a partition between male members., Two brothers, on partition of family joint properties, agreed to invest in equal shares for their mother's maintenance. Held, the mother was entitled to require her sons to make the investment.

iii. Acknowledgement of liability:- Where a person admits his Liability thereafter if he refused be will be stopped from denying his liability. Example X receives money from Y for paying it to Z. X admits the receipt of that amount to Z. Z can recover the amount from X, even though the money is due from Y.

iv. Assignment of contract. Assignee (the person to whom benefits of contract are assigned) can enforce upon the contract.

v. Contract entered into through an agent.

vi. Covenants running with land. Stranger to consideration:- "Stranger to contract" must be distinguished from a stranger to consideration need not necessarily be provided by the promises if may flow from a third party also such a person is ' stranger to consideration,. (Chinnaya Vs Ramayya).

CONSIDERATION

MEANING

1. a) Consideration is a quid pro quo i,e something in return it may be –
   (i) some benefit right, interest, loss or profit that may accrue to one party or,
   (ii) some forbearance, detriment, loss or responsibility suffered on undertaken by the other party [currie V mussa]

   (b) According to Sir Frederick Pollock, "consideration is the price for which the promise of the other is bought and the promise thus given for value is enforceable.
2. Definition [Sec 2(d)]:- when at the desire of the Promisor, the promise or any other person. (a) has done or abstained from doing , or [Past consideration] (b) does or abstains from doing, or [Present consideration] (c) promises to do or abstain from doing something [Future consideration] such act or abstinence or promise is called a consideration for the promise.
3. Example (i) 'P' aggress to sell his car to 'Q' for Rs.50,000 Here 'Q's Promise to pay Rs50,000 is the consideration for P's promise and 'P's promise to sell the car is the consideration for 'Q's promise to pay Rs.50,000. (ii) 'A' promises his debtor 'B' not to file a suit against him for one year on 'A's agreeing to pay him Rs.10,000 more. Here the abstinence of 'A' is the consideration for 'B's Promise to pay.

Legal Rules for valid consideration

1. Consideration must move at the desire of the promisor. D constructed a market at the instance of District collector. Occupants of shops promised to pay D a commission on articles sold through their shops. Held, there was no consideration because money was not spent by Plaintiff at the request of the Defendants, but at instance of a third person viz. the Collector and, thus the contract was void. Durga Prasad v. Baldeo
2. Consideration may move from the promisee or any other person who is not a party to the contract. [Chinnaya's Vs Ramayya] A owed Rs.20,000 to B. A persuaded C to sign a Pro Note in favour of B. C promised B that he would pay the amount. On faith of promise by C, B credited the amount to A's account. Held, the discharge of A's account was consideration for C's promise. National Bank of Upper India v. Bansidhar
3. Consideration may be past, present, Future: • Under English law, Past consideration is no consideration. • Present consideration :- cash sale • Future or executory consideration:- A

Promises to B to deliver him 100 bags of sugar at a future date . B promise to pay first on delivery.

4. Consideration should be real and not illusory. Illusory consideration renders the transaction void consideration is not valid if it is. (i) Physically impossible (ii) Legally not permissible (iii) Uncertain (iv) illusory (fulfillment of a pre existing obligation)
5. Must be legal:- Consideration must not be unlawful, immoral or opposed to public policy.
6. consideration need not be adequate. A contract is not void merely became of the fact that the consideration is inadequate. The law simply requires that contract should be supported by consideration. So long as consideration exists and it is of some value, courts are not required to consider its adequacy. Example: A agreed to sell a watch worth Rs.500 for Rs.20, A's consent to the agreement was freely given. The consideration, though inadequate. Will not affect the validity of the contract. However, the inadequacy of the consideration can be considered in order to know whether the consent of the promisor was free or not . [Section 25 Explanation II]
7. The performance of an act what one is legally bound to perform is not consideration for the contract mean's something other than the promisor's existing obligation.

Exceptions to the Rule "No consideration . No contract"

Nudo Pacto non oritur action, i.e., an agreement without consideration is void.

1. Written and registered agreements arising out of love and affection:- [25 (1)] • Expressed in writing and registered under law for the time being in force for registration of document • Natural love and affection • Between parties standing in a near relation to each other Example:- An elder brother, on account of natural love and affection, promised to pay the debts of his younger brother. Agreement was put to writing and registered. Held, agreement was valid. Exception: - Rajlukhy Dabee Vs Bhootnath Mukharjee Example: A Hindu husband by a registered document, after referring to quarrels and disagreements between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence. Held that the promise was unenforceable since natural love and affection was missing.
2. Promise to compensate [25(2)] • Promise to compensate wholly or in part • Who has already voluntarily done something for the promisor • Something which the promisor was legally compellable to do. Example:- A finds B's purse and give to him. B Promise to give A Rs.500. This is a valid contract.
3. Promise to pay a time – barred debt. [Sec 25(3)] • A debt barred by limitation con not recovered. Hence, a promise to pay a such a debt is without any consideration. • Can be enforced only when – in writing and sighed by Debtor or his authorized agent. Example : A owes B Rs.10,000 but the debt is barred by Limitation Act. A signs a written promise to pay B Rs.8,000 on account of debt. This is a valid contract.
4. Completed gift- gift do not require any consideration.

5. Agency (185) – According to the Indian contract Act. No consideration is necessary to create an agency.
6. Bailment (148)- consideration is not necessary to effect a valid bailment of goods. It is Called Gratuitous Bailment.
7. Remission (63).
8. Charity- If a person promises to contribute to charity and on this faith the promises undertakes a liability to the extent not exceeding the promised subscription, the contract shall be valid.

FREE CONSENT

According to section 13. Two persons are said to have consented when they agree upon same thing in the same sense. In English law, this is called 'consensus – ad – idem'

Effect of absence of consent:

When there is no consent at all, the agreement is void – ab – initio'. It is not enforceable at the option of either party

Example 1:- X have two car one Maruti car and one Honda city car. Y does not know that X has two cars Y offers to buy car at Rs.50,000. Here, there is no identity of mind in respect of the subject matter. Hence there is no consent at all and the agreement is void – ab – inito.

Example 2:- An Illiterate woman signed a gift deed thinking that it was a power of attorney – no consent at all and the agreement was void – ab – inito [Bala Devi V S. Manumdats]

Free consent

Consent is said to be free when it is not caused by [Section 14] (a) coercion [Section 15] (b) Undue influence [Section 16] (c) Fraud [Section 17] (d) Misrepresentation [Section 18] (e) Mistake [Section 20, 21,22]

Effect of absence of Free Consent :- If consent coercion, undue influence, fraud , Misrepresentation the contract is voidable at the option of party whose consent was not free [19, 19A]

Coercion- Section 15

(a) Committing any act which is forbidden by the IPC
(b) Threatening to commit any act which is forbidden by the IPC.
(c) Unlawful detaining of any property or
(d) Threatening to detain any property.

Essential elements of coercion

Above four [a – d]

(e) coercion need not necessary proceed from party to contract.
(f) Coercion need not necessary be directed against the other contracting party.
(g) It is immaterial whether the IPC is or is not in force at the time or at the place where the coercion is employed [Bay of Bengal caption]

Effect of threat to file a suit:- A threat to file a suit (whether civil or court) does not amount to coercion unless the suit is on false charge. Threat to file a suit on false charge is an act forbidden by the IPC and thus will amount to an act of coercion.

Effect of Threat to commit suicide:- Threat to commit suicide amounted to coercion and the release deed was example discussed in class. Therefore voidable. [Chikham Ammiraju v seshama]

Duress v Coercion

English Law - Duress does not include detaining of property or threat to detain property. - Duress can be employed only by a party to the contract or his agent.

Effect:- when coercion is employed to obtain the consent of a party the contract is voidable at the option of the party where consent was obtained by coercion.

A threat to strike by employees in support of their demands is not regarded as coercion. This is because the threat to strike is not an offence under the I.P.C. it is a right given under the Industrial Disputes Act.

Detaining property under mortgage: Detention of property by a mortgage until the payment of loan does not amount to coercion.

Undue Influence (Section 16)

Meaning of undue influence:- dominating the will of the other person to obtain an unfair advantages over the others.

(a) Where the relation subsisting between the parties must be such that one party is in position to dominate the will of the other.
(b) The dominant party uses his position.
(c) Obtain an unfair advantage over the other.

Presumption of domination of will:-

Circumstances	Examples
Where he holds a real or apparent authority over the other Where he stands in a Trust fiduciary (benefit) relation to the other Mental Capacity of a person is temporarily or permanent effected by reason of age, illness or mental or bodily distress	Master and servant, parent and child, Income Tax officer and assesses principal and a Temporary Teacher. Trustee and beneficiary spiritual Guru and his disciples, solicitors and clients. Guardian and wards Relationship between medical attendant and ward.

Example :- A Poor Hindu widow agreed to pay interest at 100% P. a because she need the money to established her right of maintenance. It was held that the lender was in position to dominate the will of widow. Duress V Coercion Undue influence [Section 16]

No. Presumption of Domination of will:-

- Landlord and Tenant
- Creditor and Debtor
- Husband and wife (other than Pardanashin)
- Principal and Agent

Effect of undue Influence:-[Section 19A]

When consent to an agreement is caused by undue influence, the contract is voidable at the option of the party whose consent was so caused.

Burden of Proof:- A contract is presumed to be induced by undue influence if the following two condition:-

- A party has the position to dominate the will of the others
- The transaction is unconscionable (unreasonable)

In such a case dominant party is under the burden to prove the undue influence was not employed.

[Unconscionable transactions:- if transaction appears to unreasonable the dominant party to prove that there is no undue influence.]

[Any other transaction:- weaker party to prove the influence was employed]

Where some transaction is entered into in the ordinary course of business, but due to certain contingencies, one party is able to make the other party agree to certain terms and conditions then it is not undue influence.

Example : A applies to a banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence.

Example : A spiritual guru induced his chela to donate all his property to the ashram and said that in return of it, he will certainly get salvation. The chela did the same. Held, that this is a case, of undue influence so it becomes void.

Contract with Pardanashin woman;-

- Induced by undue influence
- Burden of Proof – Full disclosure is made to pardanashin women
- Pardanashin Women - Understand the contract - Receipt of competent independent advice .

Rebutting presumption:-

- Dominant party – full disclosure
- Price was adequate
- Receipt of competent independent advice before entering into contract – weaker party.

Fraud- Section 17

The term fraud means a take representation of facts made willfully with a view to deceive the other party. Sec.17- fraud means any act committed by a party to a contract or with his connivance or by his agent with intent to deceive another party there to or his agent or to induce to enter into contract.

Essentials of fraud :-

(a) By a party to the contract
(b) There must be representation – [an opinion a statement of expression – does not fraud].
(c) The representation must be false.
(d) Before conclusion of contract.
(e) The misrepresentation must be made willfully.
(f) The misrepresentation must be made with a view to deceive the other party.
(g) The other party must have actually been deceived.
(h) The other party have suffered a loss.

Fraud – definition include

- The suggestion, as to fact, of that which is not true by one who does not believe it to be true.
- The active concealment of a fact by one having knowledge or belief of the fact. Ex. A furniture dealer conceals the crakes in furniture by polish work.
- A promise made without any intention of performing it.
- Any other act fitted to deceive.
- Any such act or omission as the law specially declared to be fraudulent.
  Ex:- T bought a cannon from H. It was defective, but H had plugged it. T did not examine the cannon, but it burst when he used it. Held as the plug had not deceived T, he was liable to pay for the cannon.
  Ex.: Where the representation was true at the time of when it was made but becomes untrue before the contract is entered into and this fact is known to the party who made the representation. If must be corrected. If it is not so corrected it will amount to be fraud.

When the silence amount to fraud:-

General rule:- Mere (only) Silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud.

EXCEPTION- where the circumstances of the case are such that regarding being had to them. It is duty of the person keeping silence to speak. Such duty arises in the following two cases.

1) Duty to speak exists where the parties stand in a fiduciary relationship, e.g. father and son, guardian and ward, trustee and beneficiary etc. or where contract is a contract of ubberima fidei (requiring utmost good faith), e.g. contracts of insurance. Ex.:- A sells by auction to B a horse which A knows to be unsound. B' is A's daughter and has just come of age. Here the relation between the parties would make it A's duty to tell B is the horse is unsound.
2) When silence itself equivalent to speech. B says to A " if you do not deny it I shall assume that the horse is sound". A say nothing – A's silence equivalent to speech. A can held liable to fraud. [Half Truth is worse than a blatant: - Example – company pay dividend – in class room]

Effect of Fraud

Sec. 19: A contract induced by fraud is voidable at the option of the party defrauded. Till the exercise of such option, the Contract is valid.

1. Rescinds of contract
2. Right to insist upon performance

3. Right to claim damages – if he suffered loss.

Exception : The contract is not voidable in the following cases.

- When the party who consent was caused by silence amount to fraud and be has the means of discovering the truth with ordinary diligence.
- When the party give the consent in ignorance of fraud.
- When the party after become aware of fraud takes a benefit.
- When the parties can't be restored to their original position.
- Where interests of third parties intervene before the contract is avoided.

Misrepresentation- Section 18

Misrepresentation is when a party (person) asserts something which is not true though he believes is to be true. In other words misrepresentation is a falls representation made innocently. An agreement is said to be influenced by misrepresentation if all the following conditions are satisfied.

(a) The party makes a representation of a fact [The representation by a stranger (By anyone with his connivance or by agent) to the contract does not affect the validity of the contract.
(b) The misrepresentation was made innocently i.e. if was not made with a view to deceive the other party.
(c) The other party has actually acted believing the misrepresent to be true.

Misrepresentation include:-

- Unjustified statement of facts – positive assertion – Believe true really not true no basis misrepresentation
- Breach of duty.
- Inducing other to make mistake as to qualify or nature of subject matter.

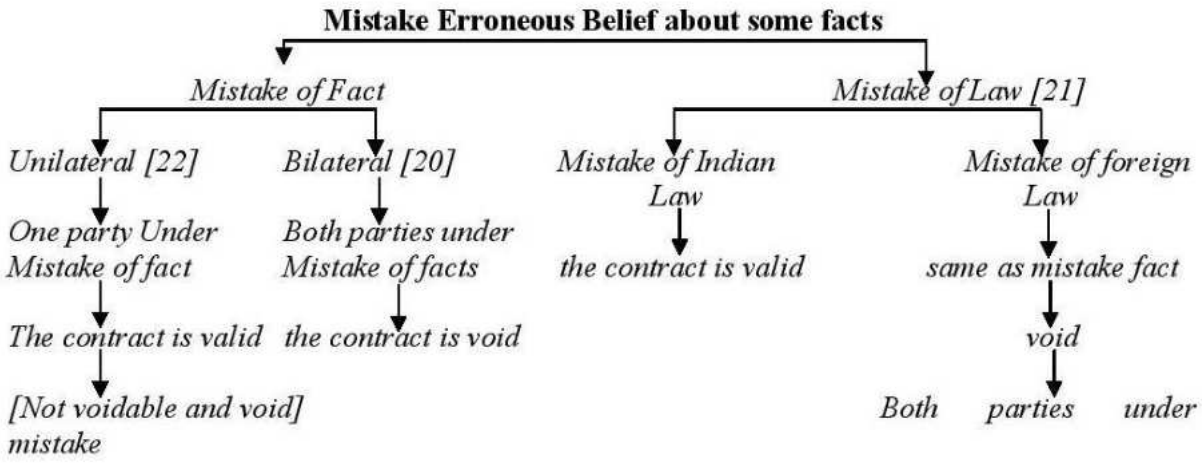
<u>Effect of Misrepresentation</u>

1) Right to Rescind contract:- Can't do
    - Discovering the truth with ordinary diligence.
    - Give consent in ignorance of misrepresentation
    - Become aware of misrepresentation takes a benefit
    - Where an innocent third party before the contract is rescinds acquires consideration some interest in the property passing under the contract.
    - Where the parties can't be restored to their original position.

2) Right to insist upon performance.

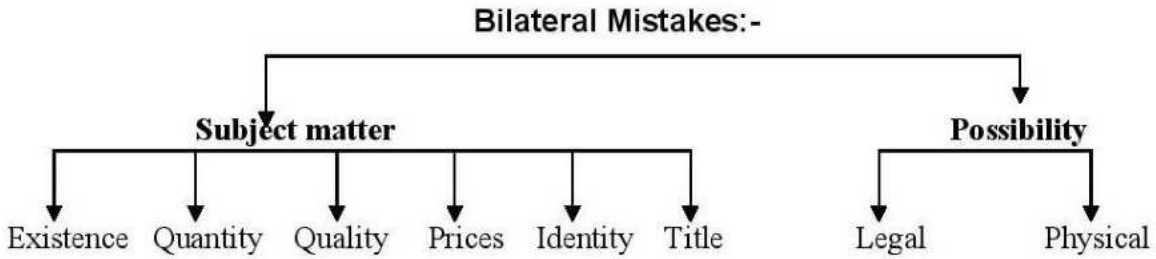
Ex.:- Unlike Fraud he cannot sue for damage.

Mistake



Exception: - Where contract is not valid (void)

1) Identity of persons contract with Ex. :- A woman, falsely misrepresenting herself to be wife of a well known Baron obtained two pearl necklaces from a firm of jewelers on the pretext of showing them to her husband before buying. She pledged them with a broker who took them in good faith. Held that there was no contract between jeweler and woman and even an innocent buyer or a broker did not get a good title. Broker must return necklaces to jeweler. Jeweler intended to deal not with her but with quite a different person, i.e., wife of a Baron.
2) as the nature of the contract Ex.:- illiterate man sign Bill of exchanges by means of false, representation that it was a mere guarantee. It was held that he was not liable for bill of exchange because never intended to sign the bill of exchange.



EVERY AGREEMENT OF WHICH THE OBJECT OR CONSIDERATION IS UNLAWFUL IS VOID [SEC 23]

(a) It is forbidden by law – law would also include the rules regulations, notifications etc. under or issued under the authority given by a statute. Ex.:- A sold liquor without license to B. The sale is unlawful as the sale of liquor without license is forbidden by the law, i.e., The Excise Act. Hence, A cannot recover the price. Ex.:- a Hindu already married and his wife alive entered into a marriage agreement with Y an unmarried girl. The agreement is void because the second marriage is forbidden by Hindu Law.

(b) If it defeats the Provisions of any Law. - not directly prohibited by any Law Ex.:- A's estate is sold for arrears of revenue under the provision defaulter is prohibited from purchasing the state upon an understanding with A becomes the purchaser and agrees to convey the estate to A . Upon receiving from him the price which B has paid. The agreement is void.

(c) If it is Fraudulent Ex.: Object or consideration of an agreement is fraudulent. An agreement with such an object or consideration is unlawful and void.

(d) If it involves or Implies injury to a person or property of another. Ex. :- Where it create injury to a person or to the property of another. An agreement with such an object or consideration is unlawful and void.

(e) If the court regards it as immoral. ⇒ X gave Rs. 10,000 to Y a married woman to obtain a divorce from her husband. X agrees to marry when divorce taken. X would not recover the amt.

1. Partially unlawful Object or consideration [Sec. 24]: An Agreement is void if - (a) any part of a single consideration for one or more objects is unlawful; or (b) any one or any part of one of several consideration for a single object, is unlawful.
2. Example: B is a licensed manufactured of permitted chemicals. A promise B to supervise B's business and combine it with the production of some contraband items together with the permitted items. B promises to pay A, Salary of Rs.10,000 p.m. Agreement is void, object of A's promise and consideration for B's promise being partially unlawful.
3. Lawful Consideration enforceable: When there are several distinct promises made for one and the same consideration and one or more of them are of such nature that law will not enforce it, only such of the promises as are unlawful cannot be enforced. Other which are lawful, can be enforced.
4. Test of Severability: (a) If illegal part cannot be severed from legal part of a covenant, contract is altogether void. (b) If it is possible to severe them, whether the illegality be due to Statute or Common Law, bad part alone may be rejected and good retained. In case of pre – existing civil liability, the dropping of criminal proceedings need not necessarily be a consideration for the agreement to satisfy that liability. (Union Carbide Corpn. v. UOI)

Illegal agreement – Void – ab – intio

- Punishable by the criminal Law of the country or by any special legislation regulation effect of illegal agreement.
- Collateral transactions – illegal
- No action can be taken for the recovery of money paid or property transferred.
- If illegal part can't be separated from the legal part. Whole agreement is altogether illegal. [Sec.57]
- If separated - Legal part – enforces illegal part – reject.
- Reciprocal promises – In respect of reciprocal promises the agreement as to illegal promise is void.

VOID AGREEMENT

2(g)- Void agreement is an agreement which is not enforceable by Law – void – ab – inito.

1) Agreement by or with person's incompetent to contract [10, 11]
2) Agreement entered into through a mutual mistake [20]
3) Object or consideration – unlawful [23]
4) Consideration or object partially, unlawful [24]
5) Without consideration [25]
6) Restraint of marriage [26]
7) Restraint of trade [27]
8) Legal proceeding [28]
9) Consideration identified [29]
10) Wagering agreement [30]
11) Impossible agreement [56]
12) An agreement to enter into an agreement in the future.

Agreement in Restraint of marriage [26]

Every agreement in restraint of marriage of any person other than a minor, is void, Any restraint of marriage whether total or partial is opposed to public policy. Ex. A promised to marry else except Mr. B, and in default pay her a sum of Rs.1,00,000. A married someone else and B sued A for recovery of the sum. Held, the contract was in restraint of marriage, and as such void. Ex. The consideration under a Sale Deed was for marriage expenses of a minor girl aged 12. Held the sale was a void transaction being opposed to public policy. Ex. Two co-widows – agreement – is one of them remarried – she shout forfeit her eight to her share in the deceased husband's property was not void because no restraint was imposed upon either of the two widows from remarrying. Ex. Wife to divorce herself and to claim maintenance from the husband on his marrying a second wife was not void because no restraint was impose upon husband from marrying a second wife.

Agreement in Restrain of trade [27]

Every agreement by which anyone is restrained from exercised a Lawful profession, trade or business of any kind is void .

Burden for Proof :- Party supporting the contract:- must show that the restraint is reasonably necessary to protect public interest. Party challenging the contract:- restraints is injurious to the public. Ex. : In Patna, 29 out of 30 manufacturers of combs agreed with R to supply combs only to him and not to anyone else. Under the agreements R was free to reject the goods if he found no market for them. Held, the agreement amounted to restraint of trade and void.

Exception to Sec. 27

Sale of goodwill: - Seller of goodwill of a business may agree with the buyer to restrain from carrying on business.

(a) Must relate to same business
(b) Restriction shall apply within specified Local limits.
(c) Restriction shall apply within a reasonable time period
(d) The specified local limits – depends on nature of business.

1) Restriction on existing partner [11(2)] - Not carry on business other than business of the firm till he is partner.
2) Restriction on outgoing partner [36] - Not carry on a similar business after retirement - Local limits + specified period – local limit – nature of business
3) Sec. 54: Upon or in anticipation of dissolution of Firm. Partners may agree that some or all of them will not carry on business similar to that of the Firm within specified periods or local limits.
4) Sec. 55(2) : Partner may agree with due buyers of Goodwill, not to use the Firm name or carry on Firm's business or solicit clients of the Firm.
5) Sec. 55(3): Upon sale of Firm's Goodwill, a partner may agree that he will not carry on any business similar to Firm's within specified periods or local limits.

Exception under judicial interpretations:-

(a) Trade combination. - Traders may from associations among them to regulate the business or to fix prices. - Such agreement like opening and closing of business venture, licensing of traders, supervision and control of dealers, etc. are valid even if they are in restraint of trade. - But, a Combination that tends to create monopoly; or when two enter into an agreement to avoid competition, they are against public policy and hence void.
(b) Sale dealing agreement: - Agreements to deal in the products of a single manufacturer or to sell the whole produce to a single dealer are valid if their terms are reasonable. Ex.: .(

Discuss in class) Agreement – buyer of goods for Delhi market not to sell them in Chennai is valid. - Not to sell any other firm – valid.

(c) Service agreement.

- Agreement: Employers may enter into agreements with employees – (i) not to engage in other work during the tenure of his employment; or (ii) not to engage in similar work after his termination.
- During Employment: The first restraint is always valid, e.g. doctors may be paid non practicing allowances to avoid practicing when they are employed in a hospital.
- After termination of service: The second restraint is valid only is it is to protect the trade interests or the employer. It may be imposed to prevent the outgoing employee from using trade secrets he had learnt during his tenure, to the detriment of his previous employer.
- Valid Agreements : Requiring employees to serve the organization for a few years after training leaving; or execution of a bond requiring employees leaving the organization to pay compensation to the employer are valid.
- Use of Personal Skills: The employer cannot prevent the employees from using his personal skills and knowledge to his benefit; e.g. an employer cannot restrain an employee to act in theatre plays or in perforating an art.

Agreement in Restraint of legal proceedings [28]

Agreement restricting enforcement of rights:

- An agreement by which any party is restricted absolutely from enforcing his legal rights under any contract is void.
- Agreements Limiting period of limitation:- An agreement which limits the time within which an action way be brought is void.
- A partial restrain is not void, eg.

Ex. 1: A clause in a contract that any dispute arising between the parties shall be subject to jurisdiction of a court at a particular place only, is valid.

Ex. 2: An agreement is not void merely because if provides that any dispute arising between two or prove person shall be referred to arbitration. - That has arises. - Which may arise - Which has already arisen?

Ex. 3: An agreement not to go in appeal to higher court against the judgment of a lower court not amount to restart of legal proceeding.

An agreement the meaning of which is not certain (Sec 29):

1. An agreement is called an uncertain agreement when the meaning of that agreement is not certain or capable of being certain. Such agreements are declared void u/s 29.

2. Areas of uncertainty: Uncertainty may relate to – (a) Subject Matter of Contract; or (b) Terms of contract.
    (a) Subject Matter: There may be uncertainty as regards – (i) existence; (ii) quantity (iii) quality; (iv) price; or (v) title to the subject matter.
    (b) Terms of Contract: There may be uncertainty as regards – (i) existence (ii) quality; (iv) price; or (v) title and other terms in the contract.

Example:

1. A says to B "I shall sell my house; will you buy?" A says, "Yes, I shall buy". Due to uncertainty of price, the agreement is void and unenforceable. There is binding contract.
2. A agreed to pay a certain sum, when he was able to pay. Held, the agreement was void for uncertainty.
3. D agrees to sell his white horse, for Rs.5,000 or Rs.10,000.

WAGERING AGREEMENT [30] :-

An agreement between two persons under which money or money's worth is payable by one person to another on the happen or non happening of a future uncertain event is called a wagering agreement.

- X promise to pay Rs. 1000 to Y if it is rained on a particular day, and Y promise to pay Rs.1000 to X if it did not.
- Wagering agreement is promise to give money or money's worth upon the determination of uncertain event.- Sir Willian Anson.

Essential elements of wagering agreements

1. The must be a promise to pay money or money's worth
2. Performance of a promise must depend upon determination of uncertain event. It might have already happened but the parties are not aware about it.
3. Mutual chancels of Gains or Loss.
4. Neither party to have control over the events
5. Neither party should have any other interest in event.
6. One party is to win and one party is to lose.

Ex. 1:- Agreement to settle the difference between the contract price and market price of certain goods or shares on a particular day.

Ex. 2: A lottery is wagering agreement. Therefore, an agreement to buy and sell lottery tickets is a wagering agreement. Section 294 – A of the Indian Penal Code declares that drawing of lottery is an offence. However, the government may authorize lotteries. The

persons authorized to conduct lotteries are exempt from the punishment. But, the lotteries still remain a wagering transaction.

Ex. 3: However, if the crossword puzzle prizes depend upon sameness of the competitor's solution with a previously prepared solution kept with the organizer or newspaper editor, is a lottery and, therefore, a wagering transaction.

Ex. 4: However, when any transaction in any commodity or in shares with an intention of paying or getting difference in price, the agreement is a wager.

Agreement not held as wagers:-

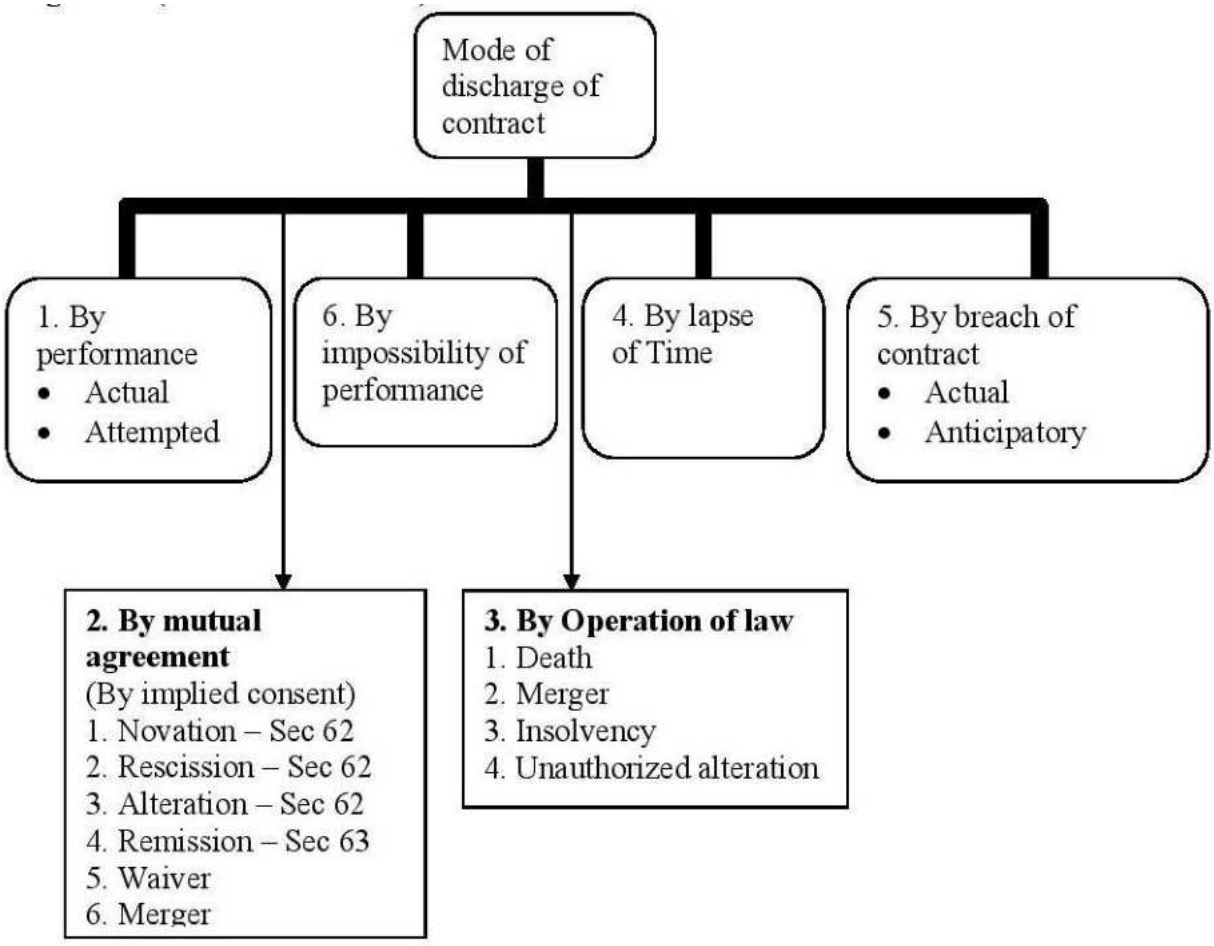
- Prize in terms of Prize competition Act, 1955 not exceeding Rs.1000 is not wagering agreement.
- Horse race [500] – An agreement to contribute a plate or prize.
- Contract of insurance utmost in good faith eg. Favour in public policy.
- Share market transaction A commercial transaction should always be distinguished from a pure speculative transaction. A commercial transaction is done with an intention of delivery of goods (commodity or security) and payment of price. Therefore, it is not wagering agreement.
- Crossword competition involving skill for its solution. If skill plays an important role in the result of a competition and prize depend upon the result, the competition is not Involve applications of skill and prizes are awarded to the participants on the basis of merit of their solutions and not on chance. Therefore, such competitions are valid and are not wagers.
- Athletic Competitions also fall in the category of games of skill. Therefore, these are also not wagers.
  Example: A and B, two wrestlers, agreed to enter into a wrestling contest in Ahmedabad on a certain day. They further agreed that a party failing to appear on the fixed day was to forfeit Rs.500 and the winning party will receive a sum of Rs.1,000. Held, it was not a wagering agreement.
- Contribution to chit fund is not wager – contributions made by the members are refunded by draw of lots.

Effects of wagering agreements:-

- Agreement is void.
- No suit can be filled for any recovery of the amount won on any wager.
- It is not illegal. Any agreement collateral to wagering agreement is valid.
- However, it is illegal in state of Maharashtra and Gujarat.

DISCHARGE OF A CONTRACT

Discharge of a contract means termination of contractual relation between the parties to a contract in other words a contract is discharged when the rights and obligations created by it are extinguished (i.e. comes to an end).



Discharge by performance

Fulfillment of obligations by a party to the contract within the time and in the manner prescribed in the contract.

(a) Actual performance – no party remains liable under the contract. Both the parties performed.
(b) Attempted performance or tender.:- Promisor offers to perform his obligation under the contract but the promise refuses to accept the performance. It is called as attempted performance or tender of performance. But the contract is not discharged.

Discharge by mutual agreement

(a) Novation [Sec 62] – Novation means substitution of a new contract in the place of the original contract new contract entered into in consideration of discharge of the old contract. The new contract may be.

- Between the same parties (by change in the terms and condition)
- Between different parties (the term and condition remains same or changed)

Following conditions are satisfied :-

1) All the parties must consent to novation
2) The novation must take place before the breach of original contract.
3) The new contract must be valid and enforceable.

Example:

- A owes B Rs.50,000. A enters into an agreements with B and gives B a mortgage of his estate for Rs.40,000 in place of the debt of Rs.50,000. (Between same parties)
- A owes money Rs.50,000 to B under a contract. It is agreed between A, B & C that B shall henceforth accept C as his Debtor instead of A for the same amount. Old debt of A is discharged, and a new debt from C to B is contracted. (Among different parties)

(b) Rescission [62]:- Rescission means cancellation of the contract by any party or all the parties to a contract. X promises Y to sell and deliver 100 bales of cotton on 1st oct his go down and Y promises to par for goods on 1st Nov. X does not supply the goods. Y may rescind the contract.

(c) Alteration [62] :- Alteration means a change in one or more of the terms of a contracts with mutual consent of parties the parties of new contracts remains the same. Ex:- X Promises to sell and delivers 100 bales of cotton on 1st oct. and Y promises to pay for goods on 1st Nov. Afterwards X and Y mutually decide that the goods shall be delivered in five equal installments at is godown . Here original contract has been discharged and a new contract has come into effect.

(d) Remission [63]:- Remission means accepting a lesser consideration than agreed in the contract. No consideration is necessary for remission. Remission takes place when a Promisee-

(a) dispense with (wholly or part) the performance of a promise made to him.
(b) Extends the time for performance due by the promisors
(c) Accept a lesser sum instead of sum due under the contract
(d) Accept any other consideration that agreed in the contract

A promise to paint a pictured for B. B after words for him to do so. A is no longer bound to perform the promise.

(e) Waiver:- Intentional relinquishment of a night under the contract.

(f) Merger :- conversion of an inferior right into a superior right is called as merger. (Inferior right end)

Discharge by operation of law

(a) Death :- involving the personal skill or ability, knowledge of the deceased party one discharged automatically. In other contract the rights and liability passed to legal represent. Example : A promises to perform a dance in B's theatre. A dies. The contract comes to an end.
(b) Insolvency:- when a person is declared insolvent. He is discharged from his liability up to the date of insolvency. Example: A contracts to sell 100 bags of sugar to B. Due to heavy loss by a major fire which leaves nothing to sell, A applies for insolvency and is adjudged insolvent. Contract is discharged.
(c) By unauthorized material alteration – without the approval of other party – comes to an end – nature of contract substance or legal effect. Example : A agrees upon a Promissory Note to pay Rs.5,000 to B. B the amount as Rs.50,000. A is liable to pay only Rs.5,000.
(d) Merger: When an inferior right accruing to a party in a contract mergers into a superior right accruing to the same party, then the contract conferring inferior right is discharged. Example: A took a land on lease from B. Subsequently, A purchases that land. A becomes owner of the land and ownership rights being superior to rights of a lessee, the earlier contract of lease stands terminated.
(e) Rights and liabilities vest in the same person: Where the rights and liabilities under a Contract vest in the same person, the contract is discharged. Example: A Bill of Exchange which was accepted by A, reaches A's hands after being negotiated and endorsed through 4 other parties. The contract is discharged.

Discharge by Lapse of time

Where a party fails to take action against the other party within the time prescribe under the limitation Act, 1963. All his rights to come end. Recover a debt – 3 Years recover an immovable property – 12 years Ex.:- On 1st July 20X1 X sold goods to Y to Rs 1,00,000 and Y had made no payment till August 20X4. state the legal position on 1st Aug 20X4 (a) If no. credit period allowed (b) If 2 month credit period allowed.

Discharge by Breach of contract

Failure of a party to perform his part of contract

(a) Anticipatory Breach of contract :- Anticipatory breach of contract occurs when the part declares his intention of not performing the contract before the performance is due .
    (i) Express repudiation: - 5 agrees to supply B 100 tunes of specified category of iron on 15.01.2006 on 31.12.2005. 5 express his unwillingness to supply the iron to B.
    (ii) Party disables himself: - Implied by conduct. Ex.:- 5 agrees to sell his fiat car to B on 15.01.2006 on 31.12.05 5 sells his fiat car to T.

(b) Actual Breach of contract :- If party fails or neglects or refuses to perform his obligation on the due date of performance or during performance. It is called as actual breach.

During performance – party has performed a part of the contact. Consequences of Breach of contract:- The aggrieved party (i.e. the party not at face it) is discharged from his obligation and get rights to proceed against the party at fault. The various remedial available to an aggrieved party.

Discharge by Impossibility performance

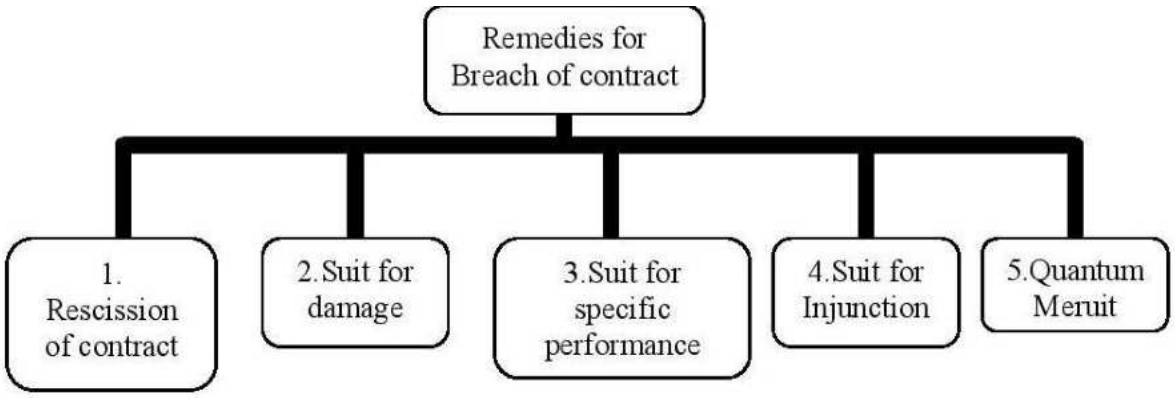
(a) Effect of Initial Impossibility (b) Effect of supervening Impossibility

(a) Initial Impossibility – at the time of making contract
- Both parties know – put life into deed body – void .
- Both don't know – void.
- One know – compensate to other party

(b) Effect of super vanity Impossibility:-
- Where an act becomes impossible after the contract is made – void
- Becomes unlawful, beyond the control of promisor – void
- Promisor alone knows about the Impossibility – compensate loss.
- When an agreement is discovered to be void or where a contract becomes void

REMEDIES FOR THE BREACH OF CONTRACT

Remedy means course of action available to an aggrieved party when other party breaches the contract.



Rescission of Contract- Section 39

- It means right to party to cancel contract.
- In case of breach of contract, other party may rescind contract.

Effect of Rescission of Contract

- Aggrieved party is not required to perform his part of obligation under contract.
- Aggrieved party claims compensation for any loss.
- Party is liable to restore benefit, if any.

When can Court Grant Rescind Contract?

Court can rescind the contract in the following situation:

- Contract is voidable.
- Contract is unlawful.

SUIT FOR DAMAGES

- It means monetary compensation allowed for loss.
- Purpose is to compensate aggrieved party and not to punish party as fault.
- In India, rules relating to damages are based on English judgment of Hadley vs Baxendale. The facts of case were – H's mill was stopped due to the breakdown of the shaft. He delivered the shaft to common carrier to repair it and agree to pay certain sum of repair it and agree to pay certain sum of money for doing this work. H has informed to B that delay would result into loss of profit. B delivered the shaft after reasonable time after repair. H filed suit for loss of profit. It was held that B is not liable for loss of profit. The court laid down rule that damage can be recovered if party has breach of contract.

KINDS OF DAMAGES

The following are the different kinds of damages:

- Ordinary damages These are the damages which are payable for the loss arising naturally and directly as result of breach of contract. It is also known as proximate damage or natural damage.
- Special damages These are damages which are payable for loss arising due to some special circumstances. It can be recovered only if special circumstances which result in special loss in case of breach of contract and party have notice of such damage. Example: A sends sample of his products for exhibition to an agent of a railway company for carriage to "New Delhi" for an exhibition. The consignment note stated: "Must be at New Delhi, Monday Certain." Due to negligence of the company, the

goods reached only after the exhibition was over. Held, the company was liable for the loss caused by late arrival of the products because the company's agent was aware of the special circumstances.

- Exemplary or punitive or vindictive damages These damages are allowed not to compensate party but as mean of punishment to defaulting party. The court may award these damages in the case of: • Breach of contract to marry – loss based on mental injury. • Wrongful dishonor of cheque – smaller amount, larger the damage.
- Nominal damages Where party suffers no loss, the court may allow nominal damages simply to establish that party has proved his case and won. Nominal damage is very small in amount.
- Damages for inconvenience If party has suffered physical inconvenience, discomfort for mental agony as result of breach of contract, party can recover the damage for such inconvenience. Example: A photographer agreed to take photographs at a wedding ceremony but failed to do so. The bride brought an action for the breach of contract. Held, she was entitled to damages for her injured feelings.
- Liquidated damages and penalty Party may specify amount at the time of entering into contract. The amount so specified may be (a) liquidated damage, or (b) penalty. If specified sum represent, fair and genuine pre – estimate damages likely to result due to breach, it is called liquidated damage. But if specified sum is disproportionate to the damages, it is called as penalty. As regard the payment of liquidated damages and penalty court can't' increase amount of damages beyond the amount specified in the contract. Example : A gives B, a bond for the repayment of Rs.1,000 with interest at 12 per cent, at the end of six months, with a stipulation that, in case of default, the interest shall be payable at the rate of 75 per cent, from the date of default. This is a stipulation by way of penalty, and B is only entitled to recover from A such compensation as the Court considers reasonable.
- Forfeiture of security deposit Any clause in contract entitling the aggrieved party to forfeit security deposit in the nature of penalty and court may award reasonable compensation.
- Payment of interest • It is permissible. • If interest is in nature of penalty, court may grant relief. • If no rate of interest is specified in contract party shall be liable to pay as per the law in force or as per custom or usage of trade.
- Cost of suit or decree The court has also discretion to award cost of suit for damages in addition to the damages for breach of contract.

Suit for Specific Performance

It means, demanding an order from court that promise agreed in contract shall be carried out.

- When is specific performance allowed?
  - Where actual damages arising from breach is not measurable.

- Where monetary compensation is not adequate remedy.

- When specific performance is not allowed?
  - When damages are an adequate remedy.
  - Where performance of contract requires numbers of minute details and therefore not possible for court to supervise.
  - Where contract is of personal in nature.
  - Where contract made by company beyond its power. (ultra – vires)
  - Where one party to contract is minor
  - Where contract is inequitable to either party.

  Example : A agree to sell B, an artist painting for Rs.30,000. Later on, he refused to sell it. Here B can file suit against A for specific performance of the contract.

Suit for Injunction

- It means stay order granted by court. This order prohibits a person to do particular act.

Where there is breach of contract by one party and order, of specific performance is not granted by court, injunction may be granted. Example: Film actress agreed to act exclusively for W for a year and for no one else. During the year she contracted to act for Z.

MODULE-II

DEFENCE CONTRACTS

DEFENCE CONTRACTS

The elements and principles of contract law and the meaning and import of various legal terms used in connection with the contracts are contained in the Indian Contract Act, 1872 read with the Sale of Goods Act, 1930. The law relating to redressal of disputes is laid down in the Arbitration and Conciliation Act, 1996. Government contracts, including those for defence procurement, are governed by the same laws which are applicable to contracts between private parties.

The parties to the defence contracts are the President of India as the purchaser acting through the authority signing the Contract/Agreement/Purchase Order etc., and the supplier named in the contract.

All defence contracts are in the name and on behalf of the President of India. However, the contract, after due approval of the CFA, may be signed by a staff officer, duly authorized by the CFA in writing. The specimen signature of such staff officer is to be sent to all concerned, including the paying and inspecting authorities. As for the contractor, the person signing the contract is deemed to have been authorized by the supplier.

Any contract, when not signed by both parties, namely the purchaser and the supplier, is deemed to come into force with the acceptance of the tender as per mutually agreed terms and conditions contained in the RFP and the firm's offer. However, in the case of supply orders, the firm should check the supply order and convey acceptance of the same within seven days of receipt of the supply order. If such an acceptance or communication conveying their objection to certain parts of the contract is not received within the stipulated period, the supply order is deemed to have been fully accepted by the firm. In case of foreign contract, normally both parties sign the document thus conveying their acceptance of the contract.

Under entry 5 of Schedule I of the Indian Stamp Act, an agreement or memorandum of agreement for or relating to the sale of goods or merchandise exclusively is exempt from payment of stamp duty.

General Principles of Contracting

The following principles are laid down for the guidance of the authorities who have to enter into contracts or agreements involving expenditure from public funds:

(a) The terms of contract must be precise and definite and there must be no room for ambiguity or misconstruction therein.
(b) Standard forms of contracts should be adopted, wherever possible, and the terms of the contract should be subjected to close prior scrutiny.

(c) As far as possible and where mandated, particularly if standard format of contract is not to be adopted, legal and financial advice should be taken in drafting of contracts and before they are finally entered into.
(d) The terms of a contract, once the contract is concluded, should not be materially varied without the previous consent of the authority competent to enter into the contract as so varied.
(e) No contract involving an uncertain or indefinite liability or any condition of an unusual character should be entered into without the previous consent of the competent financial authority.
(f) Whenever practicable and advantageous, contracts should be placed only after tenders have been openly invited.
(g) In selecting the tender to be accepted, the financial status of the individuals and firms tendering must be taken into consideration in addition to all other relevant factors.
(h) Even in those rare cases where a formal written contract is not made, no order for supplies, etc., should be placed without at least a written agreement as to the price.
(i) Adequate provision must be made in the contracts for safeguarding Government property entrusted to the service provider.

Changes in the Terms of/Amendment to a Concluded Contract

Changes in the Terms of a Concluded Contract

No variation in the terms of a concluded contract should normally be made, unless the contract specifically provides for it, in which case this can be done with the specific written consent of the parties to the contract.

Amendment to a Concluded Contract

Amendment to a contract already concluded may become essential in certain situations when either party to the contract requests for an amendment and the proposed amendment is acceptable to other party to the contract.

Enhancement in Rates

No enhancement in rates/prices should be made unless the contract specifically provides for it. Such situations may arise in those cases where the contract provides for price variation clauses or the change is due to variation in Excise/Custom Duties/other Government taxes & levies and the contract provides for payment of these duties on the basis of actual rates, provided the supplies are made during the original delivery period. Consultation with Integrated Finance in such cases would be required if the original contract was concluded with the concurrence of Integrated Finance or, after increase in value, the contract falls within the delegated powers of the CFA, exercisable with the concurrence of Integrated Finance.

Vetting of Price Variation Clause

Financial Advisor should be consulted for vetting of price variation clauses/exchange rate variation clauses.

Imposition of LD While Granting Extensions

While granting extensions of delivery period on an application of the contractor, the letter and spirit of the application should be kept in view in fixing a time for delivery and it must be decided while granting extension whether it would be with or without imposition of Liquidated Damages.

Liability on Account of Taxes etc. in the Event of Grant of Extension of Delivery Period

While grating extension of delivery period, any increase in the taxes and levies would not be payable, unless the contract specifically provides for it or it is expressly agreed to with the concurrence of the Integrated Finance.

Consultation with IFA

All amendments to contracts, which have financial implications, including short closing and delivery period extensions (with or without LD) should be approved by the CFA in consultation with the IFA, where the original contract was concluded with the concurrence of integrated finance.

Amendments of Minor and Non-financial Nature

Amendments of minor nature concerning Drawing No., Part Nos., etc., which do not have financial implication, may be approved by an authority one step below the contract approving authority, if such authority is specifically authorized by the CFA.

APPROVAL PROCESS AND CONCLUSION OF DEFENCE CONTRACTS

Procurement of Goods and Services

The need for procurement of goods may arise in the following circumstances:

(a) to make up the deficiency of stores, which are authorized as per scales laid down in various Government letters, revealed as a result of provisioning reviews;
(b) to build up authorized stocks; or
(c) on account of non-scaled and not-in-vocabulary (NIV) items, which may include any kind of equipment, spares and other medical/miscellaneous stores.

The need for procurement of services may arise for any of the following reasons:

(a) maintenance of any equipment/asset already held on charge;
(b) performance of any task being performed in-house but considered appropriate for outsourcing;
(c) need for engaging consultants;
(d) any new function which can be performed economically by an outside agency.

Processing of Procurement Proposals

Processing of Proposals for CFA's Approval

All procurement proposals should be initiated in the form of a statement of case (SOC), which should clearly bring out all aspects of the proposal, including the justification/reason for procurement, quantity, cost, likely sources of supply, mode of tendering, etc. The format of SoC given in Appendix 'B' may be used for this purpose, with suitable changes as required. It needs to be kept in view that expeditious processing of the proposal depends on the comprehensibility and quality of the SoC. Draft NIT/RFP should also be submitted along with the SOC for approval of the CFA in consultation with integrated finance, where required as per the delegation of financial powers.

Costing of Procurement Proposals

It is important that the procurement proposal is costed with due attention and care. The basis of costing must be placed on record. The level of approval by the CFA would depend on the entire cost of a proposal, inclusive of all taxes, levies and other charges. The procedure for costing is given in Chapter 13 of Defence Procurement Manual.

Processing of Proposals after CFA's Approval

After CFA's approval, the procuring agency is required to go through the tendering action approval as per the provisions of Chapter 4 of Defence Procurement Manual and obtain CFA's approval for the proposed procurement in consultation with integrated finance, where required as per the delegation of financial powers.

Processing of Proposals Subject to Availability of Funds

A procurement proposal should normally be processed only if it figures in the Annual Procurement Plan (wherever such Plans are being prepared, irrespective of the nomenclature of the Plan) and subject to availability of funds. Availability of funds should be determined only after accounting for cash outgo during the relevant financial year on account of committed liabilities.

Processing of Proposals Without Linking Them With Availability of Funds

Subject to the general rule that purchase proposals should be processed with due regard to availability of funds, a procurement proposal may be processed without linking it with actual availability of funds, if it is certified by the budget holder that there is reasonable certainty of funds becoming available by the time the proposal reaches the final stage of contracting/placing of supply order. In such cases, however, availability of funds would be determined after taking into account cash outgo on account of the committed liabilities.

Prior Concurrence of Integrated Finance

Competent Financial Authority's approval is subject to prior concurrence of integrated finance, if required as per the delegation of financial powers.

Ex-post Facto Financial Concurrence

There is no provision under the delegated financial powers to obtain ex-post facto concurrence of integrated finance. Such cases where prior concurrence is not obtained, though required as per the delegation of financial powers, would be treated as cases of breach of rules and regulations and referred to the next higher CFA for regularization. Such regularization will be subject to concurrence of IFA to the next higher CFA.

Ex-post Facto Approval of the CFA

Where a proposal is approved, with or without the concurrence of integrated finance, by an authority not competent to sanction that proposal as per the delegation of financial powers, ex-post facto sanction may be accorded by the appropriate CFA with or without the concurrence of the IFA, as the case may be, as per delegation of financial powers.

Disagreement with the IFA

In case of disagreement with the IFA, the CFA can overrule the IFA under intimation to the next higher CFA as well as the IFA giving reasons for overruling the financial advice. In such cases, it would be open to the IFA to take up the matter with the higher IFA and CFA or drop it.

Acceptance of Necessity

Acceptance of Necessity in Respect of Scaled Items

Acceptance of Necessity in case of scaled items would actually only entail vetting of quantities, assessment of physical requirement of various resources with respect to targets fixed and budget availability.

Acceptance of Necessity In Respect of Scaled Items Whose Inventory is Computerized

In case of scaled items where inventories are maintained through automated systems and IFAs have been provided terminal on the same, IFA will vet the quantity on the automated systems based on data available on such automated systems, which would be deemed to be financial concurrence for acceptance of necessity also.

Acceptance of Necessity in Respect of Non-Scaled and NIV Items

Acceptance of necessity in respect of non-scaled and NIV items would depend entirely on the justification provided for their procurement. It must be ensured that procurement of such items does not introduce a new practice and does not have the effect of changing the existing scales or policy.

Acceptance of Necessity in Respect of Items Included in Procurement Plans

Some of the Services HQrs/Command HQrs and other establishments prepare annual procurement plans for revenue procurement. Where such a plan, irrespective of its nomenclature, is being prepared with the concurrence of Integrated Finance, necessity would be deemed to have been accepted in respect of each item included in the plan. No separate AON would be necessary in such cases. However, the AON would be for the item and not the quantities required. In such cases, however, Integrated Finance should be consulted for vetting of quantity, mode of tendering, identification of vendors in case of LTE/STE/PAC and vetting of draft RFP, where financial powers are to be exercised with the concurrence of integrated finance.

Provided that if in any such case Integrated Finance wishes to make any observation regarding necessity, it may be done with the specific approval of the IFA concerned. Further processing of the proposal would, however, not be deferred pending resolution of the issue raised by Integrated Finance, unless the procuring agency considers it desirable to resolve the issue before proceeding further. Where it is decided not to defer further processing of the proposal, the observations made by Integrated Finance would be brought to the notice of the CFA while seeking approval for the proposal.

Provided further that AON of the CFA would need to be taken in consultation with the IFA, where financial powers are to be exercised with the concurrence of integrated finance, before the proposal is processed any further in case of non-scaled items which do not also figure in any approved procurement plan.

Quantity Vetting

Quantity Vetting in Respect of Scaled Items

Care should be taken to avoid purchasing quantities in excess of requirement to avoid inventory carrying costs. The IFA is supposed to vet the quantity indented/ projected for procurement of scaled items so as to ensure timely provisioning. In order to ensure that there is no infructuous provisioning, the IFA must have access to all inputs required to assess the basis of the projection of indented quantity. The calculation sheet showing the authorized scales, dues-in, dues-out, reserves, etc. must be made available to the IFA. In case an IT based management system is operational in the department, the IFA is to undertake such vetting of quantity on the system itself.

Quantity Vetting in Respect of Non-scaled and NIV Items

While no fixed guidelines can be laid down for vetting of quantities of non-scaled and NIV items, it has to be ensured that purchase proposals of such items are based on the bare minimum inescapable requirement with due regard to economy of scales. Where financial powers are to be exercised with the concurrence of integrated finance, IFA should vet the quantity of such items if the procurement is proposed to be made under the delegated financial powers exercisable with the concurrence of integrated finance. If requirement of such items is found to be arising repeatedly, central procurement agencies should be intimated about the requirement.

Seeking Approval of the CFA

Combining Various Stages of Processing

It is not necessary that a proposal should be processed sequentially for AON, Quantity Vetting, financial concurrence, etc. A proposal, when initiated, should be complete in all respects so that all the aspects relating to AON, quantity vetting, costing, vetting of NIT/RFP, etc., could be examined simultaneously by the IFA, where required as per the delegation of financial powers.

CFA's Sanction

A sanction is a written authority from the CFA authorizing the expenditure. A sanction invariably indicates the reference to the authority under which expenditure is being sanctioned, the financial implication, the item for which the expenditure is approved and the budget code head. Whenever the final expenditure exceeds the sanctioned amount, revised financial sanction of the CFA, in whose delegated powers the total expenditure would fall, is required to be obtained. The format for Sanction letter is given in Appendix K.

Responsibility of the CFA

Responsibility of CFA in Purchase Decision

The CFA must consider all aspects of the case, including the quoted terms and conditions of the contract, delivery period, taxes and duties applicable, freight, insurance and other charges and the compliance to the specification before a purchase decision is taken. One of the important responsibilities of the CFA to ensure proper ranking of all offers so that the decision making process is totally transparent. The financial implication should be considered as the all-inclusive cost to the User on delivery to the designated consignee(s). Conditional offers and those with specifications not in conformity with the tendered specifications (Essential QRs) should not be considered. Before according sanction, concurrence of integrated finance should be taken wherever the powers are exercisable subject to such concurrence.

Compliance with Procedures

While taking the purchase decision, the CFA needs to satisfy himself that proper procedures have been followed at various stages of procurement, purchase policies of the Government have been complied with and capacity and financial status of the firm have been checked. Purchase decisions should be taken through a formal order in a written form.

Accountability

The decentralization of decision making mechanism and delegation of financial powers are aimed at facilitating faster decision making and obtaining best value for money. However, the delegation of powers also implies 'authority with accountability'. The CFA approving the expenditure must ensure financial propriety and probity, transparency and fair play as well as optimum utilization of resources. The designated CFA and all members of committee CFA are accountable for all decisions taken by them while approving any measure involving Government funds. This accountability is unconditional and absolute.

Time frame

Need for Expeditious Processing

It is imperative that the procurement process is fully responsive to the need of the Defence Services and other departments and facilitates expeditious procurement so that requirements are met on time. It is, therefore, essential that all prescribed activities are undertaken expeditiously and advice rendered within a specified time frame.

Time Frame

The time frame as given in Appendix 'A' is suggested for all activities in the procurement process to ensure that the bids are finalized within validity period. In case the prescribed time

frame cannot be adhered to in any specific case, suitable extension of validity of the bids should invariably be asked for well in time.

CONDITIONS OF A CONTRACT UNDER DPP

A contract is a legal document and must be governed by certain terms and conditions to protect the interest of both the parties to the contract. It is important that every purchase officer is not only thoroughly familiar with each conditions of a contract, but that he is also able to take appropriate and timely action to safeguard the rights and honour of the Purchaser. It is also desirable that the conditions of a contract are practical, fair and just for both the Purchaser and the Supplier. The conditions of contract become binding for both parties on signing/acceptance of the mutually agreed contract.

In order to facilitate clear understanding of the conditions of contract, a set of standard conditions, generally applicable to all contracts, is formulated and made available to all firms at the time of registration itself. It is desirable that the Standard Conditions of Contract (SCoC) as given in part III of Appendix C of Defence Procurement Manual are publicized on the Defence website also. The Request for Proposal format contains reference to the standard as well as special conditions in Part III & Part IV respectively of Appendix C that the bidders would be required to abide by. The contract must also include the standard as well as special conditions specific to a particular case, as mentioned in the RFP. The standard and special conditions of contract are included in the format of the RFP as well as the supply order and contract given in Appendices 'D' and 'E' respectively.

The Standard and Special Conditions of Contract are applicable to Supply Orders also as given in Appendix D. Acceptance of Supply Order by the Firms/PSUs is essential to make the same as legally valid document.

Special conditions of contract are supplementary conditions applicable to a specific tender and contract. Such conditions become essential particularly in cases of contract for supply of services or even equipment. Special conditions of contract are given in Part–IV of Appendix C, D, & E which can be included on case-to-case basis. In addition, there may be a need to stipulate conditions like stage inspection, acceptance trials, installation, setting to work, and commissioning or pre-defined stages of payment for services. Such conditions should be decided while processing the proposal for CFA's approval and mentioned in the Request for Proposal as well as the contract/supply order.

Applicability of Conditions of Contract

The formats of the RFP and the contract agreement contain all the standard and special conditions of contract. While the special conditions may be mentioned in the RFP and

subsequently in the contract, as applicable in a particular case, all the standard terms and conditions should invariably be mentioned in the RFP and the contract. Minor changes in the text would be permissible, as long as such changes do not materially alter the context or import of the relevant article. CFAs would be competent to take a decision in this regard in consultation with Integrated Finance, wherever such consultation is required for sanctioning the proposal. Legal opinion may be sought, if considered necessary, before making any such alteration. However, wherever standard text of clause given in Part III of Appendix C, D & E are concerned, the text of such clauses should not be altered without seeking legal opinion.

Effective Date of Contract

The effective date of commencement of contract should be invariably indicated in each contract as per agreed terms and conditions. Normally, the date of signing of the contract will be the effective date of contract as given in Para 2, Part III, Appendix C. However, except when specifically provided otherwise in the contract. Where specifically agreed to by the parties to the contract, effective date may be the date on which any or the last of the following conditions, as applicable, is complied with:

(a) Furnishing of the Performance Bond in the form of PBG by the Seller.
(b) Obtaining of the Export License for supply of stores by the Seller and a confirmation in writing sent to the Buyer within specified days of signing of the contract.
(c) Receipt of Bank Guarantee for advance payment.
(d) Date of Issue of the End User Certificate. (The supplier should normally provide the End User Certificate within 30 days of the signing of the contract.)

Payment of Advance

<u>Advance Payment to Suppliers</u>

Ordinarily, payments for services rendered or supplies made should be released only after the services have been rendered or supplies made. Therefore, no advance should be offered in the RFP. However, it may become necessary to make advance payments in the following types of cases:

(a) Advance payments are demanded by firms holding maintenance contracts for servicing of air-conditioners, computers, other costly equipments, etc.
(b) Advance payments demanded by firms against fabrication contracts, turnkey contracts, etc.

Where it is decided to provide advance payment, the quantum should be incorporated upfront in the RFP.

Quantum of Advance

Advance payment should not exceed fifteen percent of the contract value or the amount payable for six months in case of maintenance contracts.

Relaxation of the Prescribed Ceilings

The ceilings mentioned above may be relaxed only with the approval of the Secretary (Defence Finance) and the Secretary of the concerned Department of the Ministry of Defence.

Stage/Part Payments

If stage/part payments are proposed to be made on achievement of milestones, it should be clearly mentioned upfront in the RFP with the approval of CFA and the concurrence of the IFA, wherever required as per the delegation of financial powers.

Securing the Advance

While making any advance payment, adequate safeguards in the form of bank guarantee, etc., should be obtained from the firm. The format in which such guarantee is to be obtained is given in Form DPM-16.

Price Variation Clause/Price Adjustment Clause

Normally a contract should be entered into on a fixed price basis. Nevertheless, in the fluctuating market conditions it may sometimes become necessary in the case of long term contracts to consider variable price quotes given by the suppliers. The following guidelines will be followed in cases where a price variation provision is sought to be included in the contract:

(a) Price Variation Clause can be provided only in long-term contracts, where the delivery period extends beyond 18 months. In short-term contracts, firm and fixed prices should be provided for. (Where a price variation clause is provided, the price agreed upon should specify the base level viz., the month and year to which the price is linked, to enable variations being calculated with reference to the price levels prevailing in that month and year.)

(b) A formula for calculation of the price variations that have taken place between the Base level and the Scheduled Delivery Date should be included in this clause. The variations are calculated by using indices published by Governments or Chambers of Commerce periodically. An illustrative formula has been given in Part IV of Appendix ‘C’ for guidance.

(c) The Price Variation Clause should also specify cut-off dates for material and labour, as these inputs taper off well before the scheduled delivery dates.
(d) The Price Variation Clause should provide for a ceiling on price variations, particularly where escalations are involved. It could be a percentage per annum or an overall ceiling or both. The buyer should ensure a provision in the contract for benefit of any reduction in the price in terms of the Price Variation Clause being passed on to him.
(e) The clause should also stipulate a minimum percentage of variation of the contract price above which price variations will be admissible (e.g. where resultant increase is lower than two per cent no price adjustment will be made in favour of the supplier).
(f) Where advance or stage payments are made, there should be a further stipulation that no price variations will be admissible on such portions of the price, after the dates of such payment.
(g) Where deliveries are accepted beyond the scheduled Delivery Date subject to levy of liquidated damages as provided in the Contract, the liquidated damages (if a percentage of the price) will be applicable on the price as varied by the operation of the Price Variation Clause.
(h) No price variation will be admissible beyond the original Scheduled Delivery Date for defaults on the part of the supplier.
(i) Price variation may be allowed beyond the original Scheduled Delivery Date, by specific alteration of that date through an amendment to the contract in cases of Force Majeure or defaults by Government.
(j) Where contracts are for supply of equipment, goods, etc., imported (subject to customs duty and foreign exchange fluctuations) and/or locally manufactured (subject to excise duty and other duties and taxes), the percentage and element of duties and taxes included in the price should be specifically stated, along with the selling rate of foreign exchange element taken into account in the calculation of the price of the imported item. The mode of calculation of variations in duties and taxes and Foreign exchange rates and the documents to be produced in support of claims for such variations should also be stipulated in the Contract.
(k) The clause should also contain the mode and terms of payment of the price variation admissible.

Exchange Rate Variation (ERV)

ERV Clause

This clause is only to be included in the contracts concluded with Defence PSUs, in case the delivery period exceeds one year from the date of contract which involves import content (foreign exchange). The offer should indicate the import content. In case DP is re-fixed / extended, ERV will not be admissible, if this is due to default of the supplier. Base exchange rate of each major currency used for calculating FE content of the contract is to be indicated.

The base date for ERV to be admissible would be the contract date and variation on the base date can be given upto the midpoint of manufacture unless the firm has already indicated the time schedule within which materials will be exported by the firm. Other conditions as above for price adjustment would be applicable.

Documentation for Claiming ERV

The following documents would need to be submitted in support of the claim on account of ERV:

(a) A bill of ERV claim enclosing worksheet.
(b) Banker's Certificate / debit advice detailing FE paid & Exchange rate.
(c) Copies of import orders placed on the suppliers.
(d) Invoice of supplier for the relevant import orders.

Performance Security Deposit

Performance Security deposit payable to the Purchaser is furnished by the Supplier in the form of a Performance Bank Guarantee (PBG) issued by a public sector bank or a private sector bank authorized to conduct government business, in the prescribed format within thirty days from the date of contract. At present, ICICI Bank Ltd., Axis Bank Ltd. and HDFC Bank Ltd. are the three private sector banks authorized to carry out government transactions. The performance security deposit is meant to compensate the Purchaser for any loss suffered due to failure of the supplier to complete his obligations as per the contract. Preferably, performance security is payable by the supplier at the rate of 10% of the contract value. PBG should remain valid for a period of sixty days beyond the date of completion of contractual obligations, including warranty. The BG is returned to the supplier on successful completion of all his obligations under the contract. In case the execution of the contract is delayed beyond the contracted period and the purchaser grants extension of delivery period, with or without LD, the supplier must get the BG revalidated, if not already valid. The format of the PBG is given in Form DPM-15.

Payment

Payment Terms

Payment terms are of great importance both for the purchaser and the supplier as the cost of finance plays a very important role in deciding the cost of an item or service being contracted for. Normally, 95% of the contract amount is released against provisional receipt of the item at the consignee's premises along with inspection note and other documents. Balance 5% is released after the stores have been properly checked and accounted for. Some suppliers prefer 100% payment after delivery and accounting, which may be accepted. In many cases,

suppliers request for allowing part supply and corresponding part payment. Such requests can also be considered by the CFA for acceptance on merit of individual cases.

Paying Authority

The specific office of the Principal Controller/Controller or the Unit Accounts Office, which would be responsible for making payment, should be clearly mentioned in the RFP and the contract.

E-payments

It will be mandatory for the suppliers/vendors to indicate their bank account numbers and other relevant e-payment details so that payments could be made through ECS/NEFT/RTGS mechanism instead of payment through cheques. A copy of the model mandate form prescribed by RBI to be submitted by suppliers/vendor for receiving payments through ECS is given in Form DPM-11. The details given in the mandate form should also be incorporated in the supply order/contract.

Documents to be Submitted for Claiming Payment

The documents to be submitted for audit and payment depend upon the nature of procurement and the terms and conditions of a particular supply order/contract. However, essential documents that are required for audit and payment are as follows:

(a) Documents to be Submitted to the Audit Authority Along With Advance Copy of the Supply Order/Contract:

i. Ink singed copy of the Supply Order/Contract Agreement/ Accepted Tender (AT) Note
ii. An ink-signed copy of sanction of the CFA indicating UO Number and date of IFA's concurrence, where applicable
iii. A copy of the techno-commercial evaluation and rejection details, if any, in case of two bid system
iv. A copy of the Comparative Statement of Tenders (CST) with price bids
v. A copy of TPC/PNC proceedings, if held
vi. PAC certificate/OEM's Certificate/ any other certificate that may be peculiar to the procurement
vii. Specimen signatures of sanctioning and countersigning authorities
viii. VAT/CST/Service Tax Registration No./PAN No.

Note:

1. The budget allotment letter(s) conveying allocation of funds under the concerned code-heads of expenditure are required to be sent as and when the allocations are made.

2. In case documents listed above are not sent in advance to the audit authority, they may be called for by such authority at the time of payment of bills/post audit, where applicable.

(b) Documents to be submitted to Paying Authority for payment along with the Bill

i. An ink-singed copy of the Contingent Bill/Seller's Bill
ii. An ink-signed copy of the Commercial Invoice
iii. A copy of the Supply Order with UO No. and date of IFA's concurrence, where required under delegation of financial powers.
iv. CRVs in duplicate
v. Inspection note
vi. Relevant documents/proof of payment in support of the claim for statutory and other levies, such as Excise duty challan, Customs duty clearance certificate, Octroi receipt, proof of payment for EPF / ESIC contribution with nominal roll of beneficiaries, etc., as applicable
vii. Exemption certificate for Excise duty/Customs duty, if applicable
viii. Bank Guarantee for advance, if any
ix. Guarantee/Warranty Certificate
x. Performance Bank Guarantee/indemnity bond, where applicable
xi. DP extension letter with CFA's sanction, UO No. and date of IFA's concurrence, where required, indicating whether extension is with or without LD
xii. Details for electronic payment as per mandate form given in Form DPM-11, if these details are not incorporated in the Supply Order/Contract or in case there is a change in these details
xiii. User acceptance
xiv. Any other document/certificate that may be provided for in the supply order/contract.

[**Note**: Depending upon the peculiarities of the procurement being undertaken, documents may be selected from the list given above and specified in the RFP and supply order/contract.]

Delivery

Timely delivery as per the delivery period (DP) stipulation in the Contract/Purchase Order is one of the most important procurement objectives as timely availability of items is vital, particularly for the department of defence. The stores are considered to have been delivered only when these are handed over to the consignee after due inspection by the designated inspecting agency. Most contracts stipulate door delivery at the consignee's end by road. In some cases, the stores are also dispatched by rail, in which case the delivery is deemed to have been made on receipt of RR and inspection note**.** In certain cases where the contractor

offers stores for inspection during the last few days of contract DP or on the last day of the contract DP, the inspector can inspect the store and sentence it as per standard franking clause.

[As per the standard franking clause, the fact that the stores have been inspected after the delivery period and accepted by the inspectorate does not bind the purchaser, unless at his discretion he agrees, to accept delivery thereof. The stores are accepted without prejudice to the right of the Purchaser.]

Correctness of the Quality and Quantity

On receipt at the consignee's premises, the stores are checked for ascertaining the correctness of quantity, quality and documents. In case the stores are found deficient in any way, the consignee has the right to reject the stores even if these were inspected and cleared by the inspector.

Failure to deliver within the DP

When the supplies do not materialize by the stipulated contract delivery date, the purchaser has the option of:

(a) Extending the delivery date with imposition of LD and denial clause, which implies denial of increase in price, taxes, duties, etc. taking place during the extended period.
(b) Re-fixing the delivery date.
(c) Canceling the contract and repurchasing the non-supplied quantity.

Deciding the Course of Action in the Event of Failure of Supply

For deciding on these options the Procuring Authority has to balance the time factor required for making repurchase and whether the supply can be arranged earlier than the period of extension sought for at cheaper rates from alternative sources and in the latter case whether the indentor can reasonably wait to take advantage of lower trend in prices. Extension shall be granted only where the CFA is convinced that supplier would come forward during extended DP. Detailed instructions are contained in chapter 12 of DGS &D Manual 1999. Suggested format for correspondence/amendment on this issue has been given in Forms DPM- 26, DPM-27, DPM-28 and DPM-29 for guidance.

Maximum Period of Extension

The maximum period of extension of delivery that can be granted by the CFA under delegated powers should be such that the total period - the original delivery period plus the extension – does not exceed twice the original delivery period. Extensions beyond this period would require sanction of the Ministry of Defence.

Liquidated Damages (LD)

Compensation of loss on account of late delivery where loss is pre-estimated and mutually agreed to is termed as the Liquidated Damage (LD). Law allows recovery of pre-estimated loss, provided such a term is included in the contract. For imposition of LD, there is no need to establish actual loss due to late supply. The legal position with regard to claim for liquidated damages is as follows:

a) Whatever the quantum of the loss sustained, the claim cannot exceed the sum stipulated in the contract.
b) Only reasonable sum can be calculated as damages, which in given situation may be less than the sum stipulated.
c) What is a reasonable sum would depend on facts.
d) Court may proceed on the assumption that the sum stipulated reflects the genuine pre-estimates of the parties as to the probable loss and such clause is intended to dispense with proof thereof.
e) The distinction between penalty and LD has been abolished by the Indian Contract Act and in every case, the Court is not bound to award more than 'reasonable compensation' not exceeding the amount so named.

Quantum of LD

As a general rule, if the contractor fails to deliver the stores/service or any installment thereof within the DP or at any time repudiates the contract before expiry of such period, the CFA, without prejudice to the right of the purchaser to any other remedy for breach of contract, may recover from the contractor a sum equivalent to 0.5% of the prices of any stores which the contractor has failed to deliver within the period agreed for delivery in the contract, for each week or part thereof during which the delivery of such stores may be in arrears, where delivery thereof is accepted after expiry of the aforesaid period. The total damages shall not exceed value of 10% of undelivered goods. The LD cannot exceed the amount stipulated in the contract.

Guidelines for levying of LD

The following guidelines would be followed while taking decision for imposition of LD:

S.No.	Circumstances	Quantum of LD
1	Delay in supplies resulted in actual/ demonstrable monetary loss and the Supplier was responsible for the delay	Full LD as per the provisions of paragraph 7.8.2, subject to the LD not exceeding 10% of the value of the contract
2	Delay in supplies resulted in actual/ demonstrable monetary loss but the	Full LD for the period for which the Supplier was responsible for the delay,

	Supplier was responsible only for a part of the delay and the remaining part was beyond Supplier's control	subject to the LD not exceeding 10% of the value of the contract
3	Delay in supplies resulted in actual/ demonstrable monetary loss but the entire delay was due to circumstances beyond the control of the Supplier	LD may be waived in full
4	Actual/demonstrable monetary loss cannot be certified and no inconvenience has been caused	LD may be waived in full

Waiver of LD

Liquidated damages may be waived in full or part, as per the guidelines contained in the preceding paragraph, with the approval of the CFA and the concurrence of the IFA, wherever such concurrence is mandated as per delegation of financial powers. In all such cases, adequate reasons should invariably be recorded for waiving the Liquidated Damages.

Consequential Damages

Consequential damage is imposed over and above LD in case of time critical Turn-key Projects. Where considered necessary, it should be included in the RFP and the contract.

Arbitration

If a dispute arises between the Purchaser and the Supplier and it does not get resolved through mutual discussions, the parties may agree for arbitration. MOD/CFAs should prepare a panel of arbitrators for selection by the Defence Secretary /CFA's who appoint an arbitrator, whose decisions taken after due consideration of factors brought out by both parties are considered final. The option of approaching Ministry of Law for appointment of Arbitrator can also be exercised. Services Headquarters have the power to appoint Arbitrators within their delegated financial powers. The standard Arbitration clauses are given in Forms DPM-7, DPM-8 and DPM-9.

There may be situations when either party approaches a court of law for appointing an independent arbitrator. Purchase officers must consult the Legal Advisor (Defence) and Government counsel in all cases of arbitration.

Force Majeure

Wherever considered necessary, this clause may be included in the RFP and in the Contract. In this context provisions of paragraph 10.9 of this Manual will apply, mutatis mutandis, to procurement from indigenous sources also, though this clause should be included in such

contracts only if absolutely necessary. The standard format of the clause is given in Part-IV of Appendix C.

Option Clause and Repeat Order Clause

Provision for repeat order and option clause should not be made as a matter of course in the RFPs as these clauses have an impact on price. Either or both these clauses may be provided in the RFP only in exceptional circumstances, where the consumption pattern is not predictable, with the stipulation that while exercising one or both these clauses the overall ceiling of fifty percent of the originally contracted quantity will not be exceeded. Repeat Order and/or Option Clause may be exercised more than once, provided altogether these orders do not exceed 50% of the original order quantity.

Option Clause

Under this clause, the Purchaser retains the right to place orders for additional quantity up to a maximum of 50% of the originally contracted quantity at the same rate and terms of the contract. Such an option is available during the original period of contract provided this clause had been incorporated in the original contract with the supplier. Option quantity during extended DP is to be limited to 50% of balance quantity after original Delivery Period. This clause may be exercised in case of procurement from single vendor/OEM also subject to there being no downward trend in prices. However, in multi vendor contracts, great care should be exercised before operating the option clause.

Conditions governing Option Clause

Against an outstanding indent for which acceptance of necessity has been approved by CFA, it may be advantageous to the Purchaser to exercise the option clause in accordance with the terms and conditions of contract. The option clause may be exercised on approval of the CFA, within whose powers total value of original supplies plus value of the option clause falls, in consultation with IFA, where applicable as per the delegation of financial powers, during currency of the contract. It should be ensured that there is no downward trend in the market prices. No fruitful result will accrue by floating fresh RFP when items are urgently required. If the contract also contains the repeat order clause, it may be kept in mind while placing order under the option clause that the total quantity under the option clause and the repeat order cannot exceed fifty percent of the originally ordered quantity.

Repeat Order

Wherever considered necessary, provision may be made in the RFP and the contract for Repeat Order. A Repeat order against a previous order may be placed at the same cost and terms and conditions as per the original order/contract with the approval by the CFA and

concurrence of integrated finance, wherever required as per the delegation of financial powers.

Conditions Governing Repeat Order

A Repeat Order may be placed subject to the following:

(a) Items ordered against the previous order had been delivered successfully.
(b) Original order should not have been placed to cover urgent/emergent demand**.**
(c) Repeat Order is not placed to split the requirement to avoid obtaining the sanction of the next higher CFA.
(d) The original order should have been placed on the basis of lowest price negotiated and accepted by CNC, and not on the basis of delivery or any other preference.
(e) There is no downward trend in the price of the item. (A clear certificate should be recorded to that effect.)
(f) The requirement is for stores of identical nature/ specifications, nomenclature etc. Minor improvements in spec(s) or phasing out of products due to obsolescence should not be precluded from the purview of repeat order but this aspect should be very carefully examined from the point of view of interchangeability of the product offered as an improved substitute.
(g) The repeat order is to be placed within six months from the date of completion of the supply against the previous order and it should be placed only once.
(h) The repeat order quantity is to be restricted to a maximum of 50% of last order quantity in case of indigenous and foreign procurement, where the contract does not also include the option clause. In case of orders for small quantities (1 to 7), the Repeat Order quantity may be rounded off to the next whole number.
(i) This provision may be exercised in case of PAC/Single vendor OEM also. However, care should be taken before exercising this provision in multi-vendor situation.
(j) Where the contract also includes an Option clause, Repeat Order may be placed only for such quantity, which, along with the quantity for which Option clause may have already been exercised, does not result in the total quantity under the Option clause and the Repeat Order exceeding 50% of the originally ordered quantity.
(k) The CFA will be decided taking into consideration the value of the originally ordered quantity and the Option clause/Repeat Order quantity.

Risk and Expense Purchase

Risk and expense purchase clause may be included in the RFP and the contract, if considered necessary. Risk and Expense purchase is undertaken by the purchaser in the event of the supplier failing to honour the contracted obligations within the stipulated period and where extension of delivery period is not approved. While initiating risk purchase at the cost and

expense of the supplier, the purchaser must satisfy himself that the supplier has failed to deliver and has been given adequate and proper notice to discharge his obligations.

Whenever risk purchase is resorted to, the supplier is liable to pay the additional amount spent by the Government, if any, in procuring the said contracted goods/ services through a fresh contract, i.e. the defaulting supplier has to bear the excess cost incurred as compared with the amount contracted with him. Factors like method of recovering such amount should also be considered while taking a decision to invoke the provision for risk purchase. A Standard Risk & Expense Purchase clause is given in Part-IV of Appendix C.

Risk and Expense purchase clause not mandatory

Risk purchase at the cost and expense of the supplier may not always be a practical proposition as it may not be feasible to enforce recovery without legal action. This clause is rarely invoked in case of import contracts for this reason. In such cases where the item is of proprietary nature or there is only one qualified firm to supply the items and there is a remote possibility of procuring the same item from an alternative source, it will be essential that instead of having risk and cost clause in the contract, the contract should have performance guarantee clause to cover any such default.

Alternative remedies to Risk & Expense Purchase Clause

In case of foreign contracts, risk and expense clause is generally not applicable. The other remedies available to the purchaser in the absence of the Risk and Expense Clause are as follows:

(a) Deduct the quantitative cost of discrepancy from any of the outstanding payments of the supplier.
(b) Avoid issue of further RFP's to the firm till resolution of the discrepancy.
(c) Bring up the issue of discrepancy in all meetings with the representative of supplier.
(d) Provide for adequate Bank Guarantee to cover such risks.
(e) In case of foreign contracts, finally approach the Government of the Supplier's country through the Ministry of Defence, if needed.

Apportionment of Quantity

In global and limited tender enquiry cases, if there is an apprehension that the L1 may not have the capacity to supply the entire requisite quantity, it should be mentioned in the RFP that the order may be placed on L2, L3 and so on for the balance quantity at L1 rates, provided this is acceptable to them. Even if there was no prior decision to split the quantities and it is discovered that the quantity to be ordered is far more than what L1 alone can supply, the order may be distributed as above among L2, L3, etc. at the L1 rate. Where it is decided

in advance to have more than one source of supply (due to vital or critical nature of the item) the ratio of splitting should be indicated in the RFP.

Acceptance of Excess or Short Deliveries

There may be occasions when excess or short supplies are made by the vendors due to various reasons like, exact multiples of the standard units of measure, or where it is difficult to mention exact weight in case of steel plates etc. A clear indication should be made in the RFP if this clause is to be applied in any particular case. These variations in supplies may be accepted with the approval of CFA, subject to the value of such excess/short supplies not exceeding 5% (five percent) of the original value of the contract. CFA will be determined with reference to the value of the original order plus excess/short supply.

Buy Back Offer

When it is decided to replace an existing old item(s) with a new item(s), a suitable clause should be incorporated in the RFP so that the prospective and interested bidders may formulate their bids accordingly. Depending on the value and condition of the old item(s) to be traded, the time as well as the mode of handing over of the old items to the successful bidder should be decided and relevant details in this regard suitably incorporated in the RFP. Suitable provision should also be made in the RFP to enable the Purchaser either to trade or not to trade the old item(s) while purchasing the new one(s).

Fall Clause

In cases where contracts have to be concluded with the firms, whose rate contract with DGS&D/other central procurement agencies has expired and renewal of RC has not taken place, a 'fall clause' should be incorporated in the Supply Order/Contract to the effect that during the currency of the Supply Order/Contract, in case rates are found to be lower on conclusion of rate contract, the lower rates as in the rate contract shall be applicable.

RATE CONTRACT

The basic objective of a procurement agency is to provide the right items of right quality and in right quantity, at the right place and right price so as to meet the requirement of the users. One of the ways to ensure this is to conclude Rate Contracts for all common user items which are regularly required in bulk by the users and whose prices are likely to be stable and not subject to considerable market fluctuations. A Rate Contract (RC) enables procurement officers to procure indented items promptly and with economy of scale and also cuts down the order processing and inventory carrying cost. The RC system takes care of supply chain management and enables an efficient transaction both for the purchaser and the supplier.

A Rate Contract (commonly known as RC) is an agreement between the purchaser and the supplier for supply of specified goods (and allied services if any) at specified price and terms

& conditions (as incorporated in the agreement) during the period covered by the Rate Contract. No quantity is mentioned nor is any minimum drawal guaranteed in the Rate Contract. The Rate Contract is in the nature of a standing offer from the supplier firm. The firm and/or the purchaser is/are entitled to withdraw/cancel the Rate Contract by serving an appropriate notice on each other, of not less than thirty days. However, once a supply order is placed on the supplier for supply of a definite quantity in terms of the rate contract during the validity period of the rate contract that supply order becomes a valid and binding contract and the supplier is bound to supply the ordered quantity.

Price Agreement

While procuring goods and services, it may be expedient to enter into a Price Agreement (PA)/Fixed Price Quotation (FPQ) with the Original Equipment Manufacturers (OEMs). The PA/FPQ may be finalized after due negotiation and market survey. Such PA/FPQ may be normally valid for a period upto three years and may be extended further suitably with next higher CFA's sanction.

Types of Items Suitable for RC

The types of items which may be considered for RC are:

a) Items required by several users on recurring basis and having clear specifications.
b) Fast moving items with short shelf life or storage constraints.
c) Items with minimum anticipated price fluctuation during the currency of the RC. Items with high probability of considerable price fluctuation should not be considered to be covered by RC except for short term contract.
d) Items that take long gestation period to manufacture and for which there is only one source for manufacturing.

Items already on DGS&D Rate Contract

No Rate Contract should normally be concluded for items in respect of which DGS&D Rate Contracts are already in place. If, however, it becomes necessary to enter into contracts for items which are already on DGS&D Rate Contract, the reasons for doing so should be recorded and CFA's approval taken after consulting integrated finance.

Authorities Competent to Conclude Rate Contract/Long Term Product Support

Authorities competent to conclude Rate Contracts: Rate Contract or Price Agreement for goods and services should be concluded only by the authorized Central and local Procurement Agencies.

Long Term Product Support: The Price Agreement for long term product support should be concluded with the approval of the authorities to whom such powers have been specifically delegated.

Period of Rate Contract

A Rate Contract should normally be concluded for one year. However, in special cases, shorter or longer period, not exceeding three years, may be considered. Any extension of the existing RC or conclusion of an RC beyond a period of three years would need the approval of the Ministry of Defence.

Fixing of the Termination Period: As far as possible termination period of RC should be so fixed as to ensure that budgetary levies would not affect the price and thereby frustrate the contracts.

Determination of the Competent Financial Authority to approve RC

Value of anticipated drawal over a period of one year should be taken into account while determining the level of CFA for conclusion of Rate Contract/Price Agreement.

Process of concluding Rate Contracts

Estimate/Indent/Requisition: A Rate Contract can be concluded based on estimated annual requirements of various users under the authority processing an RC proposal. The contract concluding authority must scrutinize the estimates for their completeness in terms of authority for raising the indent, specification of the item, desired delivery schedule, packing and preservation, etc. Adequate budget provisions must be made and confirmed in the normal manner.

Selection of Firms: Rate Contracts should be normally concluded only with the registered firms based on their capacity assessment by the designated Registering/Inspecting Agency. In respect of new items being bought on Rate Contract for the first time, RC can be awarded to unregistered firms also on the basis of favourable technical capacity and financial capabilities. Past performance of a firm will be a major consideration while awarding a Rate Contract. The following aspects should normally be kept in mind:

a) No new RC should be placed with firms having backlog, which is likely to continue for major portion of the year.
b) Performance of the contractor for the last 3 years should be taken into consideration.
c) If the contractor does not have current RC, performance against earlier two immediate rate contracts should be considered.

d) If the RC holder is a defaulter in furnishing drawal report, this should be looked into, if the defaulter is bidding.
e) The minimum performance level / performance criteria should be specified in the bid documents.

Price Negotiation: While concluding RC, it is preferable to conduct price negotiations by the CNC in order to obtain best value for money and also to clarify all aspects of the RC to avoid ambiguity and dispute at a later stage. All Rate Contracts and Price Agreements should be processed through the committee CFA or the CNC so as to ensure best value for money, quality assurance and transparency. Participation of finance member in all deliberations, particularly regarding the pricing and conditions of contract, is mandatory.

Signing of Rate Contract: RC concluded for various wings of the MOD will be signed for and on behalf of the President of India. RC itself may be signed by the authority to whom powers to enter into RC are delegated or an officer authorized to sign financial documents on his behalf, after CFA's approval.

Conclusion of Parallel RC

Parallel Rate Contracts: In case it is observed that a single supplier does not have enough capacity to cater to the entire demand of an item or where it is desirable to have a wider vendor base due to criticality of the items, it may become desirable to conclude parallel RCs with more than one firm. The CFA, based on the merit of each case, may decide the number of firms to be awarded RC for an item so that DDOs will have a wider choice. Efforts should be made to conclude parallel RCs with firms located in different parts of the country to cater to users over a wider geographical spread. Parallel RC may be concluded with marginal price difference say up to 5%. In such cases approval of the next higher CFA is to be taken.

All DDOs to operate the RCs: Orders against a Rate Contract concluded by any authority may be placed on the same terms and conditions by all Direct Demanding Officers of Services/ Departments/ Organizations/Units/Establishments under the Ministry of Defence, subject to there being no downward trend in prices. To facilitate such operation, a suitable provision should be made in the RCs and the details of the RCs posted on the website of the Service/Organization concerned.

Special Conditions Applicable for Rate Contract

Some conditions of rate contract differ from the usual conditions applicable for other contracts. Some such important special conditions of rate contract are as follows:

i. Earnest Money Deposit (EMD) is not applicable.
ii. In the Schedule of Requirement, no quantity is mentioned; only the anticipated drawal may be mentioned without any commitment.

iii. The purchaser reserves the right to conclude more than one rate contract for the same item.
iv. The purchaser as well as the supplier may withdraw the rate contract by serving suitable notice to each other. The prescribed notice period is generally thirty days.
v. The purchaser has the option to renegotiate the price with the rate contract holders.
vi. In case of emergency, the purchaser may purchase the same item through ad hoc contract with a new supplier.
vii. Usually, the terms of delivery in rate contracts are FOR dispatching station. This is so, because the rate contracts are to take care of the users spread all over the country. However, wherever it is decided to enter into RCs which are FOR destination, the cost of transportation should be separately asked for.
viii. Supply orders, incorporating definite quantity of goods to be supplied along with all other required conditions following the rate contract terms, are to be issued for obtaining supplies through the rate contract.
ix. The purchaser and the authorized users of the rate contract are entitled to place supply orders upto the last day of the validity of the rate contract and, though supplies against such supply orders will be effected beyond the validity period of the rate contract, all such supplies will be guided by the terms and conditions of the rate contract.
x. The rate contract will be guided by "Fall Clause".

Fall Clause

Fall clause is a price safety mechanism in rate contracts. The fall clause provides that if the rate contract holder reduces its price or sells or even offers to sell the rate contracted goods following conditions of sale similar to those of the rate contract, at a price lower than the rate contract price, to any person or organization during the currency of the rate contract, the rate contract price will be automatically reduced with effect from that date for all the subsequent supplies under the rate contract and the rate contract amended accordingly. Other parallel rate contract holders, if any, are also to be given opportunity to reduce their price as well, by notifying the reduced price to them and giving them 15 (fifteen) days' time to intimate their revised prices, if they so desire, in sealed cover to be opened in public on the specified date and time and further action taken as per standard practice. On many occasions, the parallel rate contract holders attempt to grab more orders by unethical means by announcing reduction of their price (after getting the rate contract) under the guise of Fall Clause. This situation is also to be dealt with in similar manner as mentioned earlier in this paragraph. It is, however, very necessary that the purchase organizations keep special watch on the performance of such rate contract holders who reduce their prices on one pretext or other. If their performances are not upto the mark, appropriately severe action should be taken against them including deregistering them, suspending business deals with them, terminating the contract, etc.

Performance Security

Depending on the anticipated overall drawal against a rate contract and, also, anticipated number of parallel rate contracts to be issued for an item, the authority concluding the Rate Contract(s) may consider obtaining performance security of reasonable amount from the Rate Contract holders. A suitable clause to this effect is to be incorporated in the tender enquiry documents. Performance Security shall, however, not be demanded in the supply orders issued against rate contracts.

Renewal, Extension, Termination and Revocation of Contracts

Renewal and Extension

It should be ensured that new rate contracts are made operative right after the expiry of the existing rate contracts without any gap for all rate contracted items. In case, however, it is not possible to conclude new rate contracts due to some special reasons, timely steps are to be taken to extend the existing rate contracts with same terms, conditions etc. for a suitable period, with the consent of the rate contract holders. Rate contracts of the firms, which do not agree to such extension, are to be left out of consideration for renewal and extension. Period of such extension should generally not be more than three months. Also, while extending the existing rate contracts, it shall be ensured that the price trend is not lower.

Termination and Revocation of RC

RC is in the nature of standing offer and a legal contract comes into being only when a supply order is placed by the CFA/Direct Demanding Officers. Being just a standing offer, embodying various terms of the offer, the contract holder may revoke it at any time during its currency. However, reasonable opportunity should be given to the supplier to represent against any revocation/cancellation of RC.

Payment

Payment Terms: Standard Payment terms, as indicated below, should be incorporated in all Rate Contracts:-

a) Upto 95 % on receipt of stores at consignee's premises against dispatch document, provisional receipt and copy number 1 of Inspection Note. However, in case it becomes essential to dispatch stores by train, 90% payment can be released against proof of dispatch, i.e., copy of the RR and inspection note.
b) Balance on accounting of stores by the consignee.
c) Payment should be effected by the paying authority within 21 working days from the date of receipt of bill, if the supporting documents meet paying authority requirement.

Consolidated observations, if any should be forwarded within 10 working days by paying authority to the CFA.

Paying authority: The organization of the Principal Controller/ Controller of Defence Accounts concerned or an authority holding cash assignment/imprest and duly authorized to make payment for such procurements will be the paying authority.

DESIGN, DEVELOPMENT & FABRICATION CONTRACTS

This part (as provided under Chapter 15 of the Defence Procurement Manual) lays down the procedures to be followed by the Defence authorities and Departments for conclusion of contracts for design, indigenous development (including indigenization) and fabrication of stores, equipment and spares required by the Defence Services. The general instructions contained herein have been made as flexible as possible to avoid time delays and to encourage the industry to come forward and undertake the design, development and fabrication of items, equipment, plant and machinery required by the Defence Services. Detailed Instructions on Procedures to be followed in-house for processing orders for items of a developmental nature/indigenisation may be drawn by the Services HQrs/ other development agencies like DRDO, CPOs etc. in consultation with the MoD (Finance) in broad consonance with the guidelines contained herein.

Decision for Indigenous Development

The Technical Directorate/ Directorate of Indigenisation /Committee for Indigenisation of the concerned Service/ Department/ Command HQ should assess the economic viability of indigenous manufacture of a defence item in the civil sector in terms of volume, likelihood of future requirement and economies of scale, residual life of the equipment/item and a clear indication of requirement over a long period (of say 3-5 years). For this purpose necessary systemic changes in planning and provisioning may be carried out by the Services. In case the above conditions are not fulfilled, the feasibility of indigenising a package of similar range of items may be considered / decided by the CFA in consultation with the IFA keeping in view the volume, future requirement and economies of scale so as to make the package commercially viable. If it is not feasible to work out a package but the item is still required to be indigenised for strategic reasons, the requirement may be projected to the Department of Defence Production and Supplies for development by the OFB/Defence PSUs etc. where feasible.

Partnership with Private Sector

The Indian private sector Industry today offers scope for their greater involvement in the Defence Sector and possesses the requisite skills and infrastructure for undertaking defence production or may be willing to invest/share the cost of setting up of such infrastructure. The industry should be encouraged to make such investment by working out the Minimum Order

Quantity to maintain the financial viability of development within the desired time schedules. As regards high technology complex systems, projects under this category should be identified, to be undertaken by Raksha Udyog Ratnas (RURs) /Indian Industry /DPSUs /OFB/ Consortia on a level playing field. This procedure may also be followed for all upgradations of equipment/parts under the 'Make' category. Outsourcing of development of equipment /systems having high technology content should be considered on the lines of parallel development for which the cost should be shared with the vendor.

Principles and Policy

General Principles

Whilst it is not possible to lay down any rigid rules covering all the contingencies that may arise in the finalisation of specific development contracts, the following guiding principles may, however, be borne in mind :-

a. Exploration of sources for placement of development order should be as wide as possible, both in the public and private sector, to encourage competition.
b. Ability of the contractor to execute work of the desired quality to the required time schedule should be evaluated by a Technical Committee.
c. Development contracts may, as far as feasible, be concluded with two or more contractors in parallel, subject to the other vendor/s agreeing to match the price of L1. In case of higher deviation the full / Economic Order Quantity (EOQ) order may be placed on the L1 firm, subject to price being found reasonable.
d. Placing of parallel contracts on two parties is particularly necessary/desirable to have more than one source of supply at bulk production stage and also, apart from competition, to ensure successful completion of development if one of the contractors fails to develop the equipment in time.
e. The ratio of splitting of the supply order between various development agencies/firms in cases of parallel development, including criteria thereof, must be pre-disclosed in the RFP itself.
f. However, in case the requirement is meager and complex technology is involved, a single source having expertise in the requisite field may be considered with appropriate justification and due approval of the CFA in consultation with IFA where required as per delegation of financial powers.
g. The contractor or the firm should be such that it can, if so desired, take up bulk production orders subsequently.
h. During the developmental stage, 20% of the total order quantity may be earmarked for development. This would, however, not be considered as a case of dual procurement.

i. The information available with the DGS&D and the Defence Inspection Organisation (DGQA, DGNAI and DGAQA) may be availed of in selecting the firms to be entrusted with the development/fabrication contracts.
j. Items indented by the indenting authority through indents/Final Depot List/ Special Requisition should be the basis to proceed with the development after requisite quantity vetting has been done, as per laid down procedure.

Processing of Development Orders

Some of the important steps involved in the processing of development contracts are as follows-

i) Identification/Selection of stores/items for indigenous development.
ii) Generation of the Paper Particulars / drawings.
iii) Identification of vendors/firms.
iv) Framing and Issue of RFP.
v) Technical evaluation of bids and holding of CNC/PNC.
vi) Conclusion of Contract/ Supply Order.
vii) Post Contract Management.

Selection of Items for indigenization/development

The following broad guidelines may be adopted to arrive at the decision for indigenous development of items/equipment :-

a. When OEM is closing down or has closed down the production line and spares are not available ex-import for equipment which has adequate residual life and population.
b. Items for which TOT has been taken.
c. Items including those which are low tech and the sample is available and which it would be economic to develop.
d. Spares which are fast moving and the requirement is recurring in nature.
e. Goods for which the import price is exorbitant.
f. Items short-listed from MRLS and import list depending upon their criticality, technological processes involved and consumption rate.
g. Where an Indian firm offers to develop an item on 'No Cost : No Commitment' basis.
h. In special cases, where it is considered in the interest of the State to indigenize or for any other strategic reason to be recorded, e.g. Secrecy devices.

Dispensation to firms undertaking Development Contracts

The contract documents may be issued free of cost. Further, submission of earnest money deposit and security deposit may not be made mandatory in case of firms of repute/firms

which are registered with DGS&D, DGQA/DGAQA or other Departments/Services on case to case basis. Development orders placed on firms may not have a liquidated damage clause, if it is found difficult to attract vendors to develop the item/ stores whose specification is normally not governed by any widely used standards like IS/BS, etc.

Paper Particulars and Design Aspects

Model. Development contracts are generally of the following two types:-

a. Those where industrial engineering of Prototype models is to be done by the firm on the complete design data which has already been evolved in the Establishment/Department by the design and development of an existing/original model.
b. Those where designing, developing and engineering are completely done by a firm under technical guidance and advice from the developmental authorities. In this case, it may be possible to utilize the expertise available in the industry and ensure quick and smooth supply.

Design Aspects

In the case of contracts as at Para 15.3.1(a) above, the development contract would always be based on a draft technical / design specification and other information to be provided by the Establishment / Dte of Indigenisation/ Laboratory / Workshop / Depot. In case of contracts as at Para 15.3.1 (b) above, the contract should contain a provision for the development of industrially engineered models/equipment and supply of models/equipment at various stages with relevant types of drawing and other documents by the contractor, as required by the contracting authority. The design material, workmanship and performance of the equipment for a specific period should also be guaranteed by the contractor.

Vendor Identification / Development

Identification of Vendors

Identification of appropriate vendors is a vital step and must be well considered. Wherever possible, the vendors who are registered with DGAQA/DGQA/DRDO/OFs/ DPSUs/Services indigenisation agencies/ NSIC should be approached. Suitable vendors can also be identified by the developing agency in consultation with other developing agencies apart from firms registered with DGQA or any other defence establishment. Unregistered firms may be considered taking into account their infrastructural facilities, capacity, technical competence and financial standing. A format for this purpose is enclosed at Form DPM - 5. Firms of national repute may also be considered based on selfcertification, with the approval of the Defence Secretary.

Development of Source by Inviting Applications for Enlistment

The following procedure will be followed:-

a. Open advertisement will be placed on the internet and advertised in leading newspapers every year, in respect of different products/components, for enlisting firms willing to participate in tenders issued by the Department/Organisation. The minimum number of products/components required to be submitted by the vendor for evaluation and likely demand for those products/components for the next two to three years will be indicated in the advertisement.
b. Interested firms may visit the factory/workshop/depot as indicated in the tender to see the product/ component required to be developed. Thereafter, the firms showing interest in developing the product/component should be asked to submit the details of infrastructure available with them, as per the documents prescribed for vendor registration;
c. The infrastructure details submitted by the firms should be studied by a team of officers constituted to assess their manufacturing capability to verify their genuine potential for developing the product/ component.
d. Firms found capable of developing the product/component should be asked to submit the required number of samples (as advertised) of the identified product(s). On acceptance of samples, the firm will be eligible for participating in the LTEs for the said component / product.
e. A firm may not be willing to submit a sample due to requirement of a heavy investment. In such cases, the indigenisation agency / Directorate may place a development order on the firm as follows :-
    i. The cost of the sample will be assessed through a Board of Officers having representation from Finance.
    ii. The firm will be asked to offer a quotation and if the price is found to be equal to or lower than the assessed cost, the development order will be placed on the firm at the price quoted.
    iii. If the firm quotes a price higher than the assessed cost, the price will be negotiated with the firm and development order placed at the assessed cost.

Capacity Assessment

Capacity assessment/verification of firms not registered with DGQA/DGNAI/DGAQA/Govt Agencies is to be undertaken by the developing agency by associating a member from the DGQA/DGNAI/DGAQA, other inspection agencies or other Technical Agencies/Committees on fast track to ensure that firms identified are capable to develop prototype equipment and systems as required. Where considered necessary by the CFA, IFA may be associated for assessment of the financial capacity of the firm. Once a firm has

successfully executed an order within +/-5% tolerance both in terms of quality and quantity, it should be encouraged to get registered.

Transfer of Technology (ToT)

When equipment is being bought from a foreign vendor, the provision of ToT to an Indian private/public firm for providing maintenance infrastructure may be considered and the foreign vendor would need to identify an Indian firm which would be responsible for providing base repairs (third line) and the requisite spares for the entire life cycle of the equipment. These firms would be DPSUs/OFB/RURs/or any other firm specially selected for this purpose. In addition Army Base Workshops/Naval Dockyards/Base Repair Depots of Air Force may also be considered for this purpose at RFP stage on a case to case basis in consultation with the DDP. The RFP would spell out the specific requirements of ToT for Maintenance Infrastructure which could cover the production of certain spares, establishment of base repair facilities including testing facilities and the provision of spares for the entire life cycle of the equipment. Both the foreign and the Indian firms would be jointly responsible for providing the maintenance facilities and support for that equipment.

Framing and Issue of RFP

Request for Proposal (RFP)

Development/ indigenisation of an item may require design, generation of drawings, manufacturing, development of prototype equipment and system, quality assurance during development process, tests and trials and inspections at various stages. RFP is to be floated to firms who have the required infrastructure for the proposed development. In order to save on development time and in case of the classified nature of stores to be developed, quotations may normally be invited on limited tender basis from firms/contractors who are known to be capable of undertaking the particular development work. However, depending upon the specific requirements of the case, the developing agency may justify issue of RFP either on OTE, LTE or STE basis, as required.

Pre-bid Conference

In case of turnkey contracts or for development of sophisticated and complex equipment, a suitable provision is to be made in the bidding documents for a pre-bid conference for clarifying issues and clearing doubts, if any, about the specification and other technical details of the plant, machinery and equipment projected in the bidding document. The date, time and place of the Pre-bid Conference must be indicated in the bidding document and should be sufficiently ahead of the bid opening date.

Receipt and Evaluation of Bids

Bid Opening/Technical Evaluation and CNC

The firms submitting their quotation will be intimated the place, date and time for opening of the quotation and the bids will be opened at the appointed time by the Board of Officers in the presence of the representatives of the firm, if present. The procedure for tender opening, technical evaluation, preparation of CST and convening of TPC/CNC for commercial evaluation thereof will be as per modality given elsewhere in the relevant Chapters of the DPM.

Resultant Single Vendor Situation

In case of LTE/Open Tender invitation if only one firm responds or if only one firm is found by the TEC to meet all the specifications, the following aspects will be examined:-

(a) Whether all necessary requirements such as Standard Tender Enquiry conditions, wide publicity, and sufficient time for formulation of tenders had been taken care of while issuing the RFP;
(b) Whether the RFP was properly dispatched and duly received by the prospective vendors;
(c) Whether SQRs could be re-formulated to generate wider competition.
(d) Whether the price quoted in the bid is considered reasonable.

Examination

If the examination reveals that requirements from (a) to (d) have been fulfilled the proposal may be processed further as a case of OTE/LTE as applicable, with the approval of the CFA, for placement of the development order. However, if the quoted price is not borne out as reasonable based on benchmarking prior to opening of the commercial bid or if the offer is not technically feasible or firm not considered capable of developing the item, the bid should be retracted with the approval of the CFA

Reasonableness of Price

It would be mandatory for the vendor to submit the detailed break-up of cost under the headings materials (indigenous/ imported, quantity, cost), labour (number of man hours, man hour rates, etc.), design and development, drawings and details of overheads which will be vetted by a technical team of the Department /Organisation. The last purchase price (LPP) of imported item will be taken as the base price to arrive at the reasonableness of the quoted rates. In case LPP is not available the base price will be arrived at by the process of benchmarking which will be done prior to opening of the Commercial bid as per the procedure given in Chapter 13 of the DPM. L1 will be determined with reference to the development cost, including the cost of prototype and the total quantity for which the initial

orders are placed. An indication of the quantities that would be required during the next two to three years should also be given in the RFP.

Types of Contracts

Adoption of Contract Type

Various types of contracts can be adopted depending upon the nature, complexity and time span of the development work /project. These are described below. However, normally Firm-Fixed-Price contracts, Fixed Price Contracts with escalation clause and Fabrication Contracts will be concluded. Contracts other than these three will be adopted only with the prior approval of Service Headquarters/ Head of Organisation /Department /Service / HQ Maintenance Command IAF in consultation with the respective IFA.

Firm-Fixed-Price Contract

Firm fixed price contract means a contract in which a lump sum amount is agreed upon for development/indigenisation and supply of the equipment based on data/specifications supplied and which is not subject to any adjustment during the performance of the contract due to any reasons whatsoever. The firm or the contractor assumes full financial responsibility in the form of profit or loss. This type of contract is best suited when reasonably definite design or performance specification is available and when Government can estimate reasonable price of development/indigenisation.

Fixed Price Contract with Escalation

This is the same as the firmfixed- price contract, except that upward or downward revision of contracted price can be allowed on occurrence of certain contingencies beyond the control of the firm/contractor such as increase/decrease in wages or cost of material. An escalation formula must be included in such contracts and a ceiling of escalation should also be fixed in the case of long term contracts. Price variation clause can be provided only in long term contracts where the delivery period extends beyond 18 months. The conditions prescribed for price variation clause elsewhere in the DPM will apply whenever such a clause is included in the developmental contracts.

Fixed Price Contract providing for Re-determination of Price

This type of contract is intended to eliminate the impact of contingencies due to causes other than those foreseen in the case of fixed price contract with escalation. These contingencies may be due to the contractor's/firm's unfamiliarity with the raw materials or manufacturing processes, to long term contracts, lack of specifications or the use of performance rather than product specifications. In such cases prospective re-determination could be done -

i) On request by either party

ii) At stated intervals
iii) At a determinable time.

Fixed Price Incentive Contract

This type of contract is designed to provide a greater incentive to the firm / contractor to reduce the contract costs by providing higher profits if costs are reduced and lower profits when costs rise. These costs, the ceilings on target cost, target profit, a price ceiling and the formula for arriving at final cost are all settled before the execution of the contract. This contract type will only be applicable for ab-initio development contracts.

Cost Plus Contract

Cost Plus contracts should ordinarily be avoided. Where such contracts become unavoidable as no vendor is willing to undertake the development, full justification should be recorded before entering into the contract. In this type of contract the firm/contractor is reimbursed the costs incurred and also receives a negotiated profit for performing the contract, i.e., the profit of the firm/contractor and not the cost of development is fixed. Contractor's responsibility towards cost of the item is minimum except that he has to use the same care and prudence as is expected under fixed price contracts. This type of contract should be concluded only when the uncertainty which is involved in the contract performance is of such a magnitude that the cost of performance cannot be estimated with sufficient reasonableness to permit the type of fixed price contract. It is also necessary to ascertain that the firms/contractors have cost accounting machinery and that the cost is clearly defined. A strict R&D surveillance has got to be provided by the Dept to ensure that costs incurred by the firm are reduced to the minimum. The RFP should provide for the firm's books of accounts to be checked by the Order Placing Agency to verify the costs by inclusion of a book examination clause as per standard format. Where supplies or works have to continue over a long duration, efforts should be made to convert future contracts on a firm price basis, after allowing a reasonable period to the supplier/contractor to stabilise their production methods.

Fabrication Contract

Fabrication contract means a one time contract concluded with a contractor or a firm for fabrication and supply of component, sub-assemblies or an assembly, which are not commercially available, against design drawings/specifications to be supplied by the Directorate of Indigenisation/R&D Laboratory/Establishment/Workshop/ Depot /Institution.

Conclusion of Development Contracts

The following points will be borne in mind by the authority entering into a contract :-

a) Contracts in writing should be placed after calling for quotations from a number of firms/contractors unless STE is resorted to for which detailed justification would be

necessary. The two bid system should be followed in design/development/fabrication contracts of a complex nature. In other cases, a single bid may be invited. A Pre bid conference may be held prior to submission of the tenders to clarify any doubtful areas and also to firm up the SQRs/QRs prior to submission of bids.

b) When the statement of case for sanctioning of various phases of the project or the indent is put up, the Head of Service or Establishment /Director/Purchase Dept concerned should mention the amount that is intended to be spent on development/fabrication contracts out of the total cost of the project. At this stage detailed particulars regarding the inquiries made with firms, if any, the number of prototypes intended for manufacture and the intention to get the prototype manufactured by one or more firms must be mentioned.

c) The financial status and technical capability verification reports as well as compliance with the techno commercial requirements will be taken into account at the TEC stage itself. 'Q' bids of only those firms will be opened who are cleared by the TEC.

d) Ordinarily advance payments need not be agreed to in the payment terms. If, however, advance payments have to be made, these should be made against a Bank Guarantee executed on proper stamp paper. If stage payments are to be made to the firm/contractor, the stages should be clearly defined and it should be ensured that the payments are in consonance with the work actually performed by the firm/contractor as per each stage, viz. Preliminary, Design Review, Detailed Design Review and Realisation of Prototype. The quantum of payment will generally not exceed 50% of the estimated expenditure incurred by the contractor upto that stage. The yardsticks for work measurement will be laid down in the contract.

e) Once a contract has been concluded, the terms and conditions thereof will generally not be varied. However where this becomes necessary/inescapable any modification will be carried out with the prior concurrence of the appropriate CFA and the respective IFA, within whose powers the revised contract value falls.

f) Whenever stores are required to be issued to the firm/contractor for fabrication or prototypes or sub-assemblies are issued for guidance in fabrication, these should be issued against appropriate Bank Guarantee. In addition to the Bank Guarantee, appropriate insurance may be asked only where it is considered necessary.

Placement of Order

In case of items considered economically viable for indigenous development, the first order may be placed for the Economic Order Quantity (EOQ) only, The balance number of items in the indent over and above the EOQ may be returned to the indenter and the latter may be asked to re-certify the funds for the EOQ only. The indenter may obtain his balance requirement, if any through import route or through any other sources. Generally a period of two to three years may be provided for indigenous development of a defence item.

In case the quantity of the equipment/ spares is limited/small and may become uneconomic (Non - EOQ) if distributed between two vendors, the entire order would be placed upon the L1 vendor only.

If the indented quantity is found to be less than the assessed EOQ, the Indigenization Agency should first float the RFP and in case there is no response, it will not be taken up for indigenization unless its' development is considered essential for strategic reasons.

Development of Second/New Sources

Procedure

With a view to speeding up development of additional indigenous sources, the question of earmarking a prescribed quantity of the indent for developing a new source has been considered, and the following procedure may be adopted for procurement of items of a development nature, particularly for high value indents of Rs 10 Crs and above:-

a. Where there is only a single developed source, or where there is a felt need for development of more than two sources, 20% only of the second indent should be earmarked for placement as an educational order on the new source to be developed. The percentage may however be modified to ensure that the quantity covered is viable for economic production. This order for the earmarked 20 % should be placed by inviting tenders (OTE/LTE) as per the normal procedure laid down, and the source already developed will not participate in this.
b. The balance 80% of the indent is to be procured from the sources already developed. The firms that execute the source development orders within 5% tolerance clause will be considered as established source subject to submission of bid for at least 50% quantity of the source development tender.
c. Pending successful development of a new source, the order should be placed on the developed source(s) for the required quantity as indented by the Services by following the usual procedure laid down in this regard in order to ensure that the requirement of Services and of Production are met fully and without any delay.
d. In case the new source on which the order for 20% of the indent was placed fails to develop the item, the order should be placed on another new source to be selected by following the usual procedure laid down.
e. A second order to an undeveloped source which has secured one order will not be issued unless:-
    i. A Bulk Production Clearance (BPC) has been accorded to it for the subject item against the first order; and
    ii. It has made at least 50% of the supplies of the first Supply Order placed on it, which have been duly accepted.

Acquiring Manufacturing Drawings

In order to rapidly develop alternative sources of supply of an item after this has been developed and productionised by one contractor, it is essential that the manufacturing drawings are passed on by the contractor to the Govt. Since the manufacturing drawings are evolved and finalised by the contractor who has initially developed the item, it is likely that the contractor would claim his rights on such drawings and not agree to part with them. Accordingly, a clause should be included in the Tender Enquiry clarifying that the manufacturing drawings /tools/ jigs/ fixtures / dyes/moulds prepared by the contractor for manufacture of the store required shall be the property of the Ministry of Defence and as such shall be passed on to the Purchaser and shall not be used by the contractor for any purpose other than this contract, without the written consent of the Competent Financial Authority, in consultation with the IFA.

Items Developed by Defence PSUs/OFB

The cases in which DRDO/ Defence PSUs/OFB /RURs have successfully developed an item for the Deptt of Defence or have taken Transfer of Technology (ToT) for Department of Defence would not be taken as single vendor cases and only a commercial RFP should be issued to them directly. Instead, they would be treated at par with the proprietary firms for any subsequent procurement, except that no PAC certificate is required. Further, the delegated financial powers of CFAs for PAC purchases will be exercised for such procurements. It will, however, be checked prior to placing of orders that the technology absorption levels agreed to while concluding the ToT contract have been achieved.

Terms of Payment

General

The normal terms of payment are 100% payment within 30 days time after receipt and acceptance of the materials in good condition or the date of receipt of supplier's bill, whichever is later. However, an amount of 10% may be withheld as performance guarantee (where Security Deposit has not been taken) during the warranty period as mutually agreed with the contractor.

Optional

Alternatively, payment upto 90% against proof of dispatch taking into consideration aspects like the reputation and past performance of the suppliers and pre-inspection of the goods at the suppliers' premises may be considered where necessary. Such payments for dispatch by road will be made only if the goods are at suppliers' cost.

Advance Payment to Suppliers

Generally no advance should be paid to the firms/contractors and payments for services rendered or supplies made should be released only after the services have been rendered or supplies made. However, it may become necessary in the case of development and fabrication contracts or in case of turnkey projects to give an advance. In such cases it should be ensured that only a minimum reasonable amount, upto 15%, is given as advance at the time of placement of the order. Such advance payments will be made only against furnishing of a proper bank guarantee by the firm from a public sector bank or private sector bank duly authorized by RBI to handle Government transactions. Format for the Bank Guarantee is given in Form DPM-16.

Intermediate Payments

The initial advance paid should be adjusted against the successive stage payments due to the supplier. The intermediary payments, if any, should be spread over the period of execution of the projects/contract and made in suitable installments keeping in view various stages of development/manufacture. These stages should be pre-determined and it should be ensured that the payments made are in consonance with work actually performed by the firm/contractor and linked to verifiable milestones viz. Preliminary Design Review, Detailed Design Review, purchase of raw materials and realisation of prototype etc. The quantum of payment will generally not exceed 50% of the estimated expenditure incurred by the contractor upto that stage. About 20 to 25% amount as last installment should be released only after the completion of the project or rendering of the services/supplies to the entire satisfaction of the authority placing the order.

Deviations

Cases of advance payment over and above the limits prescribed above would require the approval of the Defence Secretary and concurrence of FA (DS)/Secy Def (Finance).

Post Contract Management

Forwarding of Contract Documents

Once a project has been sanctioned and a contract is concluded for development/fabrication, a copy of the contract will be forwarded to the Heads of Technical Directorates/Services at Headquarters / AHSP. Two copies of the contract (one for the CDA and the other for the LAO concerned) will be forwarded to CDA and IFA concerned for such action as may be considered necessary by them.

Responsibility for Technical Matters

The responsibility in technical matters relating to the development shall rest with the Head of the Service/ Establishment / Directorate of Indigenisation / Laboratory/ Workshop / Depot / Institution concerned.

Inspections

There may be two to three inspections during the development stage and firms may be made more accountable for their product. They may be asked to furnish reports of various tests from the various laboratories as required by the Purchaser, The requirements are to be indicated in the approved Quality Assurance Plan (QAP). A clause should be provided that in case it is subsequently found that the firm has used fraudulent means to obtain the report/s and the item developed is not as per specifications indicated in the RFP the firm will be blacklisted for a minimum period of three years from any future tender. Once an item has been declared as free flow, for further procurement the inspection will be done by the DGQA/DGAQA as per normal procedure.

Monitoring Progress

Responsibility to monitor the progress and operation of the Development/Fabrication contract will rest with the authority that has entered into such contract. The customer will provide necessary guidance to the firm as required from time to time and will maintain close liaison with them to clarify any doubts. The progress of development will be monitored closely and in case the progress is not found to be satisfactory, suitable action will be taken as provided for in the contract.

Return of Documents

Documents, specifications, drawings issued to the firms/contractors or prepared by them should be taken over as these belong to the Govt. A provision to this effect should be made in the contracts. Loss or damage to these documents shall be recoverable from the contractors.

Declaration of Free Flow

Declaration of Item as Developed

The indigenization of an item will be considered complete and the item declared as free flow under the following conditions-

a) When the initial quantity is not large enough to be split and/or the equipment/ system / item is a high tech complex one requiring substantial investment even at the time of development in terms of plant and machinery, the development of a single source and successful delivery against the order placed may be considered sufficient to declare the item as developed.

b) In all other cases, when at least one successful purchase is made and at least two sources are fully established, which would not only ensure price competition but also avert Government's dependence on any single source.
c) Completion of codification of the item / equipment by the AHSP (applicable in all cases).
d) If a second source for the item is not developed under clause at serial (b) above within five years from the date of completion of the first supply order, the item may be declared as "free flow" i.e as developed thereafter; however, there could be exceptions with full justification where an item is declared free flow even earlier.

Bulk Production by Agencies associated with Development

After the item has been declared as developed, the first bulk order will be placed on the production agency / agencies associated with the HQrs/Department in the development of the item and the following procedure will be adopted for this purpose:-

a) There should be a reservation of quantity not exceeding 50% of the initial order quantity for production agency (ies) associated with the development of the product.
b) Where the initial quantity is not large enough to be split and / or the item is a high-tech one, requiring substantial investment even at the time of development in terms of plant and machinery, the ordered quantity shall be covered on such production agency (ies).
c) In the case of (a) above, the price will be settled on the basis of competitive quotations by issuing a tender enquiry to other agencies who, though not associated with the development of the product, are considered competent to productionise the item. In such a case if the production agency associated with the development of the product quotes a price higher than the lowest acceptable offer, such agency shall be asked to match the lowest price, failing which they can be considered, for a price preference not exceeding over the lowest acceptable offer.
d) In the case of (b) above, the quotations would be obtained only from the production agency associated with the development and price will be settled through a study of the various elements of cost, the data for which will be furnished by the concerned agency.
e) The dispensation as indicated above shall be given to the production agency associated with the development only where their association is with regard to the development of an item which can be separately procured.
f) Even in case the source is not already registered, the latest bulk order can be placed on them. However, their continuance as an established supplier of the item will be subject to their capacity verification and registration by the competent authority/ Department.

CONTRACT FORMAT INSTRUCTIONS AS PROVIDED UNDER DEFENCE PROCUREMENT MANUAL

Subsidiary Instructions to Buyer for framing Contract

1. Part I contains Preamble and it should be mentioned as it is.
2. Part II contains details of items being contracted and their finalized prices. Format of Price bid in Part-V of RFP should be the base for listing out the details. The information may also contain the following as mentioned in Part-II of RFP and finalized by the Buyer-
    a. Relevant technical parameters
    b. User requirements in terms of functional characteristics
    c. Specifications / Drawings, if applicable
    d. Requirement of training / on-job training
    e. Requirement of installation, Commissioning
    f. Requirement of FATs, HATs and SATs.
    g. Requirement of technical documentation.
    h. Type of future assistance on completion of warranty.
    i. Earliest Acceptable Year of manufacture
    j. Delivery Period
    k. Relevant INCOTERM for Delivery and Transportation
    l. Consignee details
3. Part III contains Standard clauses which might have a legal bearing. Therefore, neither any deviation from the text given in these clauses nor deletion of any of these clauses should be allowed. In case a deviation from these clauses is required to be allowed due to insistence of the Seller during negotiations, then approval of Raksha Mantri will be required. Para 15 pertaining to Pre-Integrity clause may be included only for cases above Rs. 100 Crores.
4. Part IV contains Special Conditions of Contract as mentioned in Part-IV of RFP. Though major deviations from RFP should not be done as it will amount to denial of equal opportunity to unsuccessful bidders, minor changes in wordings of these clauses may be done if the Seller insists upon the same or to suit a particular case.
5. Part V contains the list of addresses and Signing formalities.

MODULE-III

DEFENCE OFFSETS

An “offset” is an agreement in which a foreign purchaser, usually a government, requires the contractor to agree to purchase a predetermined level of components from subcontractors located within the purchasing nation, or to fulfill other portions of the private firm’s international purchasing requirements from firms within that nation, or even to assist that nation in selling its unrelated products to third parties. This definition is similar to the one under the Government Procurement Agreement (GPA) under the World Trade Organization (WTO).

Offsets agreements have emerged in three forms: “direct”, “semi-direct”, and “indirect”. In a “direct” offset transaction, the seller agrees to coproduce specific components of his products or obtain related services in the buying nation's territory; and the specific components (or it could be services) are thus “directly” related to the supplies envisaged under the principal contract. There are several ways to execute a direct offset, the most common being through coproduction, direct license production and subcontractor production or maintenance agreements. An “indirect” offset is where the supplier agrees to assist the importing country in the development of its export or in investment requirements unrelated to the principal contract. Some countries recognize a third type as “semi-direct” offsets relative to equipment and/or services very similar to the items covered by the main purchase contract, where technological level of semi-direct offset orders is similar to that of direct participation, but their realization depends on sales to other markets.

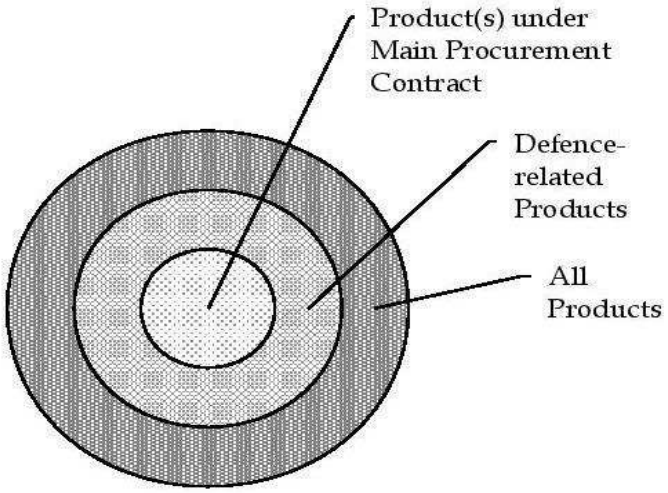


Figure 1: Direct, Semi-Direct and Indirect Offset Categorization

Offsets are sometimes referred to in national policies as “Industrial Participation” (as in Belgium and Turkey), or as “Industrial Compensation/Cooperation” (as in Lithuania, Taiwan and Denmark), but the essential objective remains the same, viz., enhancing local industrial base in defence and commercial high-end technology infrastructure. There is seldom a zero-cost to offset contracting, and bidders will inflate their costs by a margin related to the cost of

performing the offset obligation, which could be 3 to 5% of the total contract price. It is in this context that the impact on economic returns to the purchasing country accruing out of imposing offset obligations assumes significant importance, and the nature of this impact should be an important factor for a purchasing country to decide whether to go in for direct, semi-direct, or indirect offsets, or whether to go in for any offset obligations at all.

Treatment of Offsets under WTO Agreements

Government purchases of goods and services for their own use are effectively excluded from the scope of the General Agreement on Tariffs and Trade (GATT). When offsets relate only to work in connection with government contracts, they are measures "governing" procurement by government agencies for the purposes of GATT Article III.8 and are excluded from the national treatment rule. There is another view, however, that holds that while countertrade does not, per se, contravene GATT rules, government measures that require, stimulate, take the form or react to countertrade could be inconsistent with national obligations under GATT policies.

The controversy regarding the use of offsets in national defence procurement is now settled under the 1994 plurilateral Government Procurement Agreement (GPA); and its Article XVI provides for a general prohibition on use of offsets in government procurements, with an exception for developing countries for use of offsets for a temporary period. There is a further exception in the GPA to military and other procurements related to national security or national defence. The GPA contains a built-in commitment to negotiations on both the text and coverage of the Agreement, and in December 2006, negotiators reached provisional agreement on a revision of the text of the 1994 plurilateral Agreement; and the "Provisionally Agreed Revised GPA Text" carries forward the existing GPA provisions in terms of general prohibition, exception for developing countries and general exemptions for military/defence/security- related procurements.

Thus, while the use of offsets in civilian procurement is conditional subject to temporary phasing-out, the national security exceptions provide an opportunity to all member-states to continue offset policies in defence procurements. The use of offsets in defence procurements is clearly not prohibited under the GPA. In fact, most GPA member-states have strong offset policies applying to defence procurement, notable ones being Canada, United Kingdom, France, Germany, Sweden, Japan, Korea, Israel, Singapore, Switzerland, Italy and Spain, and the trend is increasing amongst national across the world to adopt offset policies aimed as industrial base mobilization in matters of national security, no doubt helped by the fact that the market for military procurement has become essentially a buyer's market allowing customers to extract favorable deals from international suppliers.

DEFENCE OFFSETS: INTERNATIONAL BEST PRACTICES

The offset mechanism is widely used by many countries in their arms trade contracts. The popularity of offsets notwithstanding, there is a wide divergence in the way offsets are used by various countries. Usually offsets demanding countries have a formal policy framework, although some countries like China and Japan do not have such a framework. Within the policy framework, countries also differ in terms of the threshold, percentage and scope of offsets. Differences are also observed in the way countries pursue their offsets objectives, particularly with respect to valuation of offset credit, establishing a long-term relationship with the offset provider and promoting indigenous defence industry. Besides, countries also differ with respect to institutional mechanisms to implement and monitor offset programmes.

This module examines, in some detail, the offset policies of six countries: Canada, Israel, Malaysia, South Korea, Turkey and UAE which not only have a declared policy on offsets but have also undertaken periodic revisions based on the experience gained over a period of time. The selection of these countries is based on the ease of the access to the official policy. An occasional reference to the Indian offset policy is also made to highlight its convergence and divergence with the policies of countries surveyed in this module.

Offsets: Threshold, Percentage and Multiplier

As a common practice, countries often define the threshold limit of the main arms contract beyond which offsets become mandatory. Countries also define the precise offset requirement by way of specifying a certain percentage of the main contract value which is to be mandatorily ploughed back into the domestic industry. Over and above these, countries also have a multiplier provision in their offset policy. While the threshold limit determines the scope of offsets, the latter two provisions (offset percentage and multiplier) determine the quantum of the offsets that can flow from the main contract. Table 1 summarises these conditions as they operate in the countries studied in the chapter. As can be seen, except for Canada, India has the highest threshold limit. This means that unlike most other countries which demand offsets in contracts valued at as low as $5-15 million, Indian industry cannot benefit unless the minimum contract value is $55 million.

India also has the lowest offset percentage requirement among the listed countries. This means, that given the value of an arms contract, the offsets that the Indian industry can get are lower than its counterparts in other listed countries. However, this may not hold true if one was to factor in the multiplier, which ranges between 1.5 and 9 for these select countries. Given the wide variation in the value of the multiplier, the actual transaction value of offsets can logically be different for countries with different offset percentage requirements. For instance, a 100 per cent offset with a multiplier of 9 (as in the case of Canada) in a procurement contract valued at, say $900 million, results in a lower offset transaction value

($100 million) than a similar contract with 60 per cent offset and a multiplier of 5 (as in the case of the UAE) where the actual value of the offset transaction would be $108 million.

Table 1. Offset: Threshold, Percentage and Multiplier

Country	Threshold Limit (US$ Million)	Offset Requirement (%)	Multiplier
Canada	100*	100	4-9
India	55	30	1.5-3
Israel	5	50	1.5
Malaysia	15	100	No multiplier**
South Korea	10	50	No multiplier
Turkey	No Threshold***	70	2-8
UAE	10	60	1.5-5

Notes:

*: Canada however the option of seeking offsets in contracts valued between $2 million and $100 million. The demand for offsets in such cases is determined by three factors: "(1) Is the procurement strategic to Canadian industry? (2) Are the potential bidding companies of interest to Canadian industry and are they capable of fulfilling [offset] obligation? and (3) Is the project a smaller part of a larger one?"

**: Although Malaysia does not allow multipliers as a general rule, it however considers it in "exceptional circumstances such as when the offset programme can lead to high-end technology acquisition or maximisation of FDI into Malaysia."

***: In its revised policy of 2011, Turkey abolished its earlier threshold limit of $10 million, virtually giving it the power to ask for offsets irrespective of the value of contract.

From the above hypothetical example, it appears that a lower offset percentage requirement with a lower multiplier is technically the same as a proportionately higher offset percentage requirement with a higher multiplier. However, this logic overlooks a critical dimension that goes beyond the simple mathematical calculation. It is noteworthy that a multiplier is used for specific activities such as investment in R&D (as is the case in Israel), platform exports, technological cooperation, enabling technology that is specifically sought (Turkey), and high-end technology transfer (India). However, in most cases, the vendors have the discretion to choose the activities for fulfilling their offset obligations. In practice, very few vendors choose these specific areas, because the transaction is deemed as being too advantageous for the buyers. This is the reason why the multiplier has been of little relevance in offset transactions at the global level. This is amply illustrated in the 17th BIS Report which notes that out of 12,100 offset transactions made between 1993 and 2012, only 12 per cent transactions had a multiplier of greater than one. The average value of the multiplier in these transactions was found to be a mere 1.2.

Since the multiplier is of lesser use, what becomes significant from a buyer's point of view is the percentage of offset requirement that determines the volume of the offsets that can flow into the domestic industry. This is perhaps the reason why countries like Malaysia and South Korea do not have a multiplier provision in their policies, but yet have a high offset percentage requirement. India on the other hand has persisted with a 30 per cent offset requirement since the policy was first announced in 2005.

Hybrid Input-Output Model for Calculation of Offset Credit

In many countries including India investment is allowed as one of the means for the discharge of the supplier's offset obligations. However few countries bother to ensure if such investments, for which the foreign vendors earn offset credits, are having any real impact on the domestic economy. In this regard, the UAE's revised offset policy of 2010 is an exception. The revised offset policy has incorporated a 'hybrid' model for calculation of offset credit that virtually puts the onus on the foreign suppliers to ensure that a part of the offset inflow brings real benefits to the UAE economy. As per the model, the total offset credit is divided into two categories: input credit and output credit. A foreign company earns input credits when it makes an investment in UAE. The investment can take place in the form of: industry enablers, knowledge empowerment and equity contribution. The maximum that the foreign company is allowed to earn input credit is 30 per cent of its total obligations. In other words, a minimum of 70 per cent credit is to be earned through output credit, which is given when the investment leads to exports, yields net profit of the ventures in which investment is made and generates income (salary) for UAE nationals. Evidently, the UAE model of calculating offset credit ensures that the flow of investment has a measurable outcome rather than being an end in itself. This model could be useful for other countries that want foreign investment but have no clue as to how to ensure that measurable outcomes flow from such investments.

Value Addition

Many countries apply the principle of value addition for the purpose of estimating the true value of the offset credit that can be claimed by foreign vendors. The value-add principle ensures that the foreign vendors get their due offset credit for the indigenisation they are able to achieve in the buying country. Normally, the value of offset credit is equal to the value addition of a product, although some countries allow 100 per cent credit beyond a certain localisation level. For instance, Norway's 2004 policy provides for 100 per cent offset credit if 80 per cent localisation, or more is ensured by the foreign vendors.

Many countries have formulated detailed guidelines for estimating value addition in offset transaction. The Industrial and Regional Benefits (IRB) policy of Canada, which seeks offset benefits from the government's defence and security procurement, provides for two methods – the Net Selling Price method and the Cost Aggregate Method - to estimate the Canadian

Content Value (CCV). The underlying principle of both methodologies is to ensure that "only the Canadian labour and materials of a particular work package is counted toward an IRB contractor's obligation; all foreign overhead, labour and materials for any particular transaction is excluded from CCV."

In India, value addition is determined "by subtracting (i) value of imported components, i.e. import content in the product and (ii) any fees/royalty paid" from the final purchase/export price of the eligible products. It is however to be noted that unlike Canada which applies the value addition principle for both products and services, India's policy is only restricted to the products. In other words, under the Indian offset guidelines, foreign vendors can claim full credit for a services related transaction which may have a 100 per cent import content. This not only gives an undue advantage to the foreign suppliers but also distorts the level playing field to the disadvantage of the manufacturing sector.

Principle of Additionality and Causality

As Hartley and Martin rightly note, an offset agreement "oblige[s] the foreign supplier and its sub-contractors to buy goods and services over and above what they would have bought from firms in the purchaser's economy in the absence of the offset agreement." In other words, offsets involve transactions that are in addition to the transactions made under the normal market forces and are purely caused by the new contractual obligations. The idea of offsets is therefore to create new market opportunities which would not have been possible without an offset contract. However, while awarding offset contracts the principle of additionality and causality is often overlooked by many countries, including India, which does not have any provision in the offset guidelines to this effect. Consequently, the foreign vendors are free to claim credits for transactions (say for purchase of goods and services) which normally would form a part of their commercial activities under normal market conditions.

Unlike to India, Canada, Malaysia and UAE emphasise additionality and causality in their offset contracts. With regard to additionality, the Malaysian policy categorically states that: "all new proposals or activities must reflect visible increment of value-add on top of the basic/ mandatory needs of the main procurement contract through direct offsets and present offset recipient's capability/capacity through indirect offsets in order to be considered for offset credits." For the purpose of causality, the Malaysian policy states that "all offset programmes must result directly from the procurement contract." The UAE policy also talks of "expansion of existing business" and "causality (causing business to happen)" as the minimum criteria for offset activities, in order for them to be considered for credits.

Compared to Malaysia and the UAE, Canada has a more scientific approach towards additionality and causality. Canada applies the following methodology with regard to additionality:

- The average of 3-year purchases immediately preceding the date of identification of offset transaction by the Canadian offset authority;
- Offset credit would be awarded in each of the reporting periods, based on those purchase values which exceed the three year average.

The above methodology for calculation does not, however, apply if the product/service being purchased:

- Involves a direct work;
- Is substantially different from what was previously purchased;
- Involves a different end use (market sale, application, etc) from what was previously purchased; or,
- Follows a competitive process to re-select the Canadian supplier.

The Canadian policy provides detailed guidelines to establish the causality factor. These require the bidder to submit, as documentary evidence, the "internal emails, official correspondence, meeting notes, corporate presentations or other complete or redacted documents", to prove that the transaction is influenced by the offset requirement. It is noteworthy that while the responsibility for demonstrating causality lies with the bidder, the acceptance of such a claim is the prerogative of the Canadian offset authorities. Among other factors, the Canadian authorities assess causality claims on the basis of the following three key factors:

- Market share: What is the market share of an offset recipient for a particular product or service?
- Business History:What is the nature, intensity and longevity of any existing business relationship between the offset supplier and the offset recipient?
- Intellectual Property: Are there any intellectual property considerations that impact the offset provider's choice of the offset recipient?

Banking and Offset Trading

Among the seven countries studied in the paper, all except for the UAE, have a banking provision in their respective offset policies, although they differ in terms of: kind transactions allowed for banking; the extent to which banking is allowed; the validity period of the banked credits and; the flexibility in the usage of banked credit (Table 2). Among the six countries that have banking provisions only South Korea restricts banking to the excess transactions generated by vendors from their ongoing offset programmes. The others allow banking in anticipation of future procurement programmes as well as in the event of the overachievement of credits from the on-going programmes. The freedom to bank is unlimited in all countries except for Canada, which requires the vendors to identify a future procurement project against which the banked credits would be used. It also stipulates a cap

for banking amount. As per the Canadian policy, vendors are allowed to bank a maximum 15 per cent of their bid price of a future contract they wish to participate in. In case of over achievement, the vendors are allowed to bank a maximum of 10 per cent of the total obligation value of an ongoing offset project, subject to a maximum of $100 million. Canada also follows a stringent methodology for the purpose of determining the validity of the banked offset credit. Unlike the others who allow the entire value of the banked credit to remain valid for a certain fixed period (3-7 years), Canada follows a 'depreciation schedule' that reduces the value of banked credit over a period of time. As per the Canadian policy, 100 per cent of the entire banked credit remains valid for first three years; this depreciates to 75 per cent of the value between third and fourth year; and 50 per cent of the value between the fourth and fifth years (the validity lapses after the fifth year).

Table 2. Offset Banking and Trading

Country	Validity of Banking Period (Years)	Trading
Canada	5	Not Permitted
India	7	Permitted within the scope of the same contract between the main contractors and its Tier-I sub-contractors
Israel	Not less than 5	Permitted among the supplier's corporate divisions and subsidiaries
Malaysia	5	Permitted subject to a limit of 50 per cent of the new obligations
South Korea	3	The banked offset credit of subcontractors can be utilised by the main contractors provided the former participate in the "identical main acquisition programme"
Turkey	5	Permitted to a limited extent
UAE	No provision	No provision

The freedom to use banked credits varies from country to country. Israel and Malaysia have a liberal policy that allows the vendors to use the entire banked credit for future use. Canada, India and South Korea however allow a limited use of banked credit. Canada has a "limit of 50 per cent of the total obligation that can be met using banked transactions." India allows full use of banked credits, but requires a minimum of two contracts for utilising the entire banked credit. In South Korea, the "ratio upon which the contractor may utilise the banked offset value against the obligations will be determined within 50 per cent by the Defence Acquisition Programme Administration (DAPA)."

Trading of banked offset credit does not seem to be popular in most countries. For instance, Canada, which allows banking for up to five years, clearly prohibits the trading of banked

transaction between the vendors. Malaysia, on the other hand, allows trading, but subjects it to a limit of 50 per cent of the new obligations.

Offset Obligations on Domestic Enterprises

In an emerging trend, some countries like Canada, India, Turkey and the UAE place offset conditions on their own companies when the product offered by the domestic companies has a certain percentage of imported elements. The idea behind this is to prevent the local companies from acting as the front organisations of foreign companies and to force them to develop sub-suppliers of parts and components through compulsory subcontracting. However, the stipulated offset requirements for own companies varies from country to country. Canada is a useful case study in this respect. The Canadian policy does not distinguish between foreign and domestic companies as far as procurement contracts are concerned. Canada's official offset policy categorically states that "any company that wins a specific Government of Canada procurement that has an Industrial and Regional Benefits (IRB) requirement must fulfil the Industrial and Regional Benefits (IRB) obligation." Since Canada stipulates 100 per cent offsets, the local companies winning contracts are also required to commit business activities amounting to 100 per cent of the contract value to the domestic industry. Like other foreign companies, Canadian companies are also required to meet the same criteria in order to become eligible. For instance, the Canadian company has to demonstrate that its offset proposals are compatible with the criteria of causality, incrementality and Canadian Content Value (CCV).

As per the Defence Offset Guidelines, Indian companies participating in 'Buy (Global)' contracts valued Rs 300 crore or more are required to provide offsets if the indigenous content of their offered product is less than 50 per cent. However unlike Canada, the Indian policy does not have a clear framework as to how the local companies are to discharge their offset obligations. Of the seven different avenues provided in the DOG for discharge of offset obligations, the local industry can at best use only one avenue (i.e. executing export orders) to discharge their obligations. Suffice it to mention that unlike foreign companies which can earn offset credit for investing in Indian enterprises or for purchase orders placed on the Indian companies, Indian companies cannot earn credits for such transactions. Clearly, Indian companies with an offset liability would be at a disadvantage vis-à-vis their foreign counterparts.

Apart from the offset avenue-related disadvantage, Indian companies also face discrimination on account of the indigenisation requirement. As mentioned earlier, Indian companies participating in 'Buy (Global)' procurement contracts are subject to offset liability if the indigenous content is less than 50 per cent. The offset liability is to be discharged at the rate of 30 per cent of the foreign exchange component of the procurement contract. From the outside it appears that Indian companies have fewer obligations than foreign companies. However, a deeper examination would show that Indian companies are more burdened than

their foreign counterparts. Unlike foreign companies who are free to supply the final product whose parts and components can be sourced from anywhere in the world, an Indian company has to ensure a certain level of indigenisation, which amounts to nothing but direct offsets. Apart from this, the Indian company has to bear the additional offset liability arising out of the import content. Moreover, the direct offsets, that indicate the level of indigenisation, are to be demonstrated at the time of field evaluation trials On the other hand, the entire 30 per cent offset liability of the foreign supplier can be discharged indirectly in areas totally unrelated to the procured item, and the time period for the discharge can exceed two years, post the warranty period of main procurement contract.

Apart from the discrimination relating to the time period, the degree of indigenisation associated with direct offsets, combined with the offset liability arising out of the import content tilt the balance against the domestic suppliers. The distortion is to the extent that except for zero indigenisation (a theoretical possibility in which case the Indian company is a mere trader), the burden on an Indian company, at all other levels of indigenisation, is more than 30 per cent. This is illustrated in Table 3 which shows the burden imposed on Indian companies at varying rates of indigenisation.

Table 3: Burden on Indian Companies under 'Buy (Global)' Contract

Indigenous Content (%)	Offset Liability, % (30% of Import content)	Total Burden, % (indigenous Content plus Offset liability)
0	30	30
10	27	37
15	25.5	40.5
20	24	44
25	22.5	47.5
30	21	51
35	19.5	54.5
40	18	58
45	16.5	61.5
49.9	15	65
50	0	50
>50	0	>50

Note: It is unlikely that an Indian company offering a product with less than 30 per cent indigenous content would be issued a 'Buy (Global)' tender to respond In that case the indigenous content between zero and 30 per cent (as shown in column 1 of the Table) remains a mere theoretical possibility

Channelling Offsets

Foreign companies tend to choose those business activities for discharging the offset obligations, which may be cost-effective for them, but are of little value from the buyer's point of view. This is primarily due to the design of policy that gives complete freedom of choice to foreign OEMs in the matter of offsets. To guard against this, countries like Turkey,

Canada and South Korea have reserved the right to demand specific offsets. Turkey, which is more concerned about boosting arms exports, specifically asks foreign vendors through the RFP to buy local made defence items as part of discharge of offset obligation. Turkey's focus on arms exports through offsets seems to be yielding rich dividend. In 2012, its total arms exports were valued at $1.2 billion, placing it among the world's 20 biggest arms exporters. It is believed that around 80 per cent of its arms exports are offset-induced.

Following the policy revision in December 2011, Canada has for the first time stipulated an Enhanced Priority Technology List (EPTL), in which a minimum of five per cent investment has to be made by the offset provider. The List, which is stated upfront in the RFP, is intended to encourage the development of advanced technologies in the aerospace and defence sectors.

In South Korea, offsets are channelled in two ways: by influencing the source selection and by reserving the right to nominate local companies to partner the foreign companies for discharge of the latter's offset obligations. The source selection is influenced by way of stating upfront in the RFP the offsets required in each acquisition. The required offsets are divided into a number of categories and each category is assigned a numerical value. The categories then become the basis for selecting the winner. Presently, South Korea has six categories of offsets with 'Category A' having the highest value of six and 'Category E' having the lowest value of one (Table 4). The DAPA also has the provision of giving 10 points provided a foreign company agrees to transfer state of the art technology that can be utilised in R&D projects.

Table 4. South Korean Offset Category and Weighted Value

Category	A	B	C	D	E
Weighted Value	6	4	3	2	1

South Korea reserves the right to select the local company, termed the Korean Industry Participant (KIP), who would partner with foreign companies for discharge of offset obligations. The DAPA also has the final say in cases where the foreign vendors are allowed to suggest a KIP. By reserving the right to select the KIP, the DAPA ensures that right domestic industry players get the opportunity, which is in the interest of the Korean industry.

Establishing Long Term Relationship through Offsets

Many countries use their offset policies to ensure that foreign companies undertake business activities in the buyer country, through legally binding contracts, the violation of which warrants penalties. However, many a time such legally binding offset-induced activities are of short duration and are not necessarily beneficial for the buyer country in the long term. This is because the business arrangement is not often based on competitiveness to sustain the viability of the offset-induced-projects after the transaction period is over. A case in point is

Malaysia, which witnessed the closure of certain projects after the supplier's offset obligation was fulfilled. Two such projects related to Malaysia's foreign purchase of modular suspension bridge and ACV300 armoured personnel carriers (APCs). As part of modular suspension bridge contract, an offset investment of $1.5 million was spent on a Malaysian firm, CTRM, by way of training the company's workers and investing in the factory's jigs and fixtures. The CTRM was to provide carbon composite launch rails for the bridges. However, once the offset period was over, the Malaysian firm received no further orders and consequently it was forced to shut down its factory. The experience was similar in the case of the APC procurement. The deal involved the off-the-shelf procurement of 146 APCs from a Turkish firm followed by the licenced production of 65 vehicles through completely knocked-down (CKD) kit by a local firm, DEFTECH. A total of $17.5 million in offset credits was claimed by the Turkish supplier, for giving the licence and for its investment in infrastructure, jigs, tools and a test track at the Pekan facility. As in the CTRM's case, the Pekan facility was not able to sustain its activities beyond the offset period.

Learning from past experience, Malaysia now emphasises the longterm viability of offset-induced projects. Its revised policy, announced in March 2011, categorically states that the offset "programmes proposed must be economically and operationally sustainable after the [offset] discharge period." It is now for the vendors to convince the Malaysian offset authorities of the sustainability of the projects they propose to undertake through the offset route.

The offset policy followed by Israel lays heavy emphasis on establishing long term partnerships with foreign companies. As such, the policy focuses on two broad principles: proactive guidance by the Israel offset authority and competitiveness of Israeli industry to work with foreign companies. Unlike the offset authorities of many countries, the Industrial Cooperation Authority (ICA) - under the Ministry of Economy - takes extra care to facilitate offset-related interaction between the domestic industry and foreign companies. The idea is to identify areas of cooperation and the Israeli companies that are best suited to undertake offset projects. Some of the functions of the ICA include:

- Assistance to overseas companies in identifying and locating suitable Israeli manufacturers and partners for joint ventures, outsourcing, R&D and other modes of cooperation and strategic partnerships with Israeli industry.
- Providing information about Israeli industry.
- Conducting surveys related to Israeli industry.
- Coordinating visits by representatives of Israeli industry to foreign companies.
- Coordinating visits by representatives of foreign companies to Israel in order to survey local industry.
- Organising conferences to enable interaction between foreign companies and Israeli industry.

Israel acknowledges that any long-term relationship with foreign companies cannot be sustained without involving the best Israeli companies. Accordingly, it encourages competition within domestic industry so as to allow the best company to partner in an offset project with a foreign company. Israel's policy seems to be yielding long-term value for the domestic industry. As stated by the outgoing chief of the Israel's offset authority, "on each $1 of [offset] obligation, we tend to secure about $3 or even $4."

The ICA model for establishing long-term partnerships, especially by playing a proactive role to cement the domestic industry's long-term relationships could be a lesson for other countries which despite having a dedicated offset authority are often unable to play the role of a true facilitator. For instance, India's Defence Offset Facilitation Agency (DOFA), or its successor, the Defence Offset Management Wing (DOMW), has never been known to function the way the ICA does.

Offset Swapping

South Korea is one of the few countries that allows offset swapping. The swapping is allowed to support the domestic industry that has offset obligations in a foreign country. Either the domestic manufacturer or the foreign partner having an offset obligation in South Korea, can approach DAPA to consider a swapping proposal.

Beyond Defence: Offset Policy at National Level

Some countries including India have an offset policy that operates within the narrow prism of defence procurement only. In other words, the offset requirement is not applicable for the non-defence sector. South Korea and Israel are, however, figure among the countries whose offset policy is applicable at the national level for both defence and civil procurement. In the case of Israel, the offset requirements, as enshrined in its official Industrial Cooperation (IC) guidelines, can be applied to any procurement by the state, government corporations and public agencies when the value of the purchased foreign goods or services exceeds $5 million. Moreover, Israel is also in the process of bringing municipal authorities under the offset purview, enabling contracts such as for sewage treatment, water treatment, power systems, etc. to mandatory industrial cooperation conditions.

Israel's (and for that matter any country's) offset policy at the national level however highlights a critical issue which merits some explanation. The issue is related to the international norms laid down by the 159- member World Trade Organisation (WTO). It is noteworthy that Israel is one of the signatories to the WTO's Government Procurement Agreement (GPA). The GPA, which has been in force since January 1996, is a legally binding agreement among the members (42 as of 2013) to promote cross border government procurement of goods and services. The Agreement prohibits discrimination against foreign suppliers in government procurement. In this regard, Article 16 of the GPA specifically forbids use of offsets for "qualification and selection of suppliers." However, an exception to

the Agreement on national security grounds, which allows virtually unrestricted use of offsets in military contracts, is provided under the Article 23.

It is to be noted that the GPA is plurilateral in nature, meaning that its applicability is limited to the GPA signatories only. In other words, the GPA is not legally binding on the 117 members of the WTO (including India) who are not signatories of GPA.

It is also to be noted that although Article 16 of the GPA prohibits offsets in government procurement, it still allows special exemption to the developing countries to "negotiate [at the time of accession to the GPA group] conditions for the use of offsets, such as the requirements for incorporation of domestic content." However, such offset "requirement shall be used only for qualification to participate in the procurement process and not as criteria for awarding contracts."

Although Israel is a developed country, it has managed to retain the right to demand offsets in civil contracts also. Israel's offset rights seem to have been allowed under the window of negotiation, provided for each party within the GPA group. The window allows a party to negotiate the list of the government agencies and the goods and services that are open to bidding by all the GPA members. Since the list is agreeable to all the parties, Israel's asking of offsets from others also means giving the same rights to other member countries. Keeping this in view, Israel's offset threshold for civil contracts within the GPA framework is different from the threshold limits for the non-GPA members and for the military contracts. These are as below:

- Defence and security purchases require an undertaking of at least 50 per cent of the foreign content value.
- Civil procurements from countries that are signatories to the Government Procurements Agreement (GPA) of the WTO will be subject to a requirement of 20 percent of the foreign content value.
- Civil purchases from non-GPA countries are subject to Industrial Cooperation amounting 35 percent of foreign content value.

Israel's dynamic threshold limits for offsets can be a useful learning for a country like India that aspires to become a member of the GPA, and is contemplating a national offset policy. When it becomes a member of the GPA, its defence offsets requirements as enshrined in the MoD's Defence Procurement Procedure (DPP) would be insulated by Article 23 of the GPA on national security grounds. And as a developing country it could bargain about the civil list (of government department and goods and services) that it wants to offer for international bidding with offset requirement.

Implementation and Monitoring

One of the trickiest issues associated with offsets is related to the management of offsets particularly with respect to implementation and monitoring. Loopholes in these two areas could be counterproductive as has been found by the CAG, which undertook a critical study of 16 offset contacts (valued at Rs 18,444.6 crore) signed by India between 2007 and 2011. The CAG had made observations regarding the : invalid selection of Indian Offset Partners (IOP); zero value addition by the Indian Offset partner (IOP); award of the offset contract in violation of the stipulated provisions; and weak monitoring of offset projects. Interestingly, the CAG's observations are to be seen in the context of weak management of offsets.

Canada has set up a IRB directorate which is the single-window agency for managing offsets for the aerospace, defence and marine branches of Industry Canada. Its management responsibilities include, deciding the applicability of offsets, evaluating the offset proposal, and allocating credits for offsets discharged. Thus the power to implement and monitor is vested in one body, even though the main procurement contract is signed by another agency.

Like Canada, Israel has a similar organisational structure for managing offsets. The Industrial Cooperating Authority (ICA) of Israel which operates under the Ministry of Economy is the nodal agency for managing the offsets. Under Israeli law, the ICA is authorised to ensure that the foreign procurement (valued $5 million or more) undertaken by any government entity is in compliance with the mandatory offset requirement. Although the ICA is not directly responsible for signing the contract, it has the responsibility to vet the offset undertaking form, which is part of the tender document. Post the signing of the main contract, the ICA is entirely responsible for enforcing the foreign vendors' obligations as per the undertaking given by vendors. The ICA's functions include all communication with the foreign suppliers; receiving periodic reports from the vendors and assigning credits based on the implementation progress; and granting time extensions, if required. Thus, the ICA acts as a single-window agency for managing all aspects related to offsets.

Turkey and South Korea also have dedicated agencies for offsets. These are: the Under Secretariat for Defence Industries (SSM in Turkish abbreviation) of Turkey and the Defence Acquisition Programme Administration (DAPA) of South Korea. However, unlike the IRB and ICA, both the SSM and DAPA are not only part of the defence ministries of these countries but their role goes beyond offsets to include defence industrial development, acquisition and R&D management. Being the single agency for the entire range of tasks including offsets, these agencies are believed to be more authoritative in decision making.

In India, however, there is no single agency for managing offsets. The Defence Offset Facilitation Agency (DOFA) or its successor, the Defence Offset Management Wing (DOMW), which functions under the Indian MoD's Department of Defence Production performs a part of the functions while the other functions are dispersed among the service

headquarters and the Acquisition Wing of the Department of Defence. Evidently there is no single point of accountability.

EVOLUTION OF THE INDIAN DEFENCE OFFSET POLICY: A CRITIQUE

India's offset policy dates back to the 1960s, although it was formally articulated only in 2005. In the wake of 1962 war with China, India made concerted efforts to build up its domestic defence industry in which offsets were a key element. The offset arrangements that India entered into with other countries were both direct and indirect, and were largely in the form of 'licenced production/technology transfer, counter or barter trade and long-term credit mechanisms'. The primary motivation was to become 'self-sufficient' in defence production and reduce the foreign exchange burden of arms imports.

The Defence Procurement Procedure 2005 (DPP 2005) for the first time set out the official offset policy, stipulating that all import contracts worth Rs 300 crore or more would have defence-specific offsets amounting to 30 per cent; and the offset obligations of foreign companies were to be discharged concurrently with the main contract, failing which the companies would be liable to be penalised (at the rate of five per cent of the annual unfulfilled portion). Foreign vendors were given two choices through which they could discharge their offset obligations. These were:

1. Direct purchase, providing market access, or creating new markets by generating export orders for Indian products, components and services.
2. Foreign direct investment in Indian public sector undertakings for defence industrial infrastructure.

To discharge offset obligations, foreign vendors were given the freedom to choose their Indian offset partner(s), either from defence public sector enterprises or from companies in the private sector, in consultation with industry associations. In choosing their Indian offset partner, the foreign vendors were given the freedom to infuse technical or financial assistance, on condition that the cost of the same would not be included in the offset offer. The policy stipulated that only a Defence Public Sector Undertaking (DPSU) or Ordnance Factory Board (OFB) would assist the MoD in the monitoring of the implementation of offsets. The monitoring would be based on a yearly status report submitted by foreign companies.

These provisions notwithstanding, the 2005 policy suffered from many weaknesses. The major weakness was the lack of vision in the policy, an aspect that continued to dog the policy makers till 2012 when the objectives of the policy were at last announced. Among other flaws, the 2005 policy did not fully elaborate the scope of offset applicability; it lacked clarity regarding the criteria as per which the industry associations would select an Indian offset partner; laid down limited avenues for discharge of offsets; did not specify the products and services eligible for offset discharge; was rigid with regard to the discharge of

offset obligations by foreign companies; and more importantly, did not identify a dedicated agency that would facilitate offset works. Some of these weaknesses were addressed when the revised offset policy was unveiled as part of the DPP 2006.

The DPP 2006, while retaining the minimum 30 per cent offsets and the penalty provision of the previous policy, included a number of improvements. Firstly, it clarified the scope of offsets by stating that offsets would apply to all capital acquisitions (including those for warship construction) categorised as 'Buy (Global)' or 'Buy and Make' where the indicative cost in the tender was Rs 300 crore or more. It further clarified that while the 30 per cent offset was to be applicable on the entire cost of the 'Buy (Global)' contracts, the same percentage of offsets would apply to the foreign exchange component of the 'Buy and Make' contracts. Secondly, the offset policy of 2006 simplified and increased the avenues for discharge of offsets. As per the revised policy, the offset obligations of the foreign companies could be discharged by a combination of the following three means:

1. Direct purchase, or executing export orders for defence products and components, or services from Indian defence industries, i.e., Defence Public Sector Undertakings, the Ordnance Factories, and any private defence industry manufacturing these products or components under an industrial licence (IL) granted for such manufacture. For the purpose of defence offsets, 'services' will mean maintenance, overhaul, upgradation, life extension, engineering, design, testing, defence-related software or quality assurance services.
2. Direct foreign investment in Indian defence industries for industrial infrastructure, for services, co-development, joint ventures and co-production of defence products.
3. Direct foreign investment in India organisations engaged in defence research and development (R&D) as certified by Defence Offset Facilitation Agency (DOFA).

Thirdly, the DPP-2006 brought in the much needed functional clarity into the offset policy by the inclusion of five key drafts: a draft undertaking to comply with offset requirements, draft technical and commercial offset offers, a draft offset contract and a draft quarterly report on the fulfilment of offset obligations. These drafts were meant to help foreign companies in devising/discharging their offsets. Functional clarity was also insured by stipulating rules for eligibility of offsets. In this regard, the policy laid down two conditions relating to the timing of offset transactions and the principle of value addition. As regards the timing of transactions, the revised policy of 2006 categorically stated that "only contracts for export of defence products or services made after signing of the main contract will be reckoned for discharging offset obligations." In other words, transactions made before the main contract was signed, were not eligible for offset purposes. To obviate a situation in which the Indian companies functioned as mere trading houses on behalf of the foreign companies, the revised policy stipulated the principle of value addition, by which products which contain imported components, only the indigenous content will count toward offset obligations.

Four, the revised policy allowed a degree of flexibility to the foreign vendors in the discharge of their offset obligations. They were given a degree of freedom to re-phase the offset obligations within the main contract period and a provision to extend discharge period.

Five, the biggest change in the DPP-2006 was the creation of the DOFA headed by a joint secretary (JS) of the Department of Defence Production (DDP), with other members to be drawn from the Service Headquarters (SHQs), Headquarters Integrated Defence Staff (HQ IDS), Defence Research and Development Organisation (DRDO), DPSUS, OFs as well as various industry associations. The agency was intended to function as a 'single window' for performing the following functions:

1. Facilitate implementation of offset policy
2. Assist in the technical vetting of offset proposals
3. Assist in monitoring the offset provisions
4. Suggest improvements in the policy procedures
5. Interact with HQ IDS and SHQs
6. Advise, in consultation with HQ IDS, SHQs, DRDO, with regard to areas in which offsets will be preferred
7. Promote exports of defence products and services
8. Provide advisory clarifications on policy and procedures (in consultation with the Acquisition Wing wherever necessary).

In addition to the above charter of functions, the DOFA was also to: 1. "assist potential vendors in interfacing with the Indian defence industry for identifying potential offset products/projects as well as provide requisite data and information for this purpose;" and (2) to "engage, following a fair, rational and transparent process, reputed independent professional expert bodies, as suggested by DRDO, to assist in its functions and commission studies by such bodies on offset policies, their implementation, utility and impact."

The above improvements notwithstanding, the offset policy of 2006 suffered from a lack of clarity and fell far short of expectations. One area where the policy lacked clarity was the scope of the offsets. Although the policy for the first time clarified the specific contracts that were liable for offset provisions, it did not specify whether such provisions would be applicable if procurement was made under the fast track procedure and the option clause.

Another area where the lack of clarity was clearly palpable was the new offset requirements for Indian companies participating in a 'Buy (Global)' contract. As per the provisions, Indian companies participating in 'Buy (Global)' contracts were not subject to offset liabilities. "However, to ensure that the offset obligation is not circumvented by joint ventures (of Indian and foreign firms) where Indian firm is bidding, the foreign firm concerned will have to discharge offset obligation." While the intent of the policy was laudable and is in fact in

line with best international practices, it did not specify the quantum of offsets and the basis on which offsets would be determined.

The third aspect in which the 2006 policy lacked clarity was on the industrial licence (IL) front. As per the revised offset policy, the private sector companies that had an industrial licence (IL) were to be eligible for becoming Indian Offset Partners (IOPs). However, there was no clarity regarding the products/services for which an IL would be given. No clarity was also provided as to which are the products eligible for discharge of offsets. Besides, there was also a difference of interpretation as to whether companies in the services sector were required to obtain an IL. As per the Department of Industrial Policy and Promotion (DIPP) of the Ministry of Commerce and Industry, services being outside the manufacturing sector were not subject to an IL. The argument was however not accepted by the MoD, which insisted on an IL before any company could be eligible for becoming an IOP.

The MoD's insistence on an IL did not end the problems of the services sector which encountered another problem due to the different interpretations of the FDI limit. As per the DIPP, the 26 per cent FDI cap in defence manufacturing did not apply to the services sector. In other words, service sector companies can have up to 100 per cent FDI and at the same time be eligible for becoming IOPs. However, as in the case of the IL, the MoD had objections and apparently did not allow companies with more than 26 per cent FDI to become IOPs.

The new policy also fell short of expectation with regard to DOFA, which was intended to be a single-window agency. Although the agency was set up soon after the policy was announced, there were apprehensions that it did not have the authority to carry out its mandated functions. Compared to the policy intent, the body, for all practical purposes, consisted of one JS and a few junior level armed forces officials who were perceived to lack the required wherewithal to evaluate proposals from the financial, legal and technical angles. As regards the post-contract monitoring of offsets, the agency was majorly handicapped as it did not have the signed offset contracts with it.

Apart from the above, the revised policy fell short on several other counts. Before it was announced, there was much speculation that the revised policy would include some dynamic provisions such as transfer of technology (ToT), the banking of offsets, and multipliers. To accommodate some of the above demands, the offset policy was again revised two years later and made part of the DPP 2008.

The DPP-2008 made six key improvements in the offset policy. First, it further clarified the scope of the offsets by stating that procurement under the FTP was outside the offset purview. Second, it provided a 'List of Defence Products' for the discharge of offset obligations. Third, it allowed the banking of offsets along with detailed guidelines for execution. As per the guidelines, foreign vendors were allowed the pre-and post-banking of

offsets, subject to certain conditions. Four, it tried to allay the concerns regarding the IL and the FDI cap by stating that the guidelines of the DIPP on these two issues were supreme. Five, the new policy clarified the offset liabilities of Indian companies participating in a 'Buy (Global)' contract, by stating that if the indigenous content of the product on offer was less than 50 per cent, then offsets would become applicable. The offsets would amount to 30 per cent of the foreign exchange component. Six, DOFA was given the additional responsibility of rejecting 'civil infrastructure and such technology that is otherwise easily available in the open market' from consideration of offsets. However, the DOFA's such new responsibility was confined to direct foreign investment in R&D.

The additional features in the DPP 2008 notwithstanding, the policy still belied expectations. The major disappointment was that no change was effected to improve the functioning of DOFA. This apart, the new policy did not specify the timeframe in which Indian companies were required to achieve the 50 per cent indigenisation, below which offset conditions became applicable.

The industry, particularly the foreign vendors were of the view that the banking period of two and a half years was too short to be attractive. The foreign vendors also expressed their disappointment that there was no dynamic provision of multipliers in the new offset policy. The domestic industry also had complaints about the non-mandatory nature of the product list. It is to be noted that the even though the MoD laid down a defence product list, it was not explicitly mandated that offsets would be discharged with reference to that list.

The DPP 2011 tried to address some of the above concerns. First, it made it mandatory that offset obligations would be discharged only with reference to eligible products and services. Second, it expanded the list of eligible products and services. The product list was expanded by adding two more categories: products for internal security and civil aerospace products.

The services list was further expanded by adding training as another avenue for discharge of offset obligations. Third, it further clarified the scope of offsets, by stating that "offset will not be applicable in "option clause" where the same was not envisaged in the original contract." These improvements notwithstanding, the policy continued to be dogged by the many weakness of the earlier versions. It was only a year later when the policy went through a major revamp, that some of prevailing weaknesses were taken care of.

Defence Offset Guidelines 2012

In a major review, the MoD in August 2012 published the comprehensively revised offset policy, titled, Defence Offset Guidelines (DOG). The guidelines, which became part of the DPP 2013, included several new provisions, besides modifying and clarifying some existing ones. The salient features of the new policy are discussed below:

Salient Features of DOG

Objectives

Nearly seven years after it was first introduced, the DOG articulated the objectives of the offset policy. As per the new policy, the objective was to:

> *[L]everage capital acquisition to develop Indian defence industry by (I) fostering development of internationally competitive enterprises, (II) augmenting capacity for research, design and development related to defence products and services and (III) encouraging development of synergistic sectors like civil aerospace and internal security.*

Enlarged Scope of Offsets

The scope of offsets was further enlarged in the DOG to include the base and depot (B&D) spares and modification costs relating to the procurement of warships for the purpose of calculating offset obligations. Interestingly, this change came after the Comptroller and Auditor General of India criticised the government for failing to add the cost of B&D spares while calculating the total value of the offsets in the purchase of fleet tankers for the Indian navy from the Italian firm, Fincantieri.

Expanded Avenues for Discharge of Offsets

The avenues for discharge of offset obligations by foreign OEMs were expanded by: (1) permitting investment in "kind" in Indian industry; (2) allowing DRDO to acquire a select list of high technologies; and (3) increasing the number of Indian Offset Partners (IOPs). As per the revised DOG, investment in "kind" is allowed in the form of transfer of technology (ToT) and transfer of equipment (ToE) for manufacture and/or maintenance of permitted items. It is however to be noted that while the ToT can either be through the equity or non-equity route, the ToE can only take place through the non-equity route.

In case the foreign original equipment manufacturers (OEMs) opt for technology transfer for discharge of offsets, the guidelines mandate that such ToT should be provided without licence fee and be so comprehensive as to cover all documentation, training and consultancy required for full ToT. The cost of infrastructure and equipment of a civil nature is, however, to be excluded from calculation of offset obligations. The guidelines also mandate that "there should be no restriction of domestic production, sale or export" resulting from such ToT. To ensure that ToT does not lead to "dumping" of foreign technology, and to guard against the undue pricing of technologies, the guidelines stipulate stringent buy-back and value addition conditions. As per these conditions, foreign companies will get offset credit not for the value of the technologies transferred but for the value addition (in India resulting from such ToT) and their eventual buy-back by foreign companies (see Table 1).

Table 1: Aspects of India's Defence Offset Policy 2012

Discharge of Offset Obligations: Avenue Type	**Multiplier**	**Banking (7 years)**	**Condition**
A. Direct Purchase of permitted goods/services	1.5 if IOP is an MSME	Allowed	Offset credit for value addition to be determined by subtracting value of imported items and any fee/royalty paid to foreign companies.
B. FDI in qualified Indian Industry	1.5 if IOP is an MSME	Allowed	FDI is allowed upto 26 per cent in case the IOP is from defence manufacturing sector.
C. ToT (both through equity (i.e., JV) or nonequity route)	1.5 if IOP is an MSME	Allowed	Offset credit is to be estimated at the rate of 10 per cent of value of buyback of items for which ToT is used. Further, the actual value addition in India will be taken for estimating the value of buy-back.
D. Transfer of equipment (only through nonequity route)	1.5 if IOP is an MSME	Allowed	Offset Credit is subject to 40% buy-back (by value) of eligible items within the period of offset contract.
E. ToT or transfer of equipment to DRDO labs, ABW, BRD and Naval Dockyards	Not Allowed	Not Allowed	
F. Technology acquisition by DRDO	Up to 3.0: 2.0 if the ToT is meant for unrestricted domesticproduction for armed forces 2.5 if the ToT is meant for unrestricted domestic production	Not Allowed	Offset credit for the critical technologies listed in new guidelines. The technology list is to be reviewed periodically.

	for both civil & military use 3.0 if ToT is meant for unrestricted production for domestic (civil & military) and export purpose		

Note: 1. A minimum 70 per cent of offset obligations are mandated to be discharged by any one or a combination of avenue types from A to D in this table. 2. Discharge of pre-approved banked offset credits, where allowed, cannot exceed 50 per cent of total offset obligations under each procurement contract. Banked offset credits are not transferable except between the main supplier and his Tier-I sub-suppliers.

The conditions are somewhat less stringent in the case of ToE. The vendors are permitted to claim credits for the entire value of the equipment they transfer to their Indian offset partner. However, this is subject to, what is understood by some stakeholders, the OEM's minimum buy-back of 40 per cent of permitted items.

Technology acquisition (TA) by the DRDO is permitted as per a select list of high-technologies, which is to be reviewed and updated periodically. The list, which presently consists of 26 categories, includes fibre laser technology; propulsion, aerodynamics and structures for hypersonic flights; nanotechnology-based sensor and displays; and pulse power network technologies, among others. The evaluation of technologies by the foreign vendors is to be to be undertaken by the Technology Acquisition Committee (TAC), which is a multi-disciplinary body comprising of the DRDO's Directorate of Industry Interface and Technology Management (DIITM), the additional financial advisor to DRDO, and members from services headquarters, among others. To ensure a two-way dialogue process between the DRDO and the foreign vendor for better understanding of each other's position, a window is provided to enable detailed discussion among the stakeholders.

The list of Indian Offset Partners (IOP) has been expanded, by including hitherto excluded government institutions and establishments (including DRDO) that are engaged in the manufacture and maintenance of eligible items. The new entrants are allowed to receive both ToT and ToE as offsets for augmenting their "capacity for research, design and development, training and education." However offsets in the form of purchase from and equity investment in these institutions by the foreign OEMs are not allowed.

Provision of Multipliers

The revised DOG for the first time added a multiplier clause to incentivise investment in select areas. The maximum value of multipliers was kept at three, which implies that a

foreign company can claim credit up to three times the value of its actual offset investment. However, multipliers have been restricted to two areas: micro, medium and small enterprises (MSMEs) and technology acquisition by DRDO. In the case of MSMEs, a multiplier of 1.5 is allowed when an offset investment takes place in the form of: purchase from, FDI in, and investment in "kind" in these enterprises. Higher multipliers of 2.0, 2.5 and 3.0 are reserved only for the technology acquisition by DRDO. The higher the multiplier, the greater the technology leverage that the DOG intends to achieve. The maximum multiplier of 3.0 is allowed only when a foreign company provides a listed technology without any restriction on the volume of its production and sales, including exports.

Extended Banking Period

The provision of banking of offsets, which was first introduced in DPP-2008, evoked a lukewarm response from foreign companies. The primary reason for this was the limited validity period of a maximum of two-and-a-half years. The revised DOG has extended the banking period to seven years. The banking provision is, however, allowed in the case of: purchase from, investment in, and technology/ equipment transfer to Indian industry (technology acquisition by the DRDO and the government establishments/institutions have been excluded from the banking purview).

In keeping with previous guidelines, the revised DOG also does not permit offset trading by restricting the transfer of banked offset credits to the main supplier and its sub-suppliers within the same acquisition proposal. However, unlike the previous version, the revised document stipulates that the pre-approved banked credits could not be used for more than 50 per cent of total offset liabilities arising out of a future procurement contract. This would mean that a foreign company would need at least two procurement contracts to discharge its banked offsets credits. The DOG has provided an eight-week window for the disposal of such cases to ensure that the banking proposals of the vendors are dealt with in a time-bound manner.

DOFA to DOMW

One of the critical features of the new DOG is the provision of a Defence Offset Management Wing (DOMW) that replaces the previous DOFA. The Wing, like its previous version, will function under the Department of Defence Production of the MoD. However unlike DOFA, DOMW has more powers in matters related to post-offset contract management. Most importantly it is one of the repositories of the signed offset contracts, which was not the case with the DOFA. The DOMW is also tasked to formulate offset guidelines; participate in technical and commercial offset negotiations; monitor/audit offset programmes; administer offset penalties in case of default by vendors; implement offset banking; and assist vendor in all offset-related matters.

Provision for Supervision by the Defence Acquisition Council

The monitoring aspect in the revised DOG has been further stressed by way of supervision at the highest decision-making level in the MoD. The revised policy stipulates that the DOMW "will submit an annual report to the DAC in June each year regarding the status of implementation of all ongoing offset contracts during the previous financial year." It is believed that by early 2015, DOMW has presented two reports to the DAC.

Clarity on Industrial Licencing and FDI Issues

As mentioned earlier, a key hurdle to participation in offset programmes from the private sector's perspective, related to the differing interpretations of industrial licencing requirements and FDI exposure of IOPs. The MoD had earlier taken the stand that an IOP, irrespective of its being in defence or non-defence sector, must have an industrial licence and its FDI exposure must not exceed 26 per cent (the Ministry of Commerce guidelines state that an Indian company is subject to IL and FDI restrictions if its activities fall only in defence manufacturing). The revised guidelines have made it clear that the provisions of the DOG will be in "harmony and not in derogation of any rules and regulations stipulated" by other agencies.

Other Provisions

Apart from the above provisions, the revised guidelines have also: expanded the list of eligible products/services against which offsets can be discharged; extended the offset discharge period; and put a cap on penalty in case of default. The list of eligible products/services has been mainly expanded in the renamed category of Products for Inland/ Coastal Security (earlier known as Products for Internal Security). Four more groups have been added to this category. The Civil Aerospace Products and Service(s) categories have been expanded by one group each. The number of groups in the "Defence Products" category, remain the same, but the group under warship building has been expanded by the inclusion of four distinct sub-groups with greater clarity. In all, there are now 39 products/services groups in which the foreign vendors are allowed to discharge their offset obligations. These groups are apart from the list of high technologies (meant for DRDO), against which the foreign vendors are allowed to discharge their offset obligations.

Regarding the offset obligation discharge period, the new guidelines have extended the period from the date of main procurement contract, by two years (the date of main procurement contract is inclusive of the date of warranty). However, the extension is subject to the vendors' submission of an additional performance-cum-warranty bond equivalent to the value of offset obligations falling beyond the period of main procurement contract. The bond is required to be submitted six months prior to the expiry of the main performance-cum-warranty bond.

While the revised DOG has kept the annual penalty - in case of default on the part of vendor - at 5 per cent, it has now mandated that the overall penalties cannot exceed 20 per cent of the total offset obligations during the main procurement contract (there will be no cap on penalty in case of default during the extended period).

Critique of the Revised DOG

Value Addition: Exclusion of Services

In a major deviation from the previous policy, the revised DOG has explicitly excluded "services" for the purpose of estimating value addition in India (the previous guidelines were silent on this aspect). With the addition of R&D services to the list of "services", the explicit exclusion of services allows far more leverage to foreign companies and very little incentive to the eligible Indian manufacturing industry. A simple theoretical illustration would help to understand the gravity of the potential consequences. For example, a foreign company opts for "training" (an eligible service) for discharge of its offset obligations worth Rs 10 crore. Since the foreign company is at complete freedom to choose an IOP, and assuming that there is cut throat competition within the Indian services sector to participate in the offsets programme, it becomes easier for the foreign company to choose an IOP that is willing to offer maximum concessions. Let us assume that the IOP agrees to a proposal to accept some surplus trainers from the pay roll of the foreign company at a cost of Rs 8.5 crore. Since value addition is not a factor in determining the offset credit, the foreign company will be entitled to claim offset credits, including those for the amount spent on its own trainers. In this case, the foreign company gets Rs 10 crore worth of offset credits (the amount will go up to Rs 15 crore if the IOP is an MSME) against the actual incurred cost of Rs 1.5 crore which the IOP receives for becoming the partner. If value addition had been a factor in determining offset credit, the foreign company would have got offset credits only for Rs 1.5 crore. Clearly, the loser in this case is Indian industry (if not the IOP which acts as a mere trading house for services and cannot see beyond its own business interests) which loses Rs. 8.5 crore worth of offset business.

The above loss is probably less when compared to the negative impact on the permitted manufacturing sector. With the increase in the number of categories on the services list, and the cost advantage to the foreign vendor in the discharge of offset obligations in this sector, the OEMs have virtually no incentive to resort to the eligible manufacturing products. In other words, the Indian manufacturing sector is at tremendous disadvantage vis-à-vis its brethren in the services sector. This will hamper their prospects of working with foreign companies or being a part of the global supply chain.

Advantage to Non-Defence IOP

The revised DOG might have clarified the position vis-à-vis the licencing and FDI regulations as stipulated by other government agencies. However, at the same time, it has

created a unique situation which has far reaching implications for the defence and non-defence sectors. For an Indian private company, defence manufacturing is subject to mandatory licencing and a 26 per cent FDI cap. These restrictions are, however, not applicable to companies in the civil aerospace, inland/ coastal security and services sectors. In other words, the companies in these sectors can become IOPs without the licencing and FDI constraints that their counterparts in the defence manufacturing would face. This clearly tilts the balance in favour of the non-defence manufacturing sectors. The foreign companies will be far more inclined to choose a non-defence IOP which does not require a licence and in which the foreign equity stake can be more than 26 per cent. In the latter aspect (equity stake) the incentive is far greater for a foreign company. Since there is no restriction on foreign equity stake in an IOP from the non-defence manufacturing sector, theoretically, a foreign company's wholly-owned subsidiary registered in India, can be its front organisation for the execution of offset programmes on behalf of the parent company! This may not be the true intent of the revised DOG, but the MoD should not be surprised if it finds this happening one day.

Lack of Clarity on Government Institutions/ Establishments

The new DOG does not specify the government institutions/ establishments that have been made eligible to receive offsets in the form of ToT and ToE for their capacity building. The names are, however, mentioned in the MoD's press release of August 2, 2012 and include: DRDO laboratories, Army Base Workshops, Air Force Base Repair Depots and Naval Dockyards, etc. The press release is not comprehensive as it uses the term "etc.", implying that some more names could be added to it later. This confusion apart, it is also not clear why the MoD has taken the press release route to identify these entities, instead of the DOG which as a part of the DPP, is the ultimate reference document. Moreover, it is also not clear why these institutions are kept away from the banking provision.

Ambiguity regarding the defence items

As mentioned earlier, the DPP 2013 provides a revised list of products and services that are eligible for discharge of offset obligations. The MoD on its part is well within its rights to specify any number of products or services which it wants to promote for exports through offsets. However such discretion has to be consistent with other government policies, including those of the MoD. It is to be noted that the DIPP in June 2014 released a list of defence items requiring mandatory IL. The list has been further modified by the DDP to include software and technologies. This would lead the industry to assume that the items which they produce as per the DIPP list, or its revised version would also be eligible for offset transactions. The industry's assumption is quite logical as the objective of the offset policy is to promote the defence enterprises that includes companies producing items under IL. However, the problem is that the industry cannot use the offset route for export of all the items, as some of the items figuring in the DIPP list, do not feature in the DPP. For instance,

"Air independent propulsion (AIP) systems (nuclear/conventional) for maritime applications" which figure in DIPP list, do not find mention in the DPP.

Inconsistency with International Practices

Last but not the least, the revised offset policy does not take into account some of the practices followed by other countries. The Indian policy is quite moderate as far as the thresholds and percentages of offsets are concerned. It does not recognise the principle of value addition in both the manufacturing and services sectors; it does not apply the principle of additionality and causality while determining offset credit; it gives complete freedom to foreign companies to choose the areas for offsets; and lacks a strong institutional mechanism to implement and monitor progress of offsets. Consequently, inherent weaknesses have crept into the policy, which need to be corrected for it to become effective.

INDIAN DEFENCE OFFSET POLICY: AN IMPACT ANALYSIS

As of December 2014, the MoD had signed 25 offset contracts valued at $4.87 billion. The offset are scheduled to be discharged between 2008 and 2022. Of the total, offsets worth $1.37 billion were to be discharged by March 2014, although the actual reported discharges have been valued at $840 million (or 17 per cent of total value of offsets signed). The Comptroller and Auditor General of India (CAG), which has audited several offset contracts in recent times is not very impressed with how these offsets have been implemented. The supreme auditor has highlighted a number of weaknesses in the offset contracts that included the zero value addition, equipment transfer, invalid selection of Indian Offset Partners (IOP) and a weak monitoring mechanism.

It should however be noted that although the CAG's findings on offsets are a useful indicator of the working of Indian offset policy, they are not so comprehensive as to throw light on policy's ultimate success or failure. The audit observations are more in the nature of fault-finding rather than a holistic analysis of the efficacy of the offset policy as a whole. For instance, at no point of time, has the CAG made mention of even a single offset contract that has worked as per the contractual terms. The aim of this chapter is to bridge this gap by examining the extent to which the offsets have impacted the policy objectives. It is true that only 17 per cent of the offsets have been discharged as of now and thus any meaningful study on the subject would be little premature at this juncture. The chapter nonetheless makes a beginning to this effect and in the process provides an objective methodology for any future study on the subject.

Offset Contracts

Among the three services, the air force tops the list with 16 contracts, distantly followed by the navy (six contracts) and the army (three contracts). Among the foreign companies, Israel has the highest (nine) number of offset contracts whereas the US has offsets of the highest value. The biggest chunk of offsets has come through the Foreign Military Sales (FMS) route. The highest valued offset worth $1.09 billion came from India's purchase of 10 C-17 Globemaster aircraft from Boeing.

Impact on FDI

Since 2005, the offset policy has retained a key provision whereby foreign companies can discharge their offset obligation through FDI. As per the revised guidelines issued on August 26, 2014, the FDI cap in defence sector stands increased to 49 per cent from earlier 26 per cent.3 It is however to be noted that while foreign companies can claim offset credit for their equity investment in JVs, all FDI is not necessarily directly linked to offsets. This is for two reasons. One, the permissible FDI is cumulative that includes portfolio investment which is not eligible for the purpose of discharge of offsets. Second, FDI can be brought in by companies that do not have (and neither wish to have in the future) direct contract with the MoD. The impact analysis has to therefore factor in the offset-induced FDI, in order to arrive at the precise impact. However, no such offset-induced FDI data is available in the public domain. What is available in the public domain is the cumulative offset inflows into defence sector and the number of approved joint venture (JV) /FDI proposals. As of October 2014, the government had approved 33 JV /FDI proposals, involving mostly Indian private sector companies that include some of the biggest names such as Tata, L&T, Bharat Forge, Mahindra and ABG Shipyard (Annexure II). However, there has hardly been any fund inflow into the defence sector, although the FDI cap has been raised to 49 per cent. Table 1 shows the FDI inflow in select sectors including defence, up to August 2014, when the revised defence FDI policy was announced. As the data shows, defence is ranked 61 among the 62 distinctly identified sectors, with a meagre inflow of Rs. 24.36 Crore ($4.94 million).

Table 1. Select Sector-Wise FDI Equity Inflows (April 2000-August 2014).

Rank	Sector	FDI Inflows		% of Total FDI Inflows
		Rs in Crore	US$ Million	
1	Services Sector	192,090.45	40,546.07	17.66
2	Construction Development	111,223.10	23,751.76	10.35
3	Telecommunications	80,621.20	16,499.09	7.19
4	Computer Software and Hardware	61,914.18	13,191.22	5.75
5	Drugs and Pharmaceuticals	61,443.39	12,500.42	5.44
41	Vegetable Oils and Vanaspati	2241.30	441.76	0.19
52	Timber Products	440.51	86.41	0.04
61	Defence Industries	24.36	4.94	0.00
62	Coir	22.05	4.07	0.00

Note: The services sector includes financial institutions, banking, insurance, non-financial/business, outsourcing, R&D, technology, testing and analysis

Table 2. Approved JVs Post-Increase of FDI Cap (August 2014-March 2015)

Name of the Indian Company	Name of the JV Company	Proposed Foreign Investment	Investment Inflow Rs. (in Crores)
Hats Off Helicopters Training Pvt Ltd	CAE Inc., Canada	Post Facto Approval for the issue of 5,84,205 equity shares of Rs.10/- each to CAE Inc., Canada	37.82
Ideaforge Technology Pvt. Ltd.	NRI Investment	0.1704	
Punj Lloyd Ltd.	FII & NRI Investment	Foreign Shareholder NRI IPO Allottees Repatriable Investment 22.79%+NRI 2.52%+FII 7.68%- Addition of activities	
Quest Global Mfg. Pvt. Ltd.	Aequs Mfg. Investment (P) Ltd., Mauritius	FDI 49% from existing 17.29%	40.0
Fokker Elmo Sasmos Interconnection Systems Ltd.	Fokker Elmo BV, Netherlands	FDI 49%	6.0
Star Wire Ltd.	Aubert & Duval France	FDI 5%	12.28
Total			**96.1**

Table 2 maps the FDI inflows post the increase in FDI cap. Although the volume of inflows in the eight months since the FDI cap increase is significantly higher than the cumulative inflows in the preceding years (more than a decade), there is no evidence of such inflows being influenced by offsets. As the table shows, not a single inflow has been brought in by companies which have offset liability with the MoD.

Impact on Exports

From 2006 onwards, the DPP has been providing a list of items that are eligible for the discharge of offset obligations. The list has been expanded over the years to include both defence and civilian items. What is significant for the purpose of this chapter, is that the items eligible for offset discharge fall into four broad categories for which the Indian Trade

Classification (Harmonisation System) – ITC (HS) – Codes have recently been announced (Table 3). These are also the precise HS Code-wise categories under which various defence items are now being made subject to an industrial licence.

Table: 3. ITC (HS) Codes for Category of Defence Items Requiring Industrial Licence

ITC (HS) Code	Category
8710	Tanks and other armoured fighting vehicles
8801 to 8805	Defence aircraft, space crafts and parts thereof
890610	Warships of all kinds
9301 to 9307	Arms and ammunition and allied items of defence equipment; parts and accessories thereof

It should however be noted that the ITC (HS) codes as mentioned in the Table 4.3 are broad-based and inclusive of non-defence items also. For instance, Codes 8801 to 8805, which come under HS Code 88 (aircraft, spacecraft and parts thereof) also include civilian aerospace items. In other words, there is no comprehensive HS Code for all the licencable defence items. This is likely to change with the new foreign trade policy promising to "create ITC (HS) codes for defence and security items for which industrial licences are issued."

It is also to be noted that India's trade statistics as captured by various ITC (HS) codes do not include defence goods "as a matter of principle". By this principle, all the offset-induced exports as captured by the above mentioned codes are essentially non-defence items.

Column 2 of Table 4 shows the export value of items that fall under the ITC (HS) Codes as mentioned in Table 3. As already mentioned, there has been a hefty growth in exports, to $4.7 billion in 2013-14, which is almost equal to the cumulative value of the offsets signed so far. Significantly, much of the growth coincides with the period post the promulgation of the offset policy. This may indeed sound incredible, but needs closer examination before any inference can be drawn. It must be noted that of the total exports, those under HS Codes 8801- 8805, which broadly cater to 'aircraft, spacecraft and parts', account for an overwhelming share – 98 per cent in 2013-14 (Column 3 of Table 4). This is not surprising given that except for Codes 8801- 8805, others mostly pertain to defence-specific items that are not captured by the official trade database.

The significant jump in the exports of 'aircraft, spacecraft and parts' raises a vital question: Does it mean that the Indian aerospace industry has come of age? Not necessarily, especially from the point of view of export of the major platform. As pointed out by an official of the Directorate General of Commercial Intelligence and Statistics (DGCIS), some of the exports under this category are 'temporary and nonrevenue earning in nature', although the precise figures are not publicly available. Explaining further, the official intimated that such exports include satellites taken out of country by the Indian Space Research Organisation (ISRO) for

launch from foreign launch pads. The major portion however consists of civilian aircraft and related components sent abroad for scheduled maintenance, repair and overhaul.

Table 4. ITC (HS) Code-wise Exports

Year	Exports under ITC (HS) Codes 8710, 8801-8805, 890610 and 9301-9307 ($ Million)	Exports under ITC (HS) code 8801-8805 ($ Million)
2004-05	52.0	49.8
2005-06	65.6	63.1
2006-07	86.9	77.6
2007-08	698.8	693.3
2008-09	1522.1	1467.0
2009-10	1064.7	1030.3
2010-11	1895.2	1766.4
2011-12	2351.6	2275.2
2012-13	2256.3	2210.2
2013-14	4674.6	4585.3

Table 5. Select Country-Wise Exports under ITC (HS) Codes 8802 & 8803, 2013-14

Country		Exports under ITC (HS) Code 8802 (US$ Million)	Exports under ITC (HS) Code 8803 (US$ Million)
Countries without Offset Liability	China	387.24	23.95
	Saudi Arabia	209.24	0.17
	Singapore	192.15	125.73
	Sri Lanka	930.71	0.77
	UAE	1041.70	13.24
Countries with Offset Liability	France	37.27	165.57
	Israel	0.89	44.34
	Italy	0.00	10.31
	Russia	0.00	73.98
	Switzerland	0.00	43.06
	UK	0.62	115.21
	US	71.92	343.55
Total		3258.47*	1296.43*

Note: *: Figures include total exports including to countries not mentioned in the table.

In order to further analyse the point made by the official of the DGCIS the major components and direction of exports can be examined under the categories ranging from 8802 to 8805. Table 5 provides the 2013- 14 value of exports under these two heads - 8802 and 8803 - which together account for more than 99 per cent of total exports under the heads 8801-8805. As seen in the table, exports under 8802, which are in the nature of platforms, are mostly to countries other than the ones which have offset obligations with Indian MoD. On the other hand, the majority of exports under 8803, which relate mostly to parts and components are

accounted for by countries which have offset liabilities in India. But the question is: To what extent is the export of the parts and components influenced by offsets. As seen in Table 6, the rise of exports to countries having offset liability with India coincides with the period post the announcement of offset policy, suggesting, prima facie, a positive relationship.

Table 6. Exports under ITC HS Code 8803 to Counties with Offset Liabilities (US$ Million)

Year	France	Israel	Italy	Russia	Switzerland	UK	US	Total
2002-03	15.3	5.2	1.3	12.1	0.5	11.1	10.2	55.8
2003-04	15.8	2.3	1.5	3.0	0.2	24.7	6.8	54.3
2004-05	15.0	0.9	2.1	4.2	0.1	7.9	5.0	35.2
2005-06	16.9	1.4	4.7	10.3	0.4	6.8	3.6	44.1
2006-07	23.6	2.4	2.4	16.4	0.0	13.4	5.6	63.9
2007-08	98.0	30.7	13.4	45.6	0.0	35.9	83.9	307.5
2008-09	142.8	36.6	11.7	72.9	6.9	84.2	265.3	620.2
2009-10	140.1	22.0	9.2	46.0	2.2	98.4	156.3	474.3
2010-11	221.6	62.7	10.5	98.5	8.7	150.7	508.7	1061.5
2011-12	158.5	38.2	6.1	61.9	72.4	315.6	237.9	890.6
2012-13	170.7	51.5	7.5	193.5	87.7	239.9	279.9	1030.7
2013-14	165.6	44.3	10.3	74.0	43.1	115.2	115.2	567.7

Impact on DPSUs/OFs

Table 7 provides the select statistics of the DPSUs and OFs, over a 10- year period beginning with 2004-05, the year before the formal offset policy was announced. As the table shows while the aggregate employment in DPSUs and OFs shows a continuous decline, the other indicators – value of sales (VoS) and value of exports – show a near continuous increase. But to what extend are these changes attributable to the offset policy?

The answer to the above question lies in the details, which need careful examination. It is important to mention that although offsets to the tune of $4.8 billion have been signed, the actual flow into DPSUs and OFs would be less, although a precise estimate is difficult to arrive at. As pointed out by the CAG, a host of offsets, including several high value ones, are in the form of equipment transfers and therefore do not contribute to the aforementioned parameters (employment, VoS and exports) of the DPSUs and OFs. Moreover, given that offsets are open to both private and public sectors, the actual share of DPSUs and OFs in the total discharged offsets would decrease further.

In view of the above factors, the extent to which offsets would influence the key parameters of DPSUs and OFs is limited. This is particularly true with respect to one indicator: value of sales (VoS), the annual value of which (particularly in later years) is larger than the cumulative offset inflows since 2005. In other words, the huge disparity in VoS and offsets makes the latter an extraneous factor. This also holds good for employment.

The continuous decline in employment is largely due the reduction of industrial worker force in ordnance factories as a consequence of an accounting change effected in late 1980s to ensure cost-consciousness in the factories organisation. Between 2004-05 and 2011-12, the manpower in the OFs has been reduced by 22,745 (19 per cent), with industrial employees accounting for 72 per cent of the total decrease.

Table 7. Key Performance Parameters of DPSUs and OFs

DPSUs/ OFs#	VoS (Rs in Cr)	% increase in VoS	Exports (Rs In Cr)	% increase in Exports	Employment	% increase in Employment
2004-05	17435.2	6.2	307.43	-27.7	192776	-2.7
2005-06	19916.8	14.2	318.76	3.7	189670	-1.6
2006-07	22046.7	10.7	439.38	37.8	186332	-1.8
2007-08	23678.1	7.4	628.15	43.0	184376	-1.0
2008-09	27237.1	15.0	854.38	36.0	180575	-2.1
2009-10	33995.9	24.8	477.76	-44.1	175164	-3.0
2010-11	36537.9	7.5	653.66	36.8	173465	-1.0
2011-12	40494.0	10.8	730.01	11.7	169556	-2.3
2012-13	40956.2	1.1	770.64	5.6	168310	-0.7
2013-14	41001.0	0.1	768.50*	1.7*	68972*	-4.2*

Note: VoS: Value of Sales; #: DPSUs do not include HSL, which came under the administrative control of the MoD in 2010; *: Figure is exclusive of OFs.

Given the size differential, offsets may have been an extraneous factor to influence the VoS of DPSUs and OFs, but it needs closer examination to see any linkages with the exports of these enterprises' exports, which is not only smaller in size but, as articulated earlier, an area of clear-cut focus of the offset policy since its inception in 2005. An analysis of the export performance at macro level and of two of the biggest exporters: Hindustan Aeronautic Ltd (HAL) and Bharat Electronics Ltd (BEL), which together account for nearly three-fourths of total exports of all DPSUs/OFs, would reveal the linkages- if any. The aim is to see the extent to which offsets have contributed to exports and through those to the overall sales, because if the offset has led to increased exports, then it must be reflected in the rising share of exports in total sales.

As seen in the Table 7, exports of DPSUs/OFs have more than doubled during the study period. However, there is hardly any increase in terms of the percentage of the total turnover. In fact, the share remains almost static at 1.8 per cent in 2010-11 and 2011-12 for all the public sector units for which comprehensive data is available. This suggests, that offsets have not yet become a key factor in the total exports of DPSUs and OFs.

The picture at the individual enterprise level, is however somewhat different. In the case of BEL, there has been a growth in exports, both in absolute terms and as a percentage of VoS (Table 8). What is more significant is that a part of this growth is offset-led. For instance in

2012-13, offset-led exports accounted for 23 per cent of the total exports of $32.8 million. Moreover, of the total accumulated export orders of $194 million, booked by the end of 2013-14, nearly 15 per cent ($28.45 million) was accounted for by offset orders.

In the case of HAL, although there has been a growth in exports in absolute terms, there is a decline in terms of the percentage of VoS (Table 8). This suggests that nearly the entire focus of the HAL is on the domestic front, with overall exports taking a backseat, and offsets playing almost a negligible role. Interestingly, according to a former head of HAL, one of the primary reasons for India's premier aircraft company's little exposure to offset is the poor quality of offsets offered by the foreign vendors. It is demeaning on the part of HAL to accept such offset work, added the official. The only major offset that HAL has so far received directly as a result of the MoD's policy is a mere $4.7 million order from the Boeing for providing the weapons bay door for the P8-I long-range maritime reconnaissance and antisubmarine warfare aircraft for the Indian Navy. HAL's negligible role in offsets combined with the similar situation for the DPSUs/OFs as a whole, thus indicates the limited impact of offsets in promoting a key area of exports.

Table 8. Exports as % of Turnover of HAL and BEL

	HAL			BEL		
	VoS (Rs in Cr)	Exports (Rs in Cr)	Exports as % of VoS	VoS (Rs in Cr)	Exports (Rs in Cr)	Exports as % of VoS
2004-05	4533.8	150.1	3.3	32112.1	36.9	0.1
2005-06	5341.5	186.2	3.5	3536.3	52.7	1.5
2006-07	7783.6	270.5	3.5	3952.7	41.4	1.0
2007-08	8625.3	341.1	4.0	4102.5	57.1	1.4
2008-09	10373.4	436.6	4.2	4623.7	72.3	1.6
2009-10	11456.7	204.7	1.8	5219.8	99.4	1.9
2010-11	13115.5	237.4	1.8	5529.7	161.7	2.9
2011-12	14204.2	348.3	2.5	5703.6	187.9	3.3
2012-13	14323.6	382.8	2.7	6012.2	166.1	2.8
2013-14	15127.9	440.0	2.9	6174.2	246.2	4.0

Impact on Private Sector

The Indian private sector may be a late entrant into Indian defence industry, but it is the most enthusiastic player. Anybody who has been to any of the defence-related seminars organised in recent years would have witnessed the active participation of private players, both big and small. Moreover, industry associations, particularly the Confederation of Indian Industry (CII), Federation of Indian Chambers of Commerce and Industry (FICCI) and the Associated Chambers of Commerce of India (ASSOCHAM), are now quite actively promoting the interests of the private industry.

The question relates to the extent to which offsets have stimulated the private sector's interest in defence production. One way of finding this enthusiasm is by looking at the year-wise issuance of Letters of Intent (LoI)/ Industrial Licences (IL) by the Indian government (Table 9). As seen in the Table, the number of LoI/IL granted has suddenly jumped after the detailed offset policy was announced in 2006, indicating a strong correlation between offsets and the private sector's interest in defence production.

Table 9. Letters of Intent/Industrial Licence Issued to Indian Private Sector

Year	No. of LoI/IL Issued	No. of LoI/ILs Issued (Cumulative)
2002-03		12
2003-04	03	15
2004-05	07	22
2005-06	06	28
2006-07	09	37
2007-08	36	73
2008-09	46	119
2009-10	8	127
2010-11	28	155
2011-12	23	178
2012-13	12	190
2013-14	20	210
2014-15 (Till Jan 2015)	41	251

It is however to be noted that the mere rise in the private sector's interest as manifested by a hefty growth in LoI/IL does not necessarily mean that offsets have led to actual defence production in the Indian private sector. It is quite possible that LoI/ILs are bagged by companies in the hope of getting offset business in the future, which may not happen in due course. This seems to be true in the case of a large number of companies which are yet to begin production even after getting the licences. In this context, it needs to be noted that of the 251 LoI/IL issued to 150 companies till January 2015, 101 companies (67 per cent) are yet to commence production.

The larger question relates to the contribution of the 49 companies (that have commenced production) to India's overall defence production and the role of offsets in this. The following section attempts to answer this question.

Official information is lacking in respect of defence-specific production or the sales of Indian private sector. The MoD which compiles the data for the DPSUs and OFs in its annual report, does not do so for the private sector. Most of the private sector companies, especially the bigger ones, on their part also do not publicise the defence related information. A part of the reason is that the defence business of major private companies is clubbed with their larger civilian business. For instance the defence and nuclear business of Larsen and Toubro (L&T) falls within the company's heavy engineering segment, and thus there is no separate accounting for the former. Similarly, TATA, which conducts its defence business through 14 group companies, also does not present its consolidated defence revenue separately. Among the very few major companies that provide some aggregate figures is Astra Microwave

Products Limited, a Hyderabad-based company engaged in the design and manufacturing of radio frequency (RF) and microwave super components and sub-systems. In 2013-14, the company's defence segment accounted for 90 per cent of its total revenue of Rs 544.2 crore.

The lack of official information across the private sector notwithstanding, there are several market surveys available on the volume of the defence business of the Indian private sector. According to one estimate, the current defence revenue of the entire private sector, including from overseas orders is around $2 billion. Among the large companies, TATA which has a defence order book of Rs. 8000 crore, generated revenues of Rs. 2500 crore in 2013-14. L&T's revenues from defence are believed to be Rs. 1200 crore. Dynamatic Technologies, a Bangalore-based company with three business verticals – aerospace, auto parts and hydraulic pumps – generated business of Rs. 1589 crore from the aerospace sector in 2013-14.

The moot question is the extent to which the offsets have impacted the private sector's defence production and sales. As in the case of DPSUs and OFs, one way of finding this out is by examining the volume and growth of exports of the private sector. The underlying rationale is that the contribution of offsets to the private sector's production and sales, should be reflected in their exports. Unfortunately, unlike the DPSUs/OFs, the comprehensive export data for the private sector is limited. Table 10 provides the value of defence exports for four years up to 2013-14 for which data could be obtained. As the table suggests, there has been a nearly a 10-fold increase in exports, indicating the possibility of a growing influence of offsets.

Table 10. Defence Exports by Indian Private Sector

Year	Exports (Rs in Crore)
2010-11	29.1
2011-12	137.5
2012-13	138.1
2013-14	286.0

Note: The export figures are based on the no-objection certificates issued by the Ministry of Defence.

It is however to be noted that the private sector's interest in offsets goes beyond immediate exports. Given that the private sector is a late entrant into defence production, many companies view offsets as not only a means of getting business but also gaining expertise through technology transfers, working with global majors, besides getting international market visibility. It is however important to know the extent to which the Indian offset policy has helped the Indian private companies. To this end, a questionnaire was sent to a number of leading private sector companies, eight of which responded. These companies are: Alpha Design Technologies Pvt Ltd, Astra Microwave Products Ltd, Dynamatic Technologies Ltd, Elcom Group, L&T, MKU Pvt Ltd, Precision Electronics Ltd and Tata Power SED.13 The

views of the companies were sought on a number of specific issues. The response of the industry is summarised below.

Six companies said they had received offsets. Of the other two, one company was in the advanced stages of negotiations with foreign OEMs but had not yet received any offsets. The other company, which despite its significant international exposure (with 90 per cent turnover coming from exports) in homeland security products, has not got any offsets so far. Of the six companies that had received offsets, the value of the offsets as a percentage of turnover was miniscule (less than 5 per cent). In one company the share had gone up to around 15 per cent, where as in another company, the share was over 50 per cent. There is almost near unanimity that the said offset-related business would not have been possible without a formal policy being in place, thus underscoring the role of the MoD's offset policy in generating defence business.

However the quality of offsets received by most companies is not significant in terms of the capability enhancement of the Indian defence industry. The majority view of the industry is that most of the offsets are build-to-print (BTP) in nature, with little value addition by the Indian partners. Most companies are also of the view that offsets have so far not been the catalyst for technology transfer. Moreover, most offsets come with strings attached. Indian partners are made to honour the intellectual property rights (IPR) of the foreign partners and abide by non-competitive agreements that restrict the freedom of export.

An Assessment

Despite the limitation of data, the evidence suggests that the offset policy has had a mixed impact on the Indian defence industry. On the positive side, the offsets seem to have made an impact on certain types of exports, particularly of civilian aerospace items (parts and components), defence exports of the private sector and overall exports of BEL, the premier defence electronics company in India. On the negative side offsets have not been a catalyst in influencing FDI inflows, which was a key objective of the policy since its very inception. Offsets have also not facilitated the ToT or any meaningful manufacturing in the industry. Moreover the main impact on exports is largely confined to parts and components of civil aerospace items, not the platforms. Considering that manufacturing and technology are at the heart of an industry like defence, it is imperative that the MoD focuses its policy accordingly. This aspect assumes importance, given that nearly $3.5 billion worth of offsets are yet to be discharged.

Rafale Deal: The Largest Offset Contract Till Date

The Rafale fighter jets deal has offset contracts worth at least 50 percent of the main Rafale contract value of $8.8 Billion (Rs 59000 Crores approx.) which amounts to almost $4.4 Billion (Rs 29500 Crores approx.). This is thereby the largest-ever offset contracts of India which is almost the same amount of Offset contract signed so far. The offset contract is likely

to be finalized and signed in 2017. The defence offsets that India is targeting under the deal include:

- Sourcing of components for future French operations
- Setting up of manufacturing facilities in India
- Providing high-tech job training

Understood the agreement stipulates that 74 percent of the 50 percent offset value must be discharged through component exports from India. This is expected to result in Euro 3 Billion boost to the Indian Defence companies in the segment. The offset contract period is seven years, compared with typically longer period envisaged in other defence contracts. There is also a six percent technology sharing component of the total offsets, which is being discussed with the Defence Research and Development Organisation (DRDO). The deal has a certain amount of technology transfer that will help scale up the production of the indigenous Tejas aircraft. The Kaveri jet engine project may get restarted with the help of Safran.

The contract makes French OEM Dassault to discharge the major portion of discharging the offset obligations. Besides Dassault, the other Tier-I vendors (and partners of OEM Dassault) namely Safran, Thales and MBDA are also likely to have a share in discharging offsets in proportion to their share of work in the main platform.

As of now, Dassault Aviation, which is the main OEM, has entered into a Strategic Partnership with India's Reliance Group in Oct 2016 and announced to establish a joint venture (JV 51:49 in favour of Reliance) to be named as 'Dassault Reliance Aerospace' in India. The new JV would be focused on supporting the IAF's Rafael programme through the production of aero structures, electronics, and components for the aircraft's Snecma M88 engines. The JV will also "develop major Indian programmes with high levels of technology transfer" and would also focus on promoting programmes under the Indian Government's new procurement category called 'Indian Designed, Developed and Manufactured', or 'Buy (IDDM)'. The JV will be based at an aerospace industry park that the group is developing in Nagpur, where RDL has been allotted 289 Acres of Land by Maharastra Govt. The facility in Nagpur will produce subsystems and components and export them to Dassault Aviation for the production of Rafale fighter Jets in France. Besides, the JV will also produce critical components. The components manufactured at Dassault Reliance Aerospace JV facility in India will form the part of Global Supply Chain for Dassault Aviation and other partner companies in other countries.

As a result of this tie-up, it is most likely that Reliance Defence will be executing a decent portion of the offset flow. Rather, this could the largest offset contract to be executed by any defence company in India till date. A part of offset will also be shared by existing partners of Dassault and its Tier-I vendors. Besides Reliance Defence, Indian public and private

companies such as HAL, Bharat Electronics, Samtel, TATA, Max Aerospace and other defence companies are also most likely also to get a piece of the offset as they have tie-up with the other four Tier-I vendors so it is likely that the technology transfer component and platform-specific work-share components will be distributed across a broad-base and a variety of companies. The work distributed to other companies could come in the form of simple outsourcing or even other joint-ventures, which would be announced by next year only. Some of the other Indian companies that could be in race for Offset contract include:

Companies	**Opportunity Area**	**Remark**
Reliance Defence	Aero structures, electronics, and components for the engines	Has tied up with the major OEM Dassault which is likely to give a major share of offset to the company
HAL	Avionics, components systems missile systems & sub systems	It has a 50:50 JV with Scenma and also has a tie-up with MBDA, Safran & Thales
BEL	Electronics & Communication Systems	Has a MoU with Dassault. And also has tie-ups with Safran & Thales
BDL	Missile & Missile systems & sub systems	Has a tie-up with MBDA
Tata Technologies, Cyient (Infotech Enterprises), Axis Aerospace & L&T Technology Services	IT, Life Cycle Support, Engineering and Design	TATA & Cyient has MoUs with Dassault while L&T has a tie up with Thales
Max Aerospace	Engines sub systems and other subsystem, Aero Structure Components, Assembly of Aircraft Sub	Max Aerospace has signed an agreement with Scnema to set up a JV company for complete

Companies	Opportunity Area	Remark
	Systems	engine support solutions.
Tata Power, Tata Advanced Systems, Rolta	Avionics, Network Centric Warfare, Airborne Assemblies, C4ISR	Thales has joint venture Rolta
Magnum Aviation	Aircraft, Engine Spares, Maintenance Repair, Overhaul	Can have a tie-up with OEMs
Maini Precision, Dynamatic Technologies, SEC Industries, Taneja Aerospace	Precision Manufacturing, Aerostructure Components , Parts and Accessories of Aircraft	Can form tie-ups with the OEMs
Samtel Display Systems, Data Patterns, Avantel	Avionics, Aircraft displays, Simulator and Training Systems	Samtel Display Systems have a JV with Thales

CONCLUSION: LESSONS FOR INDIA

Since the articulation of its defence offset policy in 2005, India has signed 25 offset contracts valued at $4.8 billion. However, the offsets do not seem to have yielded any meaningful benefits for the Indian industry beyond some increase in the exports of civilian aerospace parts and components. This is amply evident from the successive reports of Comptroller and Auditor General of India (CAG) and the analysis made in this Monograph of the various performance parameters of the Indian defence industry. Considering that offsets have a cost implication (in the sense that they inflate the cost of the main procurement contract), it is high time that India reviews its offset policy. This would imply that India either abolishes the offsets as a tool for incentivising local industry; or undertakes a comprehensive reform of the policy framework. As argued in this study, much of offsets' poor performance is due to the inherent weaknesses in the policy itself and lack of effective implementation and monitoring. Therefore, it would be only logical for India to tighten its policy framework, before taking

the extreme step of abolishing the policy altogether. Some policy options that India could consider are as follows:

Lower the Threshold and Increase the Offset Percentage

India is perhaps the only major arms importing country that has a very modest offset percentage requirement (30 per cent). Other countries demand a higher percentage of offsets, even 100 per cent, as in the case of Canada and Malaysia. Moreover, compared to other countries that demand offsets in contracts valued as low as $5 million (Israel), India's threshold is quite high (Rs 300 crore or $55 million). The higher threshold combined with a lower offset percentage means that compared to others, Indian Industry gets lower offset benefits for any given value of arms contract. Given that India's objective is to develop a strong defence industrial base, it could consider lowering the threshold to, say, $10 million, and raising the offset percentage requirement to a minimum of 50 per cent, in order to ensure an enhanced flow of offsets to the Indian industry.

Channel Offsets to Desired Areas

India is also the one major country that allows foreign companies to discharge their offset obligations as per their choice. Moreover, India also allows foreign vendors to violate offset guidelines with impunity, and dump 'in-kind' offsets that result in practically zero value addition. Unlike India, other countries demand specific offsets. South Korea goes to the extent of making offsets the sole criteria for determining the supplier, besides nominating local players who would partner foreign suppliers in the discharge of offset obligations. Canada stipulates a select list of futuristic technologies on which the foreign vendors are required to invest at least five per cent of their total offsets obligations. Turkey uses offsets as a tool to promote export by stipulating the export requirement in the tender document itself. In view of the above international practice, it would be better for India to demand specific offsets. The specific offsets could be demanded upfront through the tender documents rather than by leaving them to the discretion of the foreign suppliers.

Application of Principle of Value Addition for both Manufacturing and Services

Although India mandates value addition for determining the offset credit, but this applies only to the manufacturing sector. This creates a bias in favour of the services sector in which foreign companies can obtain offset credits for the import content. Considering that manufacturing is at the heart of any industry, a bias against it does not augur well for the India defence industry. In this regard, India could learn from Canada, which does not discriminate between manufacturing and services and imposes uniform value addition requirements on both the sectors.

Uniform Offset Obligation for both Domestic and Foreign Companies

Many countries such as Canada, India and Turkey impose offset obligations on their own companies in case there is an import content in the products offered by them. The idea is to prevent the local industry from becoming a mere trading house and at the same time compel it to develop a support industry. However compared to others, particularly Canada, which has a clear policy of providing a level-playing field for both the foreign and local industry, India on the other hand discriminates its own industry. For instance in a 'Buy (Global)' contract, the offset liability on an Indian company can range between 30 to 65 per cent, compared to a flat 30 per cent for the foreign companies. Moreover, while foreign companies have the freedom to discharge their offset obligations in an extended warranty period, Indian companies are bound to discharge their obligation from the very outset, especially for the part they are contractually mandated to indigenise. This dissuasive policy should be rectified by imposing a uniform offset obligation on all the players, irrespective of their country of origin, to allow the local industry to operate in level playing field.

Application of the Principle of Additionality and Causality for determining Eligibility of Offsets

A major weakness of the Indian offset policy is that it completely ignores the fundamental principle of offsets with regard to additionality and causality. Consequently, foreign companies have the freedom to earn offset credits for the transactions they undertake under the normal market force irrespective of offset contract. Evidently such a freedom defeats the very purpose of leveraging offsets for the benefit of local industry. In this regard, India could learn from others, particularly from Canada which insists on applying the principle of additionality and causality for determining the eligibility of offset transactions.

Promote Long term Relationship through Offsets

One of the successes of offsets lies in the establishment of long term relationships between local and foreign companies. Realising the importance of this, countries such as Malaysia and Israel insist on the long-term viability of projects initiated through offsets. In the case of Israel, the long-term relationship is fostered by a proactive offset authority and by allowing competition to determine the best domestic companies that could work with foreign companies. India could follow this practice to foster partnerships that go beyond the offset contract period.

Offset Policy at National Level

India's offset policy is narrowly focussed on defence procurement although reports suggest that India is mulling a national offset policy for both defence and civil procurement. For India to articulate a national offset policy, it has to factor in the WTO provisions relating to the Government Procurement Agreement (GPA) that prohibit offsets in government

procurement. However certain exemptions are provided in the WTO's GPA framework itself that enable counties to demand offsets in both defence and civil procurement. Among the countries, Israel seems to have adapted quite well to the exemptions provided in the GPA framework. This is reflected in its dynamic approach that stipulates 50 per cent offsets in defence procurement, 35 per cent offsets in civil procurement from non-GPA signatories, and 20 per cent offsets in civil procurement from GPA members. India could follow the Israeli example for its national offset policy.

Single Window Agency to Manage Offsets

The efficacy of the offsets lies in the effective implementation and management of offsets. India's poor track record is largely due to poor implementation and ineffective monitoring, which in turn stems from the absence of a credible authority to manage offsets. The Defence Offset Facilitation Agency (DOFA) and its successor, the Defence Offset Management Wing (DOMW) are inadequately manned to perform the task they are entrusted with. On top of that, the power to manage offsets is dispersed across stakeholders that include the Service Headquarters and the Acquisition Wing. Unlike India, countries such as Canada, Israel, South Korea and Turkey have dedicated, single-window agency to manage offsets in all aspects, ranging from vetting offset proposals, to awarding offsets credits to vendors and monitoring them. India too needs a similar organisation with powers to manage offsets in their totality.

MODULE-IV

INTERNATIONAL DEFENCE CONTRACTS

INTERNATIONAL CONTRACTUAL NEGOTIATIONS

INTRODUCTION

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

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

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

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

PRE-CONTRACTUAL LIABILITY

When negotiations fail and a court determines that no final agreement materialized during the course of those negotiations a variety of problems may arise. There may arise some questions about possible liability from a party's failure to negotiate in good faith. Even though the damages are available, some more issues may surface concerning the scope of the duty and the appropriate measure of damages. While civil law jurisdiction has historically proved

more receptive to claims based on pre- contractual liability, common law jurisdictions have shown an increasing willingness to entertain similar complaints in recent years.

The Common Law Approach

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

Pre-Formation Negotiation

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

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

Post-Formation Negotiation

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

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

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

serve a valuable function in the marketplace in recent years and the courts are becoming more aware of this fact.

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

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

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

International Negotiating

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

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

with the liability arising out of pre contractual negotiations in case *Texaco, Inc. v. Pennzoil, Co*.

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

ASCERTAINING CREDIT-WORTHINESS OF THE FOREIGN PARTY

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

Need for Creditworthiness of a Foreign Party

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

Writing extra-judicially, Lord Steyn later expanded on his argument that the central objective of the law of contract is to uphold the reasonable expectations of honest men. In particular, he discussed a number of areas where English law might be considered deficient in this regard. One of those areas was the approach of the courts to the concept of good faith. He had "no heroic suggestion for the introduction of a general duty of good faith in our contract law". Indeed, he said: It is not necessary. As long as our courts always respect the reasonable expectations of parties our contract law can satisfactorily be left to develop in accordance

with its own pragmatic traditions. And where in specific contexts duties of good faith are imposed on parties our legal system can readily accommodate such a well-tried notion. After all, there is not a world of difference between the objective requirement of good faith and the reasonable expectations of parties. However, his Lordship did express surprise and concern regarding the decision of the House of Lords in *Walford v Miles* that an express agreement to negotiate in good faith is unenforceable.

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

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

Honesty as an Objective Concept

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

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

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

Lord Nicholls' opinion was recently the subject of detailed analysis and reinterpretation by the House of Lords in the important case of *Twinsectra Ltd v Yardley*. Their Lordships were divided, but not in a way that affects the main point being made here, concerning the justifiability of the honesty standard. In brief, the division of opinion concerned whether Lord Nicholls laid down a wholly objective test of dishonesty so that "a person can be held to be dishonest even though he does not realize that what he is doing is dishonest by the ordinary standards of honest people". Lord Millett, who delivered a powerful dissenting judgment, could find "no trace in Lord Nicholls' opinion that the defendant should have been

aware that he was acting contrary to objective standards of dishonesty". In his view, except "where, for example, liability depends upon intent to defraud", such a requirement was not "an appropriate condition of civil liability, which does not ordinarily require a guilty mind". In civil law "dishonesty" usually referred to a course of conduct rather than a state of mind. His Lordship summarized his view as follows:

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

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

MAJOR LEGAL CONSIDERATIONS AND ALTERNATIVES

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

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

disinvestment: the river of available investment capital flows from lending institutions to bustling suburbs while inner city communities are marred by economic drought.

Lenders Evaluation of Creditworthiness

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

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

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

In current lending practice, lenders use one of two methods to evaluate the creditworthiness of a loan applicant: the judgmental method or the statistical method. In some instances, they combine the two. Judgmental scoring is a subjective process in which the loan officer

personally evaluates an applicant's income, employment, and credit history. Pertinent information usually includes the applicant's current and future income, length and type of employment, credit history, credit references, and accumulated wealth. Traditionally, these factors have been referred to as the "three C's" of credit: capacity, character, and collateral. Judgmental scoring relies on the professional judgment of the loan officer to determine if the applicant seems willing or will be able to pay back the loan.

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

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

The Economic Forces Shaping the Creditworthiness Evaluation

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

Lenders attempt to attract depositors and investors by offering higher rates of return on both deposits and equity than their competitors. In order to maximize the return that they offer to depositors and investors and still maintain margins sufficient for survival, lenders must maximize the return on their loans. Ensuring the repayment of loans offers greater certainty,

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

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

Protection to Lenders' Negative Economic Rights

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

This section of this Note seeks to explain how the scant legal framework that regulates creditworthiness evaluation by lenders functions to legitimate "rational" inner city disinvestment and to justify its degenerative effects on inner city communities. Even though the current practice of creditworthiness evaluation subjects inner city residents to conditions of poverty and economic disenfranchisement, current laws leave the evaluation process predominately unregulated. The legal doctrines and statutes chosen by lawmakers defer to lenders' judgments of what constitutes "creditworthiness" and implicitly ratify the evaluation methods they adopt, thus tacitly endorsing the arguably oppressive effects of "rational" inner

city disinvestment. The law legitimates "rational" inner city disinvestment and its effects by framing the relationship between lenders' and loan applicants in the paradigm of negative economic rights. By conceiving the lender/loan applicant relationship in these terms, the law makes the social decay associated with inner city disinvestment seem to be the necessary and inevitable result of protecting individual rights and promoting economic efficiency.

Legal Framework Regulating Evaluation Methods of Lenders

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

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

The Equal Credit Opportunity Act ("ECOA") imposes scant restrictions on the criteria and methods lenders may use to determine the creditworthiness of loan applicants. First, the ECOA prohibits lenders from associating certain personal characteristics of loan applicants with their ability and willingness to repay a potential loan. The ECOA makes it unlawful for lending institutions to turn down a loan applicant because of the applicant's "race, color, religion, national origin, sex or marital status or age." In addition, lending institutions may not reject an applicant because "all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the ECOA." Second, the ECOA minimally restricts the methods that lenders may use to evaluate creditworthiness. Under regulations promulgated to enforce the ECOA, lenders may not use practices that have the "effect" of discriminating against a class of individuals protected by

the ECOA. Pursuant to the ECOA, the Federal Reserve Board issued regulations governing the evaluation criteria lenders may use. The regulations, known collectively as "Regulation B," place restrictions on the information a creditor may obtain for the evaluation process and on how that information may be used. Regulation B expressly regulates the two types of evaluation systems available to lending institutions. The regulation further states that in addition to intentional discrimination, creditors may not use facially neutral evaluation practices that have a discriminatory effect. Thus, even though creditors may not intend to discriminate and the credit decisions may appear neutral, if their lending practice has "a disproportionately negative impact on a prohibited basis," it is considered unlawful. The regulatory impact of the ECOA on how lenders may evaluate credit is limited by the "business necessity" exception stated in Regulation B. Although the "effects test" of Regulation B apparently has the capacity to remedy "rational" inner city disinvestment, the "business necessity" exception of Regulation B limits the statute's reach. The "effects test" restricts lenders from using evaluation methods that appear neutral on their face, such as consideration of an applicant's wealth, but have a disproportionate impact on minorities who apply for loans. However, evaluation methods with a disparate impact on minorities are legal under the ECOA if they meet "a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact." The comments to Regulation B expressly state that even though a practice may result in greater rejection of women and minorities, Regulation B does not limit creditors from using such criteria as "income in excess of a certain amount" as long as there is a "demonstrable relationship" between the criteria and creditworthiness for the level of credit involved. Thus, the ECOA imposes few "real" restrictions on how lenders may evaluate the creditworthiness of loan applicants, and lenders maintain vast control over the evaluation process. The ECOA does not impose on lenders a mandatory procedure for creditworthiness evaluation. Instead, the statute merely removes certain personal characteristics from the universe of factors that lenders' may use to determine creditworthiness. In addition, the statute restricts lenders from using those methods that have a disparate impact on minorities and have no business necessity. However, as was highlighted by the earlier discussion of "rational" inner city disinvestment, most of the evaluation methods that result in the flow of capital away from inner cities are founded on legitimate and necessary business reasons in light of the competitive environment in which lenders must operate.

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

CHOICES TO BE MADE BY THE PARTIES

It is necessary to know the philosophy of creditworthiness evaluation for exercising choice by the parties. The French philosopher of the twentieth century, Michel Foucault has theorized that normative judgments cast through social institutions order society. The

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

Choice of Law

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

Law Applicable to Foreign Contracts – A Chinese Approach

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

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

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

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

Application of Foreign Law

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

The "foreign influence" syndrome seems to have become less acute in China since the nation started to move closer to the rest of the world both economically and socially in the 1980s. Ever since foreign investments flooded in business transactions with foreign countries have become an indispensable part of the Chinese economy. An unavoidable consequence of business interactions with foreign countries is the occurrence of "foreign" civil disputes, to which the special attention of the people's courts was called, and a great deal of which

involved contracts. In response, all people's courts at the intermediate level or above have designated civil divisions to handle foreign cases. In addition, given their complexity and importance, foreign civil cases that were deemed significant could be commenced at the intermediate people's courts, as opposed to a lower level court.

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

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

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

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

International Law Conflicts: A New Challenge

Although China has a unitary legal system, the "unitary" status affects only the mainland; it excludes Hong Kong and Macao despite the fact that these two regions became part of China in 1997 and 1999 respectively. This creates a factual pattern that represents a unique type of

interregional conflict of laws and imposes challenges to the country as to how the law conflicts between Mainland China and those regions are to be resolved effectively.

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

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

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

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

Thus, if a contract that is concluded in the mainland is to be performed in Hong Kong or Macao, or vice versa, choice of law would necessarily become an issue. The different legal systems together with the different social systems between the mainland and the SARs would complicate the determination of governing law for the contract. For example, since the mainland differs sharply from either Hong Kong or Macao, a contractual right lawfully

acquired in the SARs may not necessarily be recognized in the mainland although the acquisition of such rights took place within the territory of the country.

Choice of Remedy

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

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

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

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

would have been concluded, in which case damages equivalent to an expectation level of recovery could be justified.

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

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

Choice of Venue

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

In light of conflict of laws, a major difference between a country with a federal system and a country with a unitary system is how the term "foreign" is defined. In China, under the unitary system, the central government has the authority to exercise its power all over the nation; the national laws in terms of legal hierarchy preempt any rules and regulations

adopted at the local level. Therefore, the term "foreign," as used in the context of choice of law, refers generally to "outside the territory of the country." A civil case that has an "outside territory element" will then be classified as a foreign civil case. A commonly used phrase in China to indicate "foreign" in civil cases is "foreign civil relations." Under the 1986 Civil Code, any case that involves foreign civil relations shall be governed by the special provisions of the Civil Code if the application of law would need to be determined. According to the interpretation of the Supreme People's Court, foreign civil relations are the civil relations in which one or both parties are foreign, a stateless person or a foreign legal person, the subject matter underlying such relations is located outside the territory of China, or the legal facts that cause the relation to be established, changed or extinguished occurred outside of China.

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

Choices of Arbitral Institution

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

The assumption makes sense when the reference is to a court of law. For instance, if the parties fail to put a choice of law clause into their contract but provide for the resolution of any disputes by the courts of New York, it would seem to be a reasonable assumption that they intended those courts to apply their own law--that is to say, the law of New York. The assumption is less compelling, however, when the dispute resolution clause provides for choice in a particular country, rather than litigation in the courts of that country. A place of arbitration may be chosen for many reasons, unconnected with the law of that place. It may be chosen because of its geographical convenience to the parties; or because it is a suitably neutral venue; or because of the high reputation of the arbitration services to be found there; or for some other, equally valid reason. In one case before the arbitration institute of the Stockholm Chamber of Commerce, the tribunal highlighted the fallacy of the principle that a choice of forum is a choice of law in the context of arbitration in the following terms: "it is highly debatable whether a preferred choice of the situs of the arbitration is sufficient to indicate a choice of governing law. There has for several years been a distinct tendency in international arbitration to disregard this element, chiefly on the ground that the choice of the

place of arbitration may be influenced by a number of practical considerations that have no bearing on the issue of applicable law ." Nevertheless, where the parties have not made an express choice of the substantive law of their contract, but have included a reference to arbitration and have chosen the place of arbitration, that choice may influence the decision as to what the substantive law of the contract should be. First, the choice of a particular place of arbitration is sometimes taken as an implied choice of the law governing the contract. The fact that the contract was in the English language may also have played some part in the court's decision. . Secondly, the choice of a place of arbitration may be taken as an indicator that the arbitration clause itself is to be governed by the law of that place, irrespective of the law, which governs the contract containing the arbitration clause. Thus, in a case where the choice of the substantive law of the contract was unenforceable, because it was too uncertain, but the arbitration clause was clear in its provision for arbitration in London, it was held that the arbitration agreement was a valid agreement and was governed by English law .

CONCLUSION

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

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

PRINCIPLES FOR DRAFTING INTERNATIONAL COMMERCIAL CONTRACTS

INTRODUCTION

The written contract is an agreement enforceable by law. The contracts could be made between the individuals, statutory persons, private parties of the same nation and some times in the practice of International business the different Nations for executing a work or supply of goods specified to fulfill the conditions of a party. The parties involved in a particular contract may be two or more than two statutory persons or two countries for which they need to come to proper understanding prior to contracting. After coming to an understanding the parties need to frame the terms and conditions of the contract and finally sign the contract. The terms, rules, conditions and clauses laid down in the contracts are being violated by the

contractees or the executants for various reasons. In a situation where there is a breech of contract, the litigators will search for the various clauses that are available in the contract agreements for presenting the case before the concerned relief machinery. In such situation if there is no basic safety clauses laid down in the contract the party affected may not be in a position to claim the damages and the agreement may become void for want of a safety clause. In view of the safety, the contracts shall be drafted based on the complications and problems, which may arise in future. The basic safety clauses have to be incorporated in the contract at the time of drafting the contract itself. Particularly the International contracts have to be drafted carefully by taking the basic facts of the field of execution, conventions, statutory obligations, customs, usage and practices of the countries involved in the contract.

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

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

IMPORTANT NORMS AND CONDITIONS OF INTERNATIONAL TRADE CONTRACTS

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

Sources of failures of International Contracts

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

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

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

1. The International conventions or regional initiatives aimed at harmonizing rules pertaining to specific issues commonly found in cross border transactions.
   Example:

- Hague rules on liability of international carriers of goods by sea.
- Agreement on Trade Related Aspect of Intellectual Property (TRIPS)
- Within the General Agreement on Tariffs and Trade (GATT).
- The Organizations of regional harmonization i.e. NAFTA and European Union (EU) along with Organization for Economic Coordination and Development (OECD).
- Lex-Mercatoria: It includes the customs or International Trade Usages to bridge the language, cultural and legal differences between businesspersons throughout the world.
  Example:
- International Chamber of Commerce (ICC), Paris.
- Uniform Customs and Practices for Documentary Credits (UCP 500).
- International Commercial Terms (INCOTERMS)

The customs have risen to near universal acceptance in the International banking and business communities. Even though many legal issues arise due to poor drafting of the written contract, it doesn't mean that clarity of writing will overcome differences in the

immutable rules of a given country. A poorly written contract is one that lacks clarity or substantively fails to deal with an issue.

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

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

Principles of Contract Drafting

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

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

before finally signing the document. This phase is important because the parties must know that up to what extent their clauses do binds the other party. In case of an artificial entity the other party's authority to bind his company is needed to be verified before entering the contract.

Roots for Contract Ambiguity

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

Limitations of Language

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

Interpreting the Contracts

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

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

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

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

STANDARD FORM CONTRACTS

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

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

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

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

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

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

The International Institute for the Unification of Private Law (UNIDROIT) is an organization, headquartered in Rome, devoted to developing generally accepted rules and procedures for international trade and commerce. Most of the major trading nations have representatives on the governing council, and the council pursues a number of different projects . These Principles set forth general rules for international commercial contracts. They shall be applied when the parties have agreed that their contract be governed by them. They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like. They may be applied when the parties have not chosen any law to govern their contract. They may be used to interpret or to supplement

international uniform law instruments. They may be used to interpret or to supplement domestic law. The Principles do not apply if the parties do not want them to apply, but they may be useful "default" rules when there is a lack of clarity about applicable principles or about the choice of domestic law. They obviously do not supplant the requirements of laws or of treaties such as the U.N. Convention on Contracts for the International Sale of Goods (CISG). They may be useful references for both parties and governing authorities in much the same way that the various ALI Restatements have been used as references by courts and commentators in this country. The Principles, by their terms, apply only to contracts that are "international"—but this is meant to have the broadest possible interpretation and to exclude only those contracts "where all the relevant elements of the contract in question are connected with one country only." Likewise, the Principles apply only to commercial contracts; but, the drafters intended to exclude only those contracts that are essentially "consumer transactions," which, in most states, are subject to a wide range of consumer protection statutes, regulations, and judicial decisions.

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

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

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

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

The European Principles and Contract Law

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

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

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

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

The Rome Convention (Contractual Obligations)

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

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

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

The future Rome II Convention (Non-Contractual Obligations)

In 2003, the European Commission put forward a "proposal for a regulation on the law applicable to non-contractual obligations". The initiative focuses on the question of civil liability for damage caused to a third party (e.g. traffic accidents, accidents caused by a defective product, invasion of privacy) and to harmonize conflict rules on both, contractual and non-contractual obligations. Referring to these developments, ICC has highlighted major sensible issues such as the conflict with the E-Commerce Directive.

Hague Conference

The purpose of Hague Conference on Private International Law (HccH) is to work for the broad unification of the rules of private international law. Therefore, HccH develops and supports international conventions in the domains of Protection of Children, Family and Property Relations, Legal Cooperation and Litigation as well as Commercial and Finance Law.

As the world's largest and most representative business organization, ICC contributed its expertise to the following HccH commercial and finance law initiatives:

- Hague Judgments Project.
- International Conference on the Legal Aspects of an E-Commerce Transaction

Hague Judgments Project

"Hague Judgments Project" aims at a global convention on jurisdiction, recognition and enforcement of foreign judgments in civil and commercial matters. ICC appreciates the decision of HccH to focus the prepared convention on the choice of court provisions between businesses (B2B) . The "Draft Hague Convention on Exclusive Choice of Court Agreements" achieves more predictability and certainty in international contracts . It has the potential to become valuable for companies engaged in cross-border transactions. To contribute to the effort of HccH and in particular to the work of the informal working group on "The Hague Judgments Project", the "ICC Task Force on Jurisdiction and Applicable Law" conducted a survey among businesses about business practices with regard to choice of court agreements. Once the new Convention enters into force, ICC is prepared to support HccH and its member states in raising awareness about this new legal instrument and its benefits to companies as well as their legal advisers around the world.

International Conference on the Legal Aspects of an E-Commerce Transaction

In October 2004 HccH, International Chamber of Commerce and the Dutch Government have hosted an international conference in The Hague on the legal issues raised by E-Commerce. The programme not only focused on the areas of private law and private international law, but other areas such as international tax law. The conference raised general and political awareness of the vast range of legal questions raised by E-Commerce (e.g. pre-contractual phase, conclusion of contract, its performance and post-contractual phase) and provided a forum for dialogue between legislators, academics, lawyers and businesses. Furthermore, the conference assessed whether the current legal framework reflects business realities. As a result, possibilities for coordination among the different actors have been identified.

International Commercial Terms (INCOTERMS)

Incoterms are standard trade definitions most commonly used in international sales contracts. Devised and published by the International Chamber of Commerce, they are at the heart of

world trade. Among the best-known Incoterms are EXW (Ex works), FOB (Free on Board), CIF (Cost, Insurance and Freight), DDU (Delivered Duty Unpaid), and CPT (Carriage Paid To). The ICC introduced the first version of Incoterms - short for "International Commercial Terms" - in 1936. Since then, ICC expert lawyers and trade practitioners have updated them six times to keep pace with the development of international trade.

Most contracts made after 1 January 2000 will refer to the latest edition of Incoterms, which came into force on that date. The correct reference is to "Incoterms 2000". Unless the parties decide otherwise, earlier versions of Incoterms - like Incoterms 1990 - are still binding if incorporated in contracts that are unfulfilled and date from before 1 January 2000. The versions of Incoterms preceding the 2000 edition may still be incorporated into future contracts if the parties so agree. However, this is course is not recommended because the latest version is designed to bring Incoterms into line with the latest developments in commercial practice.

The English text is the original and official version of Incoterms 2000, which have been endorsed by the United Nations Commission on International Trade Law (UNCITRAL). Authorized translations into 31 languages are available from ICC national committees. The Correct use of Incoterms goes a long way to providing the legal certainty upon which mutual confidence between business partners must be based. To be sure of using them correctly, trade practitioners need to consult the full ICC texts, and to beware of the many unauthorized summaries and approximate versions that abound on the web.

The ICC now publishes a brief introduction to Incoterms on a new special section of its website. The section does not provide all the answers but will help understanding of what Incoterms are for and how they are organized. We describe how to order Incoterms in the original English version and many of the world's main languages from ICC Publishing in Paris and New York, or ICC national committees around the world. The site includes for the first time the Preambles to each term, in read-only format. The Preambles explain the areas the terms cover but do not spell out the obligations of buyer and seller - information that can be obtained only by consulting the full published texts of the 13 Incoterms. As the guardian and originator of Incoterms, ICC has a responsibility to consult regularly all parties interested in international trade to keep Incoterms relevant, efficient and up-to-date. This is a long and costly process for ICC, which is a non-governmental, self-financed organization. The work is financed out of sales of Incoterms 2000 and related publications, which are protected by copyright.

Electronic Contracting

ICC offers e-Terms 2004 in response to the challenges and opportunities through new technologies, which shape the business practice. By agreeing to abide by ICC eTerms 2004, the parties make it clear to arbitrators and judges resolving any disputes they might have on the workings of the substantive contract between them that they do not have a dispute about

the technical means by which they had contracted. With ICC eTerms 2004 in place, the parties have intentionally agreed to contract electronically. The effect: one dispute less, to resolve and to spend money.

ICC e-Terms 2004

- ICC e-Terms 2004 are designed to enhance the legal certainty of contracts made by electronic means.
- ICC e-Terms 2004 provide with two short articles, easy to incorporate into your contracts, which make it clear that the contractee and the contractor intend to agree to a binding electronic contract.
- ICC e-Terms 2004 do not affect the subject matter of contract, and do not interfere in any way with any terms the contract may have otherwise agreed upon: they simply facilitate the procedures and the use of electronic means in concluding a contract.
- One can use ICC e-Terms 2004 for any contract for the sale or other disposition of goods, rights or services.
- One can use ICC e-Terms 2004 wherever you contract through electronic means whether through a website, by e-mail, or by EDI.

ICC Guide to e-Contracting

ICC also provides a product accompanying ICC e-Terms 2004 to explain how one can apply ICC e-Terms 2004 to the contract. ICC recognizes that the speed and ease of electronic contracting is a balance of risks and chances on a knife's edge. These anxieties can frequently more easily be allayed in-house, through sensible, practical and flexible precautions, rather than through international legislation or through contract terms. With this in mind, the ICC Guide to electronic contracting provides flagging steps, which might be taken by businesses to reassure them when contracting electronically.

The United Nations Commission on International Trade Law (UNCITRAL)

The United Nations Commission on International Trade Law (UNCITRAL) is the core legal body within the United Nations (UN) to harmonize and unify international trade law. It coordinates the work of organizations, which are active in the field of International Trade, and encourages cooperation across borders in the first place. Secondly, The UNCITRAL promotes acceptance of existing as well as new international conventions or model and uniform laws . As a close advisor to the United Nations, International Chamber of Commerce (ICC) is presently working with the UNCITRAL working groups (WG) in four areas of expertise:

- Procurement (UNCITRAL WG I)
- Arbitration and Conciliation (UNCITRAL WG II)
- Transport Law (UNCITRAL WG III)
- Electronic Commerce (UNCITRAL WG IV)

Procurement

The ICC Commission on Trade and Investment Policy serves as an advisor to UNCITRAL WG I to update the 1994 “UNCITRAL Model Law on Procurement of Goods, Construction and Services" . The review was decided in 2004 as a result from the experience gained in the use of the Model Law as a basis for law reform in general, and the increased use of electronic communications in public procurement in particular. ICC provided its “ICC E-Terms 2004 “as a major input to UNCITRAL WG I .

Arbitration and Conciliation

Longstanding ICC experience in administering international arbitration has led parties such as UNCITRAL, to seek its assistance in selecting arbitrators for cases not conducted under the “ICC Rules of Arbitration". Since 1982, ICC has had rules setting out a procedure for the appointment, challenge and replacement of arbitrators conducted under the rules of arbitration of UNCITRAL. Furthermore, the ICC Commission on Arbitration attends and observes the sessions of UNCITRAL WG II. From 2000 to present, the aim of WG II has been to discuss the desirability and feasibility of further improvement of the laws, rules and practices of international commercial arbitration.

Transport Law

With its committees on both, Maritime and Air Transport, the ICC Commission on Transport and Logistics acts as an advisor to UNCITRAL WG III in the field of transport law. The work programme goes in line with the UNCITRAL efforts in the domain of E-Commerce. It is considered as a review of current practices and laws in the area of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving greater uniformity of laws.

Electronic Commerce

Recently, ICC has been following the UNCITRAL efforts to regulate companies' use of data messages (e.g. electronic contracting via email). Observing the sessions of UNICITRAL WG IV and providing “ICC E-Terms 2004" as well as the “ICC Guide to Electronic Contracting", ICC helped to develop the “international draft convention on the Legal Aspects of Electronic Commerce" and offered business expertise. Additionally, ICC worked closely with UNCITRAL on the “UNCITRAL Model Law on Electronic Signatures” and the “UNCITRAL Model Law on Electronic Commerce" . The projects allow for legal certainty regarding the use of electronic signatures and utilization of modern means of communications as well as the storage of information.

The United Nations Centre for Trade Facilitation and Electronic Business (UNCEFACT)

The United Nations Centre for Trade Facilitation and Electronic Business (UNCEFACT) is an organisation of United Nations of America, which supports activities dedicated to improve the ability of business, the trade and administrative organizations to effectively exchange

products and relevant services. Its focus is to facilitate national and international transactions, through the simplification and harmonization of processes, procedures and information flows. This reinforces the growth of rules-based, open international trade. The International Chamber of Commerce (ICC) coordinates its work with international organizations and contributes its world business proficiency to the initiatives of UNCEFACT such as Electronic Invoicing and Unified Business Agreements and Contracts (UBAC) etc.

Electronic Invoicing

Recently, private companies have invested substantially to provide the technical infrastructure for electronic invoices. Meanwhile governments have approved the relevant laws and regulations designed to provide the necessary legal infrastructure (e.g. Directive 2001/115/EC amending Directive 77/388/EEC). The lack of usage of common international standards for layout and data requirements as well as differences in the local implementation of existing directives and recommendations avert a harmonization in this field. Through its different Task Forces, ICC has been actively following UN/CEFACT initiatives on electronic invoicing and calls for participation in the UN/CEFACT ITPWG-TBG15. The purpose of this project is to revise the "UN/CEFACT Recommendation on Aligned Invoice Layout Key for International Trade" (Recommendation 6) to ensure that it contains the elements required to exchange information electronically (e.g. data, electronic signature, layout).

Unified Business Agreements and Contract (UBAC)

Prior to message exchanges, the parties agree to do business electronically. This agreement consists of an infrastructure level agreement (e.g. EDI, ebXML) and a business level agreement (e.g. Business Collaboration Framework). UBAC is conducting research for legally enforceable business agreements. The project amplifies the UN/CEFACT Business Process Working Group efforts to develop a framework for E-Businesses defining their external information interchanges and related business activities as a means of a Business Collaboration Framework. UBAC extends the support for executable E-Business relationships through agreements and contracts. It rescheduled the target date for the end of the requirements phase to end of February 2004.

ICC model contracts and clauses

The Commission on Commercial Law and Practice (CLP) develops ICC model contracts and ICC model clauses, which give parties a neutral framework for their contractual relationships. These contracts and clauses are carefully drafted by experts of the CLP Commission without expressing a bias for any one particular legal system. The idea behind ICC model contracts and clauses is to provide a sound legal basis upon which parties to international contracts can quickly establish an even-handed agreement acceptable to both sides. The contracts are the products of some of the finest legal minds in the field of international commercial law. They are constructed to protect the interests of all the parties, combining a single framework of rules with flexible provisions allowing the parties to insert their own requirements.

Contracts and Clauses being developed	
ICC Model Selective Distributorship Contract	ICC Model Technology Transfer Contract
ICC Mergers and Acquisitions Model Contracts II - Business and Assets Agreement	ICC Model Major Project Turnkey Contract
ICC Business Guidance on Electronic Contracting	ICC Model Clauses on Electronic Contracting

Existing model contracts and clauses	
ICC Model International Sale Contract	**ICC Model Commercial Agency Contract**
ICC Model Distributorship Contract (sole importer-distributor)	**ICC Short Form Agency & Distributorship Model Contracts**
ICC International Franchising Contract	**ICC Model Occasional Intermediary Contract**
ICC Model Turnkey Supply of an Industrial Plant Contract	**ICC Mergers and Acquisitions Model Contracts I - Shares Purchase Agreement**
ICC Force Majeure Clause 2003	ICC Hardship Clause 2003

COMMERCIAL CONTRACTS

Some corporate clients have a tendency when negotiating with foreign authorities to present maximum positions on politically sensitive issues, only to cave in completely when they encounter a harsh response from the other party. It may be more effective in protecting the company's interests to present more subtle solutions which have some chance of being accepted. It is important that the client consider at the outset what its firm objectives are in respect of political risks.

Risks in International Commercial Contracts

It is important issues to be resolved to face the political risks and the major legal problems that arise in dealing can be identified as follows:

- The first is the civil law concept of the administrative contract, a troublesome doctrine that engenders uncertainties for companies contracting with foreign authorities.
- The second relates to new legislation enacted by Congress this week that strengthens the role of arbitration as a remedy for breach of contract and expropriation by foreign states.

Parties that invest in foreign countries or that enter transactions with foreign states or government agencies face a wide variety of political risks. If the venture prospers, no political problems may arise. If the deal should turn sour, however, or there is a political or financial crisis in the host country, disputes are likely. Then, the investment or the project could be threatened in many different ways. If the client has an agreement with a foreign government agency, that agency may fail to meet its obligations or its performance may be blocked by an act of state by the host government. In an extreme case, the host government could expropriate the assets of the venture or terminate its license to do business. Alternatively, it might decide to take a controlling interest in the local venture company by nationalizing part of the shares. It could enact legislation raising taxes or wages to confiscatory levels, or establish price controls that make the venture unprofitable. It could pass legislation compelling the transfer of technology or permitting violations of the investor's intellectual property rights. There is always the risk of exchange controls blocking the repatriation of profits or payment of debt. The possibilities are too numerous to mention.

Remedies

In the event the client encounters a political act affecting its property or contract rights, it must be doubted that the courts of the host country will be helpful, particularly if the host is a developing country. The independent judiciary we know in the United States is rare in other political cultures, and even here we see instances where political passions influence the courts. Sometimes the State Department or an insurance agency may suggest the exhaustion of local judicial remedies. In my experience, that course of action can be a terrible mistake. On the other hand, one can prefer to bring a lawsuit in the United States or a third country, you may face difficult, even insuperable problems, of jurisdiction, sovereign immunity, or the act of state doctrine. In some cases, you may have problems establishing a cause of action for breach of international law. I am thinking particularly of cases involving foreign exchange regulations, termination of a license to do business where there is no taking of assets, unilateral changes in administrative contracts, regulatory action and cases of partial compensation where the fair market value of an investment may be difficult to establish.

There are three routes to jurisdiction in a U.S. court under the FSIA in cases involving foreign transactions.

1. First, under Section 1605 (a)(3), an action for damages can be brought if "rights in property taken in violation of international law are in issue,". Either the property taken (or property exchanged for it) is present in the United States, or the foreign government agency controlling the expropriated property is engaged in a commercial activity in the United States. This is a narrow grant of jurisdiction. The only decision sustaining jurisdiction under this provision is my Kalamazoo Spice case against Ethiopia.

2. Second, an action based upon a commercial activity may be brought under Section 1605 (a) (2) of the Act if the claim is based on a commercial transaction having substantial contacts with the United States. It may be that a financial loss suffered in the United States is sufficient to establish jurisdiction, but most of the cases relying on such a loss have involved other contacts, such as letters of credit payable in the United States

3. The third, and the cleanest, path to jurisdiction under the FSIA is an express or implied waiver of sovereign immunity under Section 1605 (a) (1)). The statutory scheme equates a waiver of immunity with consent to the jurisdiction of the court. However, to avoid any constitutional questions relating to personal jurisdiction, it is best to stipulate such consent expressly along with the waiver of immunity.

Act of State Doctrine

If a client is making an investment in a foreign country where that investment is subject to political risks, but no contract with the host government is required, my first recommendation is to consider the feasibility of establishing a formal contractual relationship with that government. Although a breach of contract may or may not constitute a taking of property or meet the requirements of the second Hickenlooper amendment, a claim for breach of contract may have advantages for your case both on the merits and in terms of the act of state doctrine.

Application of the principle, *pacta sunt servanda*, to agreements between private parties and foreign sovereigns is still controversial, but there are respectable authorities that give effect to stabilization clauses in expropriation cases involving the breach of concession agreements that contain such clauses. These clauses may be helpful where either the fact of the taking or the measure of damages is at issue. For instance, it is far from clear at what point a radical increase of taxation passes from un-compensable regulatory action to the status of a compensable, albeit indirect, taking of property. If you can negotiate contractual protections concerning taxation, it may be easier to establish a compensable breach of contract than a taking. In the Libyan oil cases, stabilization clauses were argued to support restitution damages. Professor Dupuy accepted that argument in the Topco case. The arbitrators in the Liamco and BP cases did not.

It is well established that the act of state doctrine applies only to property situated within the territory of the sovereign, and there are several cases, including the second Allied Bank decision in the Second Circuit , holding that a debt is situated where it is payable under the contract. There is also a well-reasoned theory that the act of state doctrine is properly viewed as a choice of law rule.

There is also a strong current of reasoning in some act of state cases, particularly the bank home office liability cases and the Mexican C.D. cases , that the outcome should reflect the reasonable expectation of the parties. If a bank promises a foreign depositor that it will make payment in New York, a court is likely to hold the bank to its promise regardless of any foreign act of state. Likewise, a citizen who deposits money in a foreign bank at a rate of interest reflecting the higher risk will have difficulty persuading a court to relieve him of the risk he was paid to run. Nothing is certain in this world, but I believe it is worthwhile to attempt to contract out of the act of state doctrine, if the transaction lends itself to that approach and your client has the necessary bargaining power.

Arbitration

Many of the obstacles presented by the Foreign Sovereign Immunities Act and the act of state doctrine can be avoided by negotiating an agreement to arbitrate disputes with the foreign state or government agency. The legislative history of the FSIA indicates the intent of Congress that a sovereign's agreement to arbitrate in another country or under the law of another country constitutes an implied waiver of immunity in an action brought to enforce the agreement to arbitrate or an award made pursuant to such an agreement.

This week Congress is considering a new measure which would improve the legal framework relating to the enforcement of international arbitration agreements. At the initiative of Senator Mathias, a rider was added to legislation implementing the Inter-American Convention on Commercial Arbitration. That rider would make three significant changes in U.S. law:

First, the Federal Arbitration Act would be amended to ensure that the act of state doctrine is not applied to bar the enforcement of an agreement to arbitrate or an arbitral award. This provision would eliminate the doubts on this point created by the unfortunate decision of the district court in *Liamco v. Libya*.

Second, the FSIA would be amended to spell out the jurisdiction of the U.S. courts to enforce agreements to arbitrate and arbitral awards. Under this amendment, it would not be necessary to show a waiver of immunity in order to execute an award that is rendered in the United States or a foreign award that falls within a treaty to which the United States is party calling for the enforcement of arbitral awards. The purpose of this amendment is to codify the District Court decision in *Ipitrade International, S.A. v. Federal Republic of Nigeria*, 465 F.Supp. 824 (D.D.C. 1978) which enforced a foreign arbitral award on the theory that Nigeria's agreement to arbitrate under ICC Rules and Swiss law constituted an implied waiver of immunity as regards enforcement of the award in the United States courts. A similar rule has been adopted by statute in the United Kingdom and Australia, and an amendment clarifying the FSIA was sought because the Ipitrade decision had been criticized in dicta in subsequent U.S. cases.

Third, the execution provisions of the FSIA would be amended to provide that a judgment against a foreign state entered on an arbitration award may be executed against any property of that foreign state which is used for a commercial activity in the United States. This provision may make an arbitral award more valuable than a judicial judgment, because execution of the latter is still limited to property of the foreign state used for the commercial activity upon which the claim is based.

These amendments are the result of a considerable effort made by the ABA and others interested in perfecting the remedies available to parties with claims against foreign governments. I had the honor to coordinate this effort for the ABA, and we will continue our effort to improve the provisions of the FSIA in the years to come.

In the *Aminoil* case, the arbitration agreement left it to the tribunal to determine the applicable law "having regard to the quality of the Parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world." The tribunal found it easy to discharge this duty; it concluded that the law of Kuwait incorporates public international law including "the general principles of law."

Another formula used in international contracts is borrowed from Article 42(1) of the ICSID Convention which provides, if the parties have not stipulated the law governing the contract, for application of "the law of the Contracting State party to the dispute … and such rules of international law as may be applicable." This is a helpful formulation, but its utility has been damaged somewhat by constructions made of it in recent annulment proceedings brought under Article 52 of the ICSID Convention.

However, the further development in the International Commercial Law is essential to establish an international legal order conducive to international commerce and economic development.

ENGINEERING CONTRACTS

Engineering Contracts

The Engineering and construction contract is a product of the Institute of Civil Engineers, and first appeared as a consultative draft in 1991. the first edition was published in 1993 under the title ‘ The New Engineering Contract’ by which name it is commonly known. There were various amendments done in the second model in the year 1995 and came under the title ‘the Engineering and Construction Contract’

However the Guide for International Engineering Contracts, drafted by the Economic Commission for Europe of the United Nations (Geneva, 1983) expressly qualifies as obligations de moyens the obligations of the engineer. Similarly, the *Fédération Internationale des Ingenieurs Conseils* (FIDIC) contract model entitled "International General Rules of Agreement between Client and Consulting Engineer for Design and

Supervision of Construction of Works," 1979 ed., at clause 2.3.1 provides that "the Consulting Engineer shall exercise all reasonable skill, care and diligence … and shall carry out all his responsibilities in accordance with recognized professional standards. The Consulting Engineer shall in all professional matters act as faithful adviser to the Client and, in so far as any of his duties are discretionary, act fairly as between the Client and third parties." This wording, and particularly the reference to the "care and diligence," is significant for the qualification of the obligations of the engineer as obligations de moyens.

Purpose of Engineering and Construction Contracts

The purposes of an Engineering Contract may be listed as follows:

1. Revolution in attitude and mind of contractors, clients and construction professionals.
2. Better building at lower cost.
3. Permitting reasonable profit to contractor.
4. Less disputes and litigation.

The ECC documents are written in a style and simple language. The present tense is used almost through out and defined terms are minimal and owe noting to established terminology of other contracts.

Options of Engineering Contracts

The ECC contract actually has six variations on a theme sold as a boxed set with guidance notes, a volume of flow charts and a form of sub-contract. The six contract options all have in common a set of nine core clauses and 15 secondary option clauses.

The (6) six contract options are:

1. Priced contract with activity schedule: It consists of a simple arrangement for a lump sum price for each activity identified on an activity schedule. The schedule is linked to a program showing he start and finish dates for each activity. Payment is earned for each activity only when it is completed.
2. Priced contract with bill of activities: It can operate as lump sum or remeasurement contract, depending on whether or not the quantities in the bills are an accurate statement of the amount or quantity of work actually required. Any difference between the stated and final quantities in the bills is a compensation event. There is no specified method of measurement.
3. Target contract with activity schedule: This is a free and cost reimbursable payment options, coupled with incentives to the contractor to remain within a set cost budget. Compensation is taken into account to adjust the target price. Option C is based on a cost based activity.

4. Target contract with bill of quantities: The only difference between this one and the one above is that this one is based on bills of quantities. The risk that the bills have been under measured rests with the employer.
5. Cost reimbursable contract: It provides for a simple cost reimbursable contract plus a percentage fee.
6. Management Contract: It is an elementary form of management contract based on actual cost plus a fee. The core clauses make no provision for a pre-construction period and the contractor remains as fully liable for the sub-contracted work or design as if th work or design had carried out by the contractor himself.

INTERNATIONAL TRANSFER OF TECHNOLOGY AGREEMENTS

In today's commercialized world, it is more important for anyone who enters in to any kind of business transaction to be familiar in the negotiation of business agreements involving the licensing technology. The U.S government in 1980 enacted the BayhDole Act to encourage the commercial use of technology developed under the federally funded research. Thereafter the development of this underdeveloped technology, it has become an industry which generates hundreds of millions in royalty payments from the sales of products using patented technology. Due to the commercialization and rapid expansion of the technology, where millions of dollars were at stake it became essential to draft this agreement with proper structure in order to protect the objectives and interests of both the parties- unquestionably a formidable task.

Basic Principles of International Technology Transfer Agreements

The following may be treated as the objectives of Technology Transfer and Commercialization of Transactions:

The exploitation of technology in its early stages of development.

Advancing the technology to a stage where it has useful commercial applications

1. Marketing and selling the technology for profit
2. To ensure that the fullest ownership or licensing rights to the technology are conveyed consistent with the intentions of the parties.
3. To ensure that after conveyance the technology is commercially exploited to the fullest extent possible to maximize the possible financial return.
4. To ensure that if the licensee fails to exploit the technology commercially, the conveyed rights will be returned or the license will become non exclusive.

<u>Basic Statements of Technology Transfer Agreements</u>

The International Technology Transfer Agreements shall contain the following basic statements.

Identification of the parties: The opening paragraph should identify the parties to the agreement with their official names, addresses and, when applicable, the location of their governing law of incorporation. Corporations should be identified as patent and subsidiary, patent, or subsidiary alone, and their legal capacity or authority should be given.

Purpose: The purpose of an agreement should be stated in a brief paragraph that captures the essence of why the licence agreement is being executed.

Effective date of the agreement: The data when the agreement comes into full force and effect is often stated in separate paragraphs.

Whereas clauses (recitals, preamble): The whereas clauses give the background and rationale for the agreement. Whereas clauses contain such things as licensor and licensee representation and background of the agreement.

Licensor representations: This clause states that the licensor owns the subject technology of the licence (patents, patent applications, know-how trade secrets, trade marks and / or copyrights), that it has the right to grant the licence and that it has not granted a previous conflicting licence.

Licensee representations: This clause indicates why the licensee wishes to obtain rights to the subject technology. The patent, patent applications, know-how, trade marks and / or copyrights the licensee owns in the field of the licensed technology is also to be incorporated.

Background of the agreement: When warranted, other clauses should include statements about any prior agreements that may relate, dominate or affect in any way the present agreement. Cancelled or suspended agreements should be mentioned as well.

Definition of terms: To preclude misunderstandings between the parties, the subject matter and key words that will have broad impact in the agreement require definition. Most important are the following:

- Licensed patents.
- Licensed know-how/trade secrets.
- Licensed improvements.
- The licensor has obtained the rights to license
- They are patentable or not
- They are developed or acquired during the term of the agreement
- They pertain to the licensed process and licensed apparatus
- They have been put into commercial use by the licensor.
- Major improvements.
- Grant-back.
- Licensed product/licensed process/Licensed apparatus.

- Net sales.
- Territory.
- Subsidiary.

Subject Matter of the licence: The International Technology Transfer agreements shall contain the following subject matter related aspects and clauses in them.

The licence grant: The grant is probably the most important part of the licence. Its provisions, outlined below, require careful thought as to their content. To protect all parties, they should be drafted unambiguously, leaving no doubt or open questions regarding the rights being granted.

Patent rights: The term "licensed patents" should be defined in the agreement in order to identify the patents, applications etc. included in the licence. The grant specifies exclusivity, territory, rights conferred, limitations, maintenance and protection of patents, and patent making.

Exclusivity: The grant can be exclusive, sole (exclusive except for the licensor) or non-exclusive. The licensee seeking an exclusive licence must be prepared to make a strong case for its ability to market the technology in the licensed territory aggressively.

It requires careful assessment of which approach will yield the greatest return. The following questions should be considered:

- Will the licensor use the technology itself?
- If so, will it be only in its own country or in several countries?
- Will the patent protection have a long life?
- Will the licensed product have a broad or narrow market?
- Are there many or few prospects for a licence?
- What is allowed or restricted by the applicable laws?

Territory: As territory is normally defined in the "definitions" section of the licence, as shown earlier, it needs only be denoted by a capital T in the licence grant. This is the preferred technique, as otherwise the licensee grant paragraph will be needlessly encumbered.

Rights conferred: It is proper for the grant to set forth exactly what a licensee is free to do under the patent rights. Depending on the claims in the patents, the licensee can be given the right to manufacture, have manufactured, use and/or sell the subject matter of the licence.

Limitations: Depending on the coverage within the claims of the patents, the licensor may wish to impose limitations beyond the geographical territory on the quantity or volume of

products sold and on field-of-use. The licensee and the licensor as well should assess the effect of such restrictions on both the market and its growth potentials.

Maintenance and prosecution of the patents: The licensor, except as noted below, usually bears responsibility for the cost of filing, prosecuting and maintaining licensed patents. This includes future patent applications if improvements are included in the agreement.

Infringement: Licensor and licensee rights concerning infringement suits may vary from country to country owing to differences in the applicable laws.

An award favoring the licensee usually pays the litigation expenses of the parties on a pro-rated basis first. The surplus, if there is one, is then split evenly between the parties. If the licensor does not participate in the litigation, the licensee should insist that no portion of the award be shared.

Patent marking: The licensor often insists on requiring the licensee to mark patented products with the patent number.

Know-how/trade secrets/confidential information: The term know-how will include both confidential information (trade secrets) and non confidential information.

The know-how: It refers to the technical and specialized knowledge that has particular value in making, using and selling the licensed process or product.

The secrecy: The secrecy obligations that permit the usual exceptions should be acceptable, i.e. confidential information that:

The licensee can prove, with written records, is already known to a licensee or is already in the possession of the licensee.

- Was in the public domain prior to disclosure by the licensor.
- Becomes a part of the public domain by publication or by any other means except an unauthorized act or mission by the licensee.
- Is received from third parties who are under no obligation to maintain such information in confidence.
- The licensee can prove, with written records, was developed by licensee independent of disclosures from licensor.
- Licensee's use of the know-how: The agreement may spell out the basis on which disclosures can be made to include a requirement that the licensee execute agreements with the pertinent employees and third parties.

Technical assistance: Technical assistance can greatly reduce the time required by the licensee to move the licensed technology into production. The common elements of the technical assistance include the following:

- Plant visits and training.
- Direct assistance.
- Consultation.

Improvements: If the party decides to include improvements made after the effective date of the agreement, this section must be drafted carefully. Improvements made by the licensee to be granted back to the licensor require a separate clause to specify how they are to be handled.

- Improvements grant
- Timing of the disclosure
- Grant-back of improvements made by licensee

The provisions with respect to definition and timing of disclosure for improvements are commonly reciprocal between the licensor and licensee.

Sub-licence rights: Subject to individual country laws, a licensee does not have sublicensing rights unless the agreement authorizes them. By so doing, it can be certain to include all the pertinent requirements from the primary agreement. This procedure should be acceptable to the primary licensee.

Payments: The payments in technology agreements usually take the form of a lump sum, a royalty or a combination of both.

Initial payment: Technology agreements frequently involve the transfer of valuable know-how. For this reason, the licensor usually requires an initial lump-sum payment when the licensee is executed. This payment should reflect the value of information transferred early in the life of agreement. If the licensee has a good negotiating position, deletion of up-front and minimum royalties should be pursued vigorously.

The amount of up-front payments depends on several factors:

- An assessment of the value of the technology.
- Whether the licence is exclusive or non-exclusive and whether it allows sublicensing or not.
- Whether advance payment of royalties is included.
- The rate of running royalties to be paid
- The amount of minimum royalties.
- The length of the period for which royalties are payable.

Royalties: Most licences require payment of royalties based on a percentage of the net sales of the licensed product, as defined in the definitions section. A reasonable procedure is for the licensor and licensee to try to develop theoretical sales projections, or to use market

projections based on the project feasibility study and then to reduce those projections by 20 to 40 percent to arrive at a fair, conservative amount to be used in the agreement.

Separate payments for patents and know-how: A trend exists to separate patent and know-how royalty payments in licence agreements. There are several reasons for this:

- Patent royalties are subject to risk since there is always a chance they can be declared invalid.
- Patent royalties can remain in effect only for the life of the patent, but know-how royalties may continue well after the licensed patents expire (see discussion on know-how licences below).
- The subject matter of the licence with respect to patents is limited to the scope of the claims, whereas the subject matter can be defined more broadly under the scope of the know-how.

Acquisition of machinery: When a licensor sells proprietary machinery to a licensee, the terms for such a transaction can be shown in separate paragraph of the agreement, in a schedule attached to the agreement or in a separate sales agreement.

Technical services: In addition to the above payments, the licensee may have to pay separately for specific technical services the licensor may provide in connection with the licence. Payment method and currency, Interest on overdue payments and Licensee records are to be also taken care of.

Boilerplate Provisions of Technology Transfer Agreements

The following Boilerplate provisions have to be incorporated in the Technology Transfer Agreements to avoid future complications at the time of drafting the Agreements.

Termination of the agreement: Termination provisions vary widely. They can be limited to expiration or invalidity of the patents, to a definite time period for know-how and/or to breach of the agreement by either party. Breach or default is usually determined in arbitration. Often the agreement will include specifically the following conditions as cause for termination: overdue payments; bankruptcy, receivership or insolvency; change of control.

Best efforts: A paragraph stating that the licensee will use its best efforts to exploit the licensed technology is common in both exclusive and non-exclusive licences.

Most favoured licensee: Non-exclusive licensee should insist on this clause. It provides that should the licensor grant another licence to a third party on more favourable terms, the more favourable terms will then apply to the first licensee.

Warranty and identification: Many times a licensor, especially one in a strong position, will make no warranty or representation of any kind, express or implied concerning any matter in the agreement. In effect, no warranty is extended.

If the licensee cannot obtain a warranty of substance in the agreement, it should insist that the warranty section be used to confirm that the licensor:

- Owns or has the rights to the licensed patents.
- Owns or has the rights to disclose the licensed know-how and other technical information.
- Has no ongoing, pending or threatened suit regarding the licensed patents and technology (assuming there is one).
- Has used the know-how to enable him to produce the licensed product. If there is no licensed product, then some statement that attests to the worth of the know-how should be given.

Export control: If the technology or products made under a licence are considered sensitive or if they might be utilized in countries to which the licensing country restricts exports, the licensor will require a clause to assure that such restrictions are not violated.

Arbitration and applicable law: Arbitration is being used more and more frequently as a means to resolve licence agreement disputes because it is usually faster, much less costly and more amicable than lawsuits.

There are many subtle points to consider in writing arbitration and applicable law clauses. Patent laws differ around the world. The use of discovery in arbitration can be limited and the generally accepted procedures for arbitration are changing. The licensee and licensor are advised to have legal counsel study the circumstances for each licence carefully before deciding on the most appropriate provisions for such clauses.

General provisions of Technology Transfer Agreements

The following general provisions will add extra strength to the Technology Transfer Agreements and they have to be also incorporated during the drafting of the Agreements.

Assignment: It is important for the licence agreement to provide for assignment or preclude it. Assignment is commonly precluded for the licensee, although there are exceptions.

Severability: A clause will usually provide that if a significant provision of the agreement is declared void or unenforceable by arbitration or court proceeding, the remaining provision of the agreement will remain in full effect.

Entire agreement: In general, almost all licence agreements contain an entire agreement clause. It is especially important when there are existing agreements or have been prior agreements between the parties related to the current or another subject matter.

Force Majeure, contingencies: This clause provides that neither party to the agreement will be responsible for failure or delay in performing their obligations due to circumstances beyond their reasonable control.

Notices: The parties will designate the principal contacts for the handling of correspondence, fax messages, telephone calls, notices, royalty payments, technical assistance, training, patent administration etc. Generally, each party appoints a technical and/or a licence administrator is appointed to handle the day-to-day business of the licence.

Demographics of Technology Transfer Agreements

Various institutions like colleges and university, business entities, independent development laboratories, non profit organizations, even government are engaged in technology transfer and commercialization. These agencies are performing or sponsoring scientific research and development but cannot exploit their rights for profit except through technology transfer. Individuals who develop technology are typically innovative, but lack all resources required for exploiting technology commercially. They lack financing and even if they receive it somehow they either lack the means for marketing, manufacturing and distribution. Even the early stage technology companies lack the potential to finally put their product for maximum profit. The technology transfer provides them the means to finance their research and development activities from the payments they receive from licensing commercialization right to others. This method provides them the means not only to realize the profit but also to generate funds, which they can later use for their further research.

Importance of Financial clauses in Technology Transfer Agreements

The cost of doing business has risen considerably over the years. The developer usually relinquishes his right for a potential income that may be generated through license fees and royalty payments. The technology transfer provides a significant way to recoup the financial investments, needed to support further research and development activities. These funds further helps in the development of new technology by providing necessary funds required for research and development. It also bridges the gap between those skilled in research and development and those skilled in manufacturing, marketing and distribution.

This method shifts the technical and financial burden of commercial development to the beneficiary, through clauses requiring up-front payments licensing fees and continuing royalty payments. Many times the licensor is also given stock ownership rights in the business entity that is created to exploit the technology commercially.

Some Typical Financial Provisions are as follows:

1. License Issue Fees and Other Up Front Payment Clauses: The first order of a business transaction is to define that what the licensee will pay in advance for the commercialization rights that are being conveyed. It might agree to pay an aggregate sum or a separate license fees for different kind of technology. It may also consist of the provision like to reimburse the licensor any costs incurred in preserving patent or other intellectual property rights in the technology until the transfer takes place.

2. Equity Ownership and Other Secondary Payment Provisions: There can also be a provision in consideration, which could provide for either an equity interest or the creation of a new entity expressly for the purpose of exploiting the technology. This arrangement provides an attractive business deal to the developer because of the potential for capital gains from an increase in the value of the issued stock.

3. Payment Term Provisions: The payment terms could also provide for an over time payment option because it takes a long time for the actual commercialization of the technology. Therefore a middle path is required to be ascertained in order to safeguard the interest of the licensor and the licensee.

4. Royalty Payment Provisions: The final part of the compensation provision might provide for the payment of royalty on the finished products finally sold. It provides for the ultimate commercialization of the technology and its exploitation in the market place. This clause helps the owner of the technology to earn the maximum profit because it doesn't have the means of financial resources, market penetration or the sales force to explicit the technology itself.

INTERNATIONAL COMMERCIAL AGENCY / FRANCHISE CONTRACTS

Twenty years ago a joint venture most often occurred in domestic construction projects by which two or more companies would join forces for a particular piece of construction, sharing the responsibilities and revenues, with the joint venture ending when the job was completed. Modern day use of the Joint Venture has enlarged its scope so that it is a typical means of engaging in business in a foreign country. A company in the United States which wishes to enlarge its operations abroad or obtain (or share) some intellectual property in a market unfamiliar to it will seek a "partner" in the other jurisdiction to engage in what is often a long term business venture in that locale.

Foreign principals have developed various strategies to address these Middle East dealer protection laws. For example, many principals seek to ameliorate the more onerous aspects of these laws, through certain provisions in their commercial agency agreements. Foreign principals should recognize that such provisions, although perhaps helpful in some instances, may not be entirely effective: Middle East dealer protections are a matter of local public policy, and consequently Middle East courts may disregard contract provisions intended to

deny those protections to a local commercial agent . The advantages of having local expertise and personnel without having to directly enter a foreign market is quite appealing to many American companies and the sharing of resources and intellectual property can be an added inducement. What used to be required by certain foreign governments (such as China) has become quite often the preferred methodology of entry into a market by the United States Company. But there are problems and issues that must be confronted before a joint venture is undertaken and this article shall outline some of the most pressing questions that a company must confront and suggest some solutions that can maximize the benefits and minimize the risks of utilization of such joint venture.

The Basic Structure of International Commercial Agency Agreement

Typically, a Joint Venture ("JV") exists so that two parties can combine resources, contacts, skills and assets to better exploit a particular market. The variations are endless. An American company with intellectual property may wish to enter a foreign market and has neither resources, contacts or the skill set necessary so approaches an Indian or Indonesian company to create some sort of relationship to market the product in that country. Or two companies with equal skill sets but without sufficient economic capital combine their capital to engage in entry into a market or to build a production site.

The typical structures are the creation of a partnership or limited liability entity in the foreign locale, which is owned, by both entities. The alternative method is to create a long-term contract between the two entities spelling out duties and division of proceeds and protection of intellectual property. Sometimes a careful party will wish both…a limited liability entity with a shareholder's agreement is not uncommon.

Tax consideration, both in the United States and abroad (where such oddities as Value Added Tax ("VAT") can have a tremendous effect on structural planning) must be integrated in and a good international CPA is as vital in structural planning as attorneys, both in the United States and in the foreign locale.

The party considering a joint venture must be careful not to let tax or local jurisdictional issues alter the power or monetary arrangements to its disadvantage. The balance between tax planning, operational planning, local legal restrictions, and cost benefit analysis becomes the primary concern of the wise executive.

The following are the examples of clauses dealing with the parties' determination of the law of contract.

- Force Majeure: what events will allow one of the parties to terminate the contract without liability for breach?
- Choice of law: In case of dispute which law will apply? Court to set aside this clause if it is against the pubic policy.
- Merger: What makes up the agreement?

- Modification: Procedure and Method
- Severance: Does the invalidity of one procedure render the whole contract unenforceable.

The Typical Issues of Confrontation in Commercial Agency Agreements

The basic recurring issue involved in Commercial Agency Agreements is sharing resources. There are certain other issues which are to be addressed properly at the time of drafting the agreements.

The recurring problems and questions confronted quite often are:

1. Power. Who makes what decisions and what happens if there is a dispute?
2. Money: Who puts in what and how are the proceeds divided?
3. Responsibilities. Who is to do what and with what priority over other business?
4. Oversight. Who reports to who and what criteria are to be utilized to gauge success? Accounting methods and oversight by whom?
5. Protection of Interests. How is intellectual property, customer lists, contacts, and the business itself to be protected from one or both joint venturers or third parties?
6. Extraordinary events: What happens if one company or owner withdraws or becomes disabled? What happens if the laws change or a new competitor comes in that changes the playing field?
7. Local Issues. Many jurisdictions restrict ownership and power of a foreign national thus the usual fair division of power is made impossible, often putting one of the JV members at risk. Restrictions on removal of currency can make this an even more difficult question. Taxes come into the picture both in terms of characterization of expenses and treaties between the United States and the particular nation.
8. Business Ethics: Not a minor issue. Not only because what one nation considers appropriate may be considered a major violation of good business practices in another, but because United States law can often prohibit activities that another nation treats as standard business practices. See our article on the Federal Corrupt Practices Act.
9. Competition by the Parties. Quite often the parties remain competitors in other fields. How is that fact to be integrated into the particular venture, both during it and afterwards? How are business advantages to be restricted to the joint venture so that one's competitor does not use the venture to drive one from the market at a later time?
10. Withdrawal from the Venture. Under what terms does one party withdraw or become forced to withdraw from the Venture? What happens to the assets and trade secrets?

These issues are to be addressed properly after systematic negotiations and understanding between the parties.

The Negotiation

A quick review of the above basic issues indicates that creation of a joint venture is not a simple process even if the parties know and trust each other. Knowledge of the law in at least two jurisdictions; knowledge of tax law; realistic and appropriate expectations; and effective means to obtain data about performance are all vital for the negotiation to conclude and the business to prosper. As per the article on International Business Transactions for the United States Business, even the negotiations themselves are subject to different requirements and many a joint venture foundered on perceived insults and slights. There are also predatory entities, particularly in certain parts of Asia, which utilize joint ventures to obtain trade secrets and will cheerfully compete against the very joint venture they are connected with. In some of those nations, there is no effective court system, and such protections as a third nation locale for dispute resolution and utilization of technology to protect technology may be vital.

There are also oddities involved in some locales that only experience or good advice can prepare the businessperson to confront. One ship building company failed in Thailand because they had not budgeted six months for the local workmen to build appropriate shrines to local deities for the ships. Another entity failed to understand that the extended family of their joint ventures would be the hidden vendors for critical materials and that while all in Indonesia knew the extent of that family's holdings, our American client had not. But this writer's favorite story was of the American client who had spent a great deal of money outfitting a state of the art warehouse in South Africa only to have an armored car driven by organized bands of thugs smash through the steel front door and steal literally every stick of furniture on the premises. None of the businesses on that street were surprised and the local warehouseman merely shrugged. A typical event in that locale and solved by hiding one's assets, not "advertising them" by putting them in a modern looking building.

The wise business person will develop a team to assist him or her in not only developing a business plan, but in achieving enough knowledge as to the local taxes, laws, customs and means of enforcement of contracts so that the odds of success are maximized. Local counsel and accountants, a knowledgeable Unites States attorney and CPA, and communications with people already resident in the local are essential. Most attorneys and CPAs who do this kind of work can form the requisite team.

Like riding a bike, if one merely lists the requirements the task appears daunting. But once one has some experience, it goes remarkably smoothly. Understanding the basic requirements and creating the right team of professionals and experts should allow the average business to engage in joint ventures that widen the available markets exponentially.

ICC Model of Commercial Agency Contract

Virtually every company engaged in international trade makes use of agents abroad, and thus faces the problem of drafting an international agency agreement. The lack of uniform rules creates difficulties for parties negotiating agency agreements abroad. There is no internationally agreed uniform legislation for agency agreements, and so parties have to rely on national laws. Not only do these laws differ from country to country, they do not take into account the international nature of the contract. The ICC Model Commercial Agency Contract provides a thought-out and truly flexible alternative solution. To assist business people engaged in international trade and using uniform contractual rules, and not based on any specific national law, the model incorporates prevailing practice in international trade as well as the principles generally recognized by the domestic laws on agency. Commercial agency agreements are the simplest and probably most frequently used means of organizing the distribution of goods in a foreign country. Almost every company engaged in international trade has at least some agents abroad. Most exporters (whether large or small) must therefore face the problem of drafting an international agency contract. To assist business people engaged in international trade (and the lawyers aiding them in drafting and negotiating contracts), ICC drew up the model contract on international commercial agency in 1991. It was the first of a successful series of model contracts that now cover almost all types of agreements relating to distribution. Ten years on, the model contract has been updated, taking account of recent developments in the law of agency and also to ensure that the contract is in harmony with the other ICC model contracts.

ICC Model of International Franchise Contract

International franchising has been seriously hampered by laws and regulations which differ from country to country. In this context, the ICC Model International Franchising Contract provides franchisors and franchisees with a uniform framework for agreement within which their rights and responsibilities can be protected . The ICC Model Contract strikes a fair balance between the interests of the franchisor and franchisee and proposes to candidate franchisors and franchisees flexible drafting solutions that accurately respond to business needs for legal certainty and compliance with common practice.

In doing so, the Contract:

Takes into account the most commonly used clauses in franchise agreements;

- Suggests alternative clauses where no single solution is possible;
- Allows the parties to insert their own requirements on certain points;
- Provides annexes which the parties can modify without changing the basic text of the agreement;
- Provides a system to resolve disputes; and
- Includes a detailed commentary explaining the various provisions

Franchising has proved over many years to be an extremely successful commercial vehicle for the distribution of products and services, making a considerable contribution to growth in business sectors that use this type of distribution channel. However, there have long been doubts about the feasibility of introducing a simple and user-friendly model contract that would reflect the diversity of franchising contracts and would encourage users to choose this type of contractual agreement.

The ICC Model International Franchising Contract clearly demonstrates that a franchising agreement, like agency, distributorship and intermediary agreements can usefully be expressed in a modal contract based on the most common clauses found in international franchise contracts. The ICC Model Franchise Contract proposes to candidate franchisors and franchisees flexible drafting solutions that accurately respond to business needs for legal certainty and compliance with common practice. For the sake of clarity and ease of use an explanatory commentary has been added to the contact, presenting alternative drafting solutions and identifying pitfalls.

This model contract is intended to apply to international direct franchises, which are a new and rapidly expanding franchising instrument. ICC's initiative supplements UNIDROIT's more traditional approach on drafting international franchise contracts, which takes the form of a comprehensive guide on master franchise arrangement. The contract meets a long-felt need, as has been confirmed by ICC's extensive consultation of all business sectors. The ICC Model International Franchise Contract is the result of many months of work carried out under the auspices of the ICC commission on International Commercial Practice.

NORMS FOR DRAFTING INTERNATIONAL COMMERCIAL CONTRACTS

Introduction

Parties to any commercial contract, whether domestic or international, must consider quality control, compliance with governmental regulations, protection of intellectual property rights, and dispute resolution.

The International aspect of the contract adds a level of complexity to negotiations, performance, and enforcement because the parties are distant, have diverse cultural backgrounds, and are subject to the laws of different countries.

International contracts must be understood within the context of the legal profession. It is those two words (‘it depends’ and ‘inform’) that have led to the development of the complex language known to the general public as “legalese” (a language particular to the legal profession).

Ex: If a sales contract requires a buyer to inform a seller that the goods being purchased must meet certain specifications, a question may arise as to the meaning of the word "inform". An attorney for the buyer might say, *"it depends."* In this case, the seller should have known that the buyer had particular specifications because the seller previously filled five orders for the buyer for the same goods.

Then the attorney for the seller might say, "*it depends."* In this case the buyer should have given written instructions because the buyer wrote the specifications on the previous five order forms. Thus, the attorney might turn the simple phrase "*the buyer must inform the seller of any particular specifications for the goods"* into legalese: "*the buyer, regardless of whether he or she has previously ordered any of the seller's goods to conform with any specifications whatsoever, shall inform, whether in writing, orally, or otherwise, the seller of any and all specifications with which the buyer demands conformance of the goods that are the subject of this contract."*

1. The Role of Contracts in International Commerce

A ***contract*** is simply an agreement that defines a relationship between one or more parties.

A ***commercial contract,*** in its simplest terms, is merely an agreement made by two or more parties for the purpose of transacting business.

The creation of an international contract is a more complex process than the formation of a contract between parties from the same country.

In a cross-border transaction, the parties usually do not meet face-to-face, they have different societal values and practices, and the laws to which they are subject are imposed by different governments with distinct legal systems.

The role of a contract in an international commercial transaction is of particular importance with respect to the following aspects:

i. Balance of Power
ii. The Party who drafts the contract (risk of loss passes to buyer)
iii. The Party Familiar with Written Contracts (Time essence)
iv. Enforcement of One-sided Contracts
v. Cross-Border Rights and Obligations
vi. Differences in Business Practices
vii. International Laws (Ex: CISG)
viii. Preciseness and Predictability(defining rights and obligations)
ix. Personal Commitment (Timely Delivery, Quality Products)

Ex: When we agree to sell or buy goods internationally, we are also responsible for complying with import, export, customs, consumer product, marking, transport, and other trade-regulating laws of two or

more countries. It is wise to ensure that the other party shares the same commitment.)

x. Governing Law

xi. Choice of Remedies

xii. Necessary Terms (In most countries, parties make their own bargains free of legal restraints. However, in most jurisdictions, the courts will enforce a contract only if the parties have agreed to four basic terms:

-The Description of the goods in terms of type, Qty. and Quality

- The Time of Delivery

- The Time and means of Payment

2. Issues Affecting International Contracts

Issues:

i) Cultural Issues

ii) Role of Politics

iii) Regulatory Laws

iv) Internet Issues

(i) Cultural Issues

- Success of foreign trade will depend on how flexible you are in recognizing and respecting the culture of other people.
- Culture is a set of rules that govern the way in which commercial transactions are conducted between nationals of particular nations.
- These rules dictate the etiquette (manners), traditions, values, communication, and negotiating styles of a group of people.
- Culture should be considered as applying to people, not to nations.

- Cultural awareness will be most important in the initial contact and negotiation, since in subsequent contacts we will have figured out many of the rules.
- In making initial contact, one should first establish whether the general protocol in the country tends to be rigidly applied.
- The next step, is to determine what that protocol is, especially for the issues that will arise at the first stage of contract negotiations. These issues include *greetings, courtesies, business ethics, decision making, gender, meeting formalities, and business attire.*
- The final step should be to ensure that we are approaching cultural issues with the proper attitude.

(ii) Role of Politics

- Political evens have a major impact on the economy of a country.

- Instability can be devasting to a country's markets, while a stable government can be a great asset.
- International trade plays such a significant role in a country's economy that governments throughout history have used direct and indirect trade barriers to force changes in the governments and policies of other countries.

- Trade barriers include boycotts, quotas, tariffs, import and export prohibitions, licenses, consumer and labeling requirements, and environmental regulations.
- Trade sanctions are often used to influence another country's domestic policies or practices and to protest a country's aggressive actions toward its neighbours.
- Favourable trade preferences are granted to countries that implement the changes thought to be desirable.

  Hence, one must be in touch with "*Political trends*"

(iii) Regulatory Laws

- It is the responsibility to know law. Lack of knowledge is not a defence to a criminal charge, penalty proceedings, or civil law suit.
- One must be familiar with the laws of other country.
- Countries are exploding with laws regulating the import, export, and sale of goods. Developing countries are taking their cues from the laws of developed countries. New and revised laws are being introduced throughout the world as countries come under pressure to join the globalization trend.

- To compete in the world economy, most countries are recognizing that they have to offer domestic and foreign traders a business-oriented environment.
- Where ever a person transact or plan to transact business, one should be aware of existing laws and regulations governing import, export, antitrust, anti-bribery, consumer protection, intellectual and industrial property rights, and environmental issues.
- One must also keep watch for changes in those laws and regulations.

(iv) Internet Issues

- The potential of the Internet, a new electronic marketplace, is an exciting concept for traders today. In just a few minutes, one can find a particular populace by search criteria and send off your advertisement. One can develop his own web site to improve customer access to his company. Sales can be made at electronic speed, suppliers can be sought worldwide, and classified advertising has taken on a global meaning.

Traders on the Internet must beware of the pitfalls. Security of the information that passes through electronic channels remains a problem. Before using the Internet for confidential information, one should be certain to encode that information. The Internet is a public domain. If one places his intellectual property – trademarks, copyrighted or patented materials, designs, etc., on the Internet, one should first ensure its protection from infringement.

3. Parties to the Transaction

- Sales transactions occur between two parties buyer and seller.
- Some times transactions involve more than several parties who are jointly buying or selling goods, but the individual interests of parties acting jointly become melded as a single interest in the sales contract.
- Hence, it leads to '*Privity of Contract'* . Here rights of the third party are not protected because he or she is not in privity of contract.
  But, whether a third party has a right to enforce the contract is an issue best left to the advice of the attorney in light of the particular circumstances involved.

Seller

- A seller is the individual or entity that places goods or services into the consuming chain and received compensation in return.
- The Seller's Goals (obtain best price keeping cost of prod. Minimal)
- The Seller's Promotion (costs of shipping, custom clearance)
- The Seller's Hidden Costs

  Product Adaptations (Intl markets require modifications of our goods or services to follow national laws or consumer cultural preferences. One has to meet legal labeling, marking (design), and advertising requirements, buyers language, translate our promotional brochures, product brand names, instruction manuals, and warning labels)
- International Shipping
- Customs Clearance
- Insurance (Product Liability: Person is injured when using the product)
- Third Party Expenses (The complexities of trading over international distances increases the potential expenses that we might incur if the buyer delays performance of fails to perform, whether the breach is avoidable or unavoidable.)
- Temporary Facilities

- ❑ Mitigation Expenses: (If sale fails, seller must find new buyer-arrange for a return shipment of goods, modify the goods to sell them to another etc.)

Buyer

- ❑ The Buyer as a Consumer: A buyer consumes goods or services in return for compensation to the seller. The buyer may be in the middle of the consuming chain or the ultimate consumer, who uses the goods or services without selling them to other buyers.
- ❑ The Buyer's Goals (obtains best quality and most quantity for least cost)
- ❑ The Buyer's Safeguards (seek assurances of quality and protection against defective or damaged goods or unsatisfactory services.)
- ❑ The Buyer's Hidden Costs: When considering the cost of the transaction, remember to add in the hidden expenses before we agree to a price. Hidden expenses include the following:

a) International Shipping: (Seller not responsible for transporting goods to the buyer but has to arrange and pay for at least part of the shipping, which include, attendant costs, delays of unloading, reloading, inspecting and administering by two or more shippers.)
b) Customs Clearance
c) Insurance
d) Interruption of Business
e) Hospitality Costs
f) Lost Sales or Production Delays
g) Temporary Facilities
h) Replacement Goods or Services

STANDARD CONDITIONS OF CONTRACT IN FOREIGN PROCUREMENT

All contracts must be in conformity with the standard and special conditions as mentioned in the RFP and the recommendations of the CNC, if held, as accepted by the CFA.

Contract commences from the 'effective date' of the contract, which normally is the date on which the contract is signed, unless specified otherwise in the contract. A contract is valid from the date of its signing or as specified in the contract, till the fulfillment of all obligations under the contract by both the parties.

Prices

Unless specifically agreed to, all prices to be quoted by the seller should be the seller's lowest export price and would be as per required delivery terms. Prices should be fixed and

firm and should be inclusive of packing charges, taxes and duties etc. levied in the country of supply.

Terms of Payment

Letters of Credit and Direct Bank Transfer: The payment should be arranged by way of Letter of Credit (LC)/ Direct Bank Transfer (DBT) through any Bank authorized by the Ministry of Defence to the bankers of the foreign supplier. DBT payment should be made within thirty days of receipt of clean Bill of Lading/AWB/Proof of shipment and such other documents as are provided for in the contract, but such payments will be subject to the deductions of such amounts as the Seller may be liable to pay under the agreed terms of the contract. No advance payments should be made, unless specified in the RFP. If so specified in the RFP and the contract, advance payment, not exceeding fifteen percent of the total value of the contract, may be made against appropriate Bank Guarantee as per the terms of the contract. Payment against a contract, the value of which does not exceed USD one hundred thousand should be made by Direct Bank Transfer.

Intimation regarding readiness of goods for dispatch: The Seller will be required to notify the Buyer within a specified period about the readiness of goods for dispatch.

Terms of Delivery

Standard Terms of Delivery: Standard terms governing delivery of goods are as follows:

a) Delivery of Goods shall be effected within specified days from the date of signing of the contract.
b) The date of delivery shall be the date of clean-on-board bill of lading/Air Way Bill.
c) Where inspection by the Purchaser prior to delivery is provided for, no stores will be considered ready for delivery until the Purchaser or his authorized representative certifies in writing that the stores have been inspected and approved by him.
d) Each contract will clearly specify the date of delivery/ date on which the items will be ready for inspection. The prescribed delivery schedule should be firm and not open-ended.
e) The stores will be shipped by sea/air as specified in the contract, all costs of packing, internal transportation, fees of forwarding agents, warehousing charges, port trust, dock and harbour dues and all other expenses, as may be incurred for the purpose and upto the point of delivery of the stores on board the nominated ship/air craft, shall be paid by the seller.
f) The contract or any part thereof, if delivered in more than one installment, shall be deemed to be complete, and the contract price for the delivered goods would become payable to the seller, only when all terms and conditions relevant to that delivery as per the provisions of the contracts have been completed.

g) The Goods are considered as delivered by the Sellers and accepted by the Buyer when they conform to the following:
   i. **In respect of quantity** – according to the number of packages in sound external condition and the weight shown in the shipping documents.
   ii. **In respect of quality** – according to the quality stated in logbooks/passports.

Inspection

Self-inspection: Under normal circumstances, the stores ordered may be accepted on the guaranty and warranty of the supplier. Towards this end, for acceptance of the inspected items or the entire batch/lot, the Seller shall also get the stores inspected by its Quality Assurance Department and furnish a certificate that the stores conform to the specifications laid down in the contract.

Inspection by the Buyer: However, where the contract specifies actual inspection by the Buyer, the Seller will arrange for the inspection, in consultation with the Buyer. The following guidelines will apply where inspection is required to be carried out:

(a) The stores shall be inspected in accordance with the provisions of the contract.
(b) Where inspection by the inspector is specified, the seller will give him sufficient advance notice of the date in writing on which the goods will be ready for inspection. The seller will also provide the inspector all the necessary facilities including appliances, tools, material and labour at no extra cost, to carry out the specified inspection. When independent tests and analyses, in addition to those made by the inspector on the seller's or sub-seller's premises, are considered necessary, the seller shall provide testing at Seller's expense and deliver, free of charge, at such place as the purchaser may direct, such materials as he may require for tests or analysis.
(c) If any of the products whether finished or in the course of production, are rejected by the inspector, they shall be marked and segregated in such a distinctive manner, to the satisfaction of the inspector, so as to ensure that they are identified as rejected products.
(d) The Buyer shall not be liable for payment for any rejected supplies or any costs of inspection thereof.
(e) The Seller shall at his own expenses and within the period of delivery, as specified in the contract, replace or make good, to the satisfaction of the inspector, any articles rejected on inspection.
(f) The decision of the inspector regarding mode, method, rejection or acceptance of the specified items/ entire batch/ lot will be final.
(g) The Buyer reserves the right to inspect the stores on arrival in India and discrepancy or defects found shall be reported to the Seller within fifteen months. The seller shall rectify the same within ninety days of receiving the intimation.

Packaging and Dispatch

The stores are required to be packaged to withstand normal conditions of shipment and short term storage in transit and in the country of destination and the following conditions will apply:

a) The Seller shall be responsible for any loss or damage or expenses incurred by the Purchaser because of inappropriate packages.
b) Packages containing articles classified as hazardous should be packed and marked in accordance with the requirements of the appropriate regulations governing their dispatch by sea or air.
c) The Seller shall also comply with the detailed packaging and dispatch instructions, if specified in the contract.
d) The responsibility of sending dispatch documents will rest with the Seller. Detailed shipping instructions issued from time to time by the Buyer will apply.

Warranty and Claims

All stores to be supplied should be free from all defects and faults in material workmanship and manufacture. They should be of the highest grade and consistent with the established and generally accepted standards for material of the type used and in full conformity with the specifications, drawings, or samples and shall, if operable, operate properly. The Seller shall be bound to furnish a clear written warranty regarding the same. In the event of the ultimate consignee in India not finding the stores in accordance with the order, the Seller will be required to replace them free of cost inclusive of all freight and handling charges. Such replacement will be done within ninety days of the claim report raised by the purchaser. These standard conditions will also apply in respect of replaced stores. This warranty shall remain valid for eighteen months after delivery or twelve months after their arrival at the ultimate destination in India, whichever is earlier, or as specified in the contract.

Warranty for use and storage in Indian conditions: The Warranty shall be applicable for use and storage of stores in Indian Climatic Conditions.

Technical Life: Technical life of the unit to be delivered for replacement will not be less than the remaining technical life of the faulty/defective/deficient unit being replaced, or the actual life of such a unit as specified in the contract, whichever is more.

Liquidated Damages

In the event of the Seller's failure to deliver the goods by the date specified in the contract the Buyer may deduct from the Seller as liquidated damages the sum of 0.5 % of the contract price of the undelivered goods for delay of each week or part of week and the Seller shall submit the documents after deduction of the liquidated damages subject to a maximum of

10% of the contract price of the undelivered goods. But if the delay is on account of any cause, which the Seller promptly notifies to the Buyer and the Buyer admits as a reasonable ground for extending the time for delivery, no liquidated damages will be leviable during the additional time thus agreed to by the Buyer.

Force Majeure

Neither party shall bear responsibility for the complete or partial non-performance of any of its obligations (except for failure to pay any sum which has become due on account of receipt of goods under the provisions of the contract), if the non-performance results from such Force Majeure circumstances as Flood, Fire, Earthquake and other acts of God, as well as War, Military operations, blockade, Acts or Actions of State Authorities or any other circumstances beyond the control of the parties that might arise after the conclusion of the contract.

Intimation regarding Force Majeure: The party for which it becomes impossible to meet obligations under this contract due to Force Majeure conditions, is to notify in written form the other party of the beginning and cessation of the above circumstances immediately, but in any case not later than ten days from the moment of their beginning.

Certification of Force Majeure: Certificate of a Chamber of Commerce (Commerce and Industry) or other competent authority or organization of the respective country shall be a sufficient proof of commencement and cessation of the above circumstances.

Extension of Time: In such circumstances, the time stipulated for the performance of an obligation under the contract is extended correspondingly for the period of time of action of these circumstances and their consequences.

Right to terminate contract: If the impossibility of complete or partial performance of an obligation lasts for more than six months, either party to the contract reserves the right to terminate the contract totally or partially upon giving prior written notice of thirty days to the other party of the intention to terminate without any liability, other than reimbursement on the terms provided in the agreement/ contract for the goods received.

Termination of Contract

The Buyer, without prejudice to any other remedy for breach of contract, by written notice of default sent to the Supplier, may terminate the contract in whole or in part:

a) If the Supplier fails to deliver any or all of the Goods within the period(s) specified in the Contract, or within any extension thereof granted by the Buyer.
b) If the Supplier fails to perform any other obligation(s) under the contract.
c) If the Supplier becomes bankrupt or otherwise insolvent.

d) If the Supplier, in the judgment of the Buyer, has engaged in corrupt or fraudulent practices in competing for or in executing the contract.

For the purpose of this clause: "corrupt practice" means the offering, giving, receiving, or soliciting of anything of value to influence the action of a public official in the procurement process or in contract execution.

"Fraudulent practice" means misrepresentation of facts in order to influence the procurement process or the execution of a contract to the detriment of the Buyer, and includes collusive practice among Bidders (prior to or after bid submission) designed to establish bid prices at artificial non-competitive levels and to deprive the Buyer of the benefits of free and open competition.

REPAIR CONTRACTS WITH FOREIGN AND INDIGENOUS FIRMS

The contracts for repair of equipment by foreign/indigenous firms are generally formulated and processed in the same manner as the contracts for procurement of stores from foreign/indigenous sources. However, in some respects, repair contracts are different from procurement contracts as they have some unique features related to their processing, as also the terms and conditions of contracts, as set out in this section. The provisions of this chapter would also apply to repair contracts with indigenous firms. The term "Customer" used in this Section shall mean the President of India acting through the officer signing the contract and the term "Contractor" would mean the firm undertaking the repair as per the contract.

Unique features related to processing of repair contracts

Preparation of Indents: The repair indent, to be sent by the Indentor to the Procuring Agency, should clearly specify the type of equipment, Quantity, type of repairs, history of previous major repair, name of the manufacturer, Total Technical Life (TTL), assessed cost of the repair, etc,. The amount should preferably be assessed or, if such assessment is not feasible, obtained through a non-obligatory budgetary quote from all the possible sources, including the OEM.

Selection of Vender: The repair should be carried out by the original equipment manufacturer only. In case the original equipment manufacturer expresses inability to undertake the repairs, any agency authorized by the OEM may be approached. In the event of the OEM expressing difficulty to undertake repairs and there being no OEM authorized agency to undertake repairs, other possible sources may be approached. The contractor has to be made accountable for the performance of the equipments. There should be suitable PBG and Warranty Guarantee provisions in the contract. In the case of Local Repair Contracts the repairs may be got done directly through trade, if considered feasible, within the delegated powers of the CFAs.

Request for Proposal: The Request for Proposal should be carefully drafted and should invariably include the following:-

a) Description/Part No. of item(s)/equipment for repair
b) Quantity
c) Year of manufacture of the equipment
d) Name of the manufacturer
e) Period of usage
f) Number and types of major repairs already carried out
g) Details of repairs/work required
h) Schedule for delivery of equipment for repair and completion of task
i) Any additional data/material, like photographs etc., indicating type of malfunction of the defective equipment
j) QA requirements including the acceptance testing norms and methodology of acceptance testing), wherever applicable
k) Any other relevant information

Terms and Conditions Unique to Repair Contracts

Terms of Delivery: The following terms of delivery of equipment, which are specific to repair contracts, should be included in the RFP and the contract:

a) The customer shall deliver the repairable equipment to the Contractor as per the terms of the Contract within thirty days of the signing of the contract. The period of delivery may be varied but it should be fixed in advance and indicated in the RFP.
b) The equipment shall be dispatched for repair in the condition as specified in the Contract, fully equipped with the details of all detachable and removable units/parts.
c) Together with the equipment, the Customer shall send the technical documentation (Certificates, Logbooks, etc.), containing the total usage time, the usage time after repair, the number of repairs, the reason for dispatching of the equipment for repair, and also information about the scheduled servicing. Documents shall have records of operating time and maintenance checks executed on the equipment.
d) The Customer shall not dispatch for repair incomplete or damaged equipment, which requires additional repair by the same Contractor and not provided for in the contract.
e) If available, the Customer shall provide the spares for replacement along with the equipment, as per the terms of the Contract.

Unforeseen Repairs: The following terms and conditions relating to unforeseen repairs should also be included in the RFP and the contract:

(a) If during the process of repair it is found that the equipment is incomplete, damaged or cannot be repaired in terms of the contract, the Contractor shall, if

possible, install missing parts of the equipment or change parts of the equipment which cannot be repaired only in consultation with the Customer.

(b) The Customer shall pay additional cost to the Contractor for the new/changed spare parts (units, sub modules, PCBs, etc). The cost of such parts shall be mutually agreed upon by both the parties to the contract and an Additional Agreement shall be signed by the Customer within sixty days after the date of handing over of the equipment to the Contractor. If there is no possibility of installing missing parts, the Contractor shall inform the Customer about this within thirty days from determination of the technical condition of the equipment but not later than sixty days after receipt of the equipment for repair.

Delivery

Date of Delivery to the Contractor: The date of delivery of the equipment for repair is the date on which the delivery-acceptance report is signed by representatives of the Contractor and the Customer.

Date of Delivery to the Customer: The date of delivery of the equipment after repair is the date on which the delivery-acceptance report is signed by representatives of the Contractor and the Customer.

Period of Delivery to Customer: The Contractor should deliver the duly repaired equipment to the Customer within three months from date of opening of the Letter of Credit, or the period as specified in the Contract. The delivery should normally be effected on CIP/CIF Indian Airport/Seaport in case of foreign contracts, unless specified otherwise in the Contract.

Terms of Payment

In the Case of Contracts with Foreign Firms: Payment for repair of the equipment should be effected by the Customer by opening irrevocable divisible Letter of Credit or by Direct Bank Transfer in favour of the Contractor for the full contracted cost of repair, or for such other amount(s) linked with clearly identifiable milestones as is agreed upon and provided for in the contract. The Letter of Credit should be opened within the period specified in the contract after the receipt of equipment by the Contractor for repair.

In the case of Contracts with Indian firms: Payment to indigenous firms should be made as per the terms of the contract through the paying authorities concerned.

Acceptance of Quantity and Completeness of Equipment

Acceptance of Quantity and Completeness of Equipment in Case of Foreign Contracts: The equipment shall be considered as delivered by the Contractor and accepted by the Customer

with regard to the quantity and completeness of the equipment in accordance with the quantity and completeness of equipment specified in the corresponding shipping documents.

Acceptance of Quantity and Completeness of Equipment in Case of Indigenous Contracts: The equipment shall be considered as delivered by the Contractor and accepted by the Customer with regard to the quantity and completeness of the equipment in accordance with the provisions of the contract.

Claims

Claim of the Customer: It should be specifically provided for in the RFP and included in the contract that the Customer has the right to make claim on the Seller for:

a) *Quality of the Repaired Equipment* – in case of its nonconformity to the quality specified in the Customer's Quality Assurance norms for repairs/overhaul/storage of the equipment, as specified in the Contract;
b) *Quantity of the Repaired Equipment* – in case of nonconformity of quantity to those specified in the packing list (shortage inside packing) on condition that the repaired equipment arrived at the place of destination in undamaged packing or in case the responsibility of the Carrier has not been specified/provided in this regard.

Period for Lodging Claims: The claims for shortfall in quality and quantity of the repaired equipment should be lodged (in case of proven fault of the Contractor) not later than sixty, ninety or one hundred twenty calendar days as per deliveries by Road (in the case of repair contracts with indigenous Contractors), Air or Sea respectively, from the date of receipt of repaired equipment by the ultimate consignee. This should be specified in the RFP and the Contract.

Particulars to be Specified in the Claim: The claim should specify the quantity and description of the defective repaired equipment, subject of and reason for the claim.

Guarantees

Guarantees regarding Technical Life, Breakdown, etc.: The following terms relating to guarantee of the repaired equipment should be included in the RFP and the contract:

a) Technical life period of the repaired equipment shall be stated in passports, logbooks and other technical documents submitted by the Contractor to the Customer.
b) All the breakdowns and deficiencies which may occur within the warranty period without a fault of the Customer shall be set right within ninety days, all the expenses being paid by the Contractor.

Warranty/Guarantee to be Specified: Warranty and Guarantee periods of repaired/replaced parts should be specified in the RFP and the repair contract.

MODULE-V

DEFENCE TENDERS AND BIDDING

TENDERS AND TENDERING PROCEDURES

CONCEPT AND MEANING OF TENDER

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

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

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

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

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

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

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

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

The Supreme Court further in *Siemens public communication Net Work(P) Ltd Vs. Union of India* AIR 2009 SC 1204 unambiguously observed that the decision making process of Government or its instrumentality should exclude remote possibility of discrimination, arbitrariness and favoritism. It should be transparent, bona fide and in public interest. In

another case, the Supreme Court approved the Swiss challenge method under taken by the state in the case of *Rani Development Vs. Shre Krishna Prathisthan* 2009(7) SCC 462. The Supreme Court further examined the award of contract in light of Article 14, and held that the action taken by authorities in awarding contract can be judged and tested in the light of Article 14 as in the case of *Meerat Development Authorities Vs. Ass. Of Management Studies*2009 (6) SCC 171. Concerning binding nature of tender conditions (NIT condition)the Supreme Court in Ramanna Case held that "It is well settled rule of administrative law that an executive authority must be rigorously held to the standards by which it professes its action to be judged and it must scrupulously observe those standards on pain of invalidation or violation of them". This rule was enunciated by U.S. Supreme Court in *Vitervalli Vs. Saton* 359 U.S. 535 in the following words.

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

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

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

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

In another case wherein it is reported in AIR 1982 Gahuathi 37 in the case of *Omega Advertising Agency Vs. State Electricity Board* where the state Electricity Board issued a notice inviting offers from advertisements fulfilling certain conditions as per NIT. One of applicants fulfilled the essential conditions, while the others had not, in this situation, the state electricity board decided to split its work between the two. The Assam High Court set aside the division of splitting the work by declaring the action of instrumentalities as being

against the tenor of notice inviting offer, and further declared that the action amounts to discrimination under Article 14, as authority had awarded the contract to a person who was not qualified according to the prescribed standards.

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

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

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

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

said power is exercised for any collateral purpose the exercise of that power will be struck down".

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

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

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

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

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

TENDERING PROCEDURE

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

Objectives: The objectives of a Tender are to purchases the best at the lowest price, infuse healthy competition amongst prospective suppliers/contractors to achieve the above

objective, adopt a method of selection of the supplier / contractor which is fair to all the suppliers/contractors particularly where competition is heavy and avoid malpractices.

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

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

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

Tendering Methods: There are three tendering methods which are

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

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

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

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

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

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

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

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

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

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

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

(i) transparency in tendering system,
(ii) Receipt and Opening of Tenders,
(iii) Members of Tender Committee,
(iv) Tender Process,
(v) Tenders,
(vi) Shortcomings in Bid Documents,
(vii) Irregularities in the Award of Contracts,
(viii) Notice Inviting Tenders,
(ix) Clause about submission of samples,
(x) Delays in Payments,
(xi) Appointment of Consultants,

(xii) Mobilization of Advances,
(xiii) Back to back Tie up by Public Sector Undertakings,
(xiv) Works/Purchase/Consultancy Contracts awarded on Nomination basis and
(xv) Transparency through effective use of Websites.

TENDERING UNDER DEFENCE PROCUREMENT

Types of Tendering

Procurement of goods by obtaining bids: Except for cases (purchase of goods without obtaining quotations, purchase of goods through Purchase Committee and purchase of goods against Rate Contracts), goods should be procured by adopting one of the following standard methods of obtaining bids:

(a) Advertised Tender Enquiry (also known as Open Tender Enquiry);
(b) Limited tender Enquiry; and
(c) Single Tender Enquiry.

Procurement of Services: The above mentioned methods will also be applicable for procurement of services, subject to other instructions contained in the Defence Procurement Manual being followed.

Advertised Tender Enquiry/Open Tender Enquiry (ATE/OTE)

The Open Tendering system should be the preferred mode for procurement of common use items of generic or commercial specifications which are readily available off-the-shelf in the market from a wide range of sources/vendors. It must be adopted in all such cases in which the estimated value of the tender is more than Rs twenty five lakhs, subject to the exceptions as provided for in this Section.

Global Tender Enquiry: Where it is felt that the goods/services of the required quality, specifications, etc., may not be available in the country and it is necessary to also look for suitable competitive offers from abroad, copies of the tender enquiry may be sent to the Indian embassies abroad as well as the foreign embassies in India. The selection of embassies would depend on the possibility of availability of the required goods/services in such countries. The tender enquiries may also be sent through the Defence Attachés wherever they are posted in the Embassies and High Commissions.

Publicity: Open tender system involves wide publicity through advertising media (Press, Trade, Journals etc). Open tender notifications should be sent to the Director General of Commercial Intelligence and Statistics, New Delhi for publication at least in one leading daily, which has a wide circulation. Such notifications should also be published in the bulletin, if any, of the Service/Department concerned.

Preparation of the Notice Inviting Tender: The Notice Inviting Tender (NIT), to be published in the journals/newspapers in the case of Advertised/Open Tender Enquiry, should be carefully drafted. It should contain salient features of the requirement in brief to give a clear idea to the prospective tenderers about the requirements. Superfluous or irrelevant details should not be incorporated in the tender notice, as it will needlessly increase the cost of advertisement. The tender notice should normally contain the following information:

(a) Description and specification of the goods and quantity
(b) Period and terms of delivery
(c) Cost of the tender/bidding document
(d) Place(s) and timing of sale of tender documents
(e) Address of the website from where the tender document could be downloaded
(f) Place and deadline for receipt of tenders
(g) Place, time and date for opening of tenders
(h) Amount and form of Bid security/Earnest Money Deposit
(i) Any other important information

Publicity through the website: All OTE notifications in respect of nonlethal/security and non-sensitive items should invariably be posted on the website of the Ministry of Defence, as also on the websites of the Service HQ/Department concerned, wherever such websites already exist. A link may also be provided to the NIC website. The website address should also be given in the notifications advertised through the ITJ and the newspapers.

Direct dispatch of tender documents: In case of OTE, Notice Inviting Tenders (NIT) and/or tender forms may also be sent to all suppliers registered for the particular range of items.

Tender documents on the website: The complete tender document should be posted on the website and the prospective bidders should be permitted to make use of the documents downloaded from the website. If such a downloaded document is priced, there should be clear instructions for the bidder to pay the amount by demand draft, etc., along with the bid. Such documents must be secured to avoid possibility of modification and restriction of access to bidders.

Time to be given for submission of bids: Ordinarily the minimum time to be allowed for submission of bids should be three weeks from the date of publication of the tender notice or availability of the bidding document for sale, whichever is later. Reduced time frame for submission of bids may be adopted in the case of emergent local purchase of supplies, provisions and medicines by use of FAX, e-tendering etc. as permissible.

Unregistered firms claiming compliance: In OTE cases, where an unregistered firm claiming compliance of technical specifications meets the laid down technical parameters detailed in the RFP, before opening the commercial bid of such firm, assessment of capability of the firm by procuring/registering agency would be mandatory. This capability verification will,

however, not amount to automatic registration of the firm by the Registering Authority. However, in the case of specialized and critical medical equipment/stores, where DGQA and DGS&D are presently not registering the firms on the grounds that SPQR are not formulated by them but by the users, manufacturers of national repute or their authorized agents may be considered, based on financial status and market reputation/past performance of the firm, as at present.

Limited Tender Enquiry (LTE)

This method may be adopted when estimated value of the goods to be procured is up to Rupees Twenty-five lakhs. Normally, the number of supplier firms in Limited Tender Enquiry should be more than three. However, Limited Tender Enquiry may be resorted to also when there are only two or three known sources of supply.

Limited Tender Enquiry in Special Circumstances: Purchase through Limited Tender Enquiry may be adopted even where the estimated value of the procurement is more than Rupees twenty five lakhs, in the following circumstances, subject to approval by the CFA and in consultation with the IFA, where required as per delegation of financial powers:

(a) The Indenter certifies that the demand is urgent and any additional expenditure involved by not procuring through advertised tender enquiry is justified in view of urgency. The nature of the urgency and reasons why the procurement could not be anticipated should also be placed on record.
(a) b) There are sufficient reasons, to be recorded in writing by the competent authority, indicating that it will not be in public interest to procure the goods through advertised tender enquiry.
(b) The sources of supply are definitely known and possibility of fresh source(s) beyond those being tapped is remote.
(c) (d)The nature of item to be procured is such that pre-verification of the competence of the firms and their registration is essential.

Publicity and dispatch of tender documents: Copies of the bidding document should be sent directly by speed post/registered post/ courier/email/fax to firms which are borne on the list of registered suppliers for the goods in question. Copies of the bidding documents should also be sent by registered post to the firms to whom these are initially sent by fax/email. Web based publicity should be given for Limited Tender Enquiry also and efforts should be made to identify a higher number of approved suppliers to obtain more responsive bids on competitive basis.

Time to be given for submission of bids: Sufficient time, normally ranging from one to three weeks, should be allowed for submission of bids in Limited tender Enquiries. For perishable goods or consumables a reduced time frame may be followed.

Unregistered firms claiming compliance: Though normally no such occasion should arise in the case of LTE, some unregistered firms may nevertheless submit unsolicited bids. In such cases action may be taken as follows:

(a) If it is a two-bid tender, the technical bid of the firm may be opened and evaluated, where procurement does not involve any trials. If the firm is found to be technically compliant, further action may be taken as per provisions of paragraph 4.2.9 of this Manual, provided it does not entail any delay in procurement, defeating the very purpose of procurement.
(b) If the firm is not found to be technically compliant, further cognizance of the tender need not be taken and the firm advised accordingly, with the advice to apply separately for registration.
(c) In a single bid tender, the tender may be considered if it does not involve any trials or does not result in delay in procurement.

Single Tender Enquiry (STE)

Procurement from a single source may be resorted to with the prior approval of the CFA and in consultation with the IFA, where required as per delegation of financial powers for reasons to be recorded in writing in the following circumstances, after determining reasonableness of the rates:

(a) In a case of emergency/urgency, the required goods are necessarily to be purchased from a particular source.
(b) On account of any other operational or technical requirement, which should, however, be clearly recorded.

Reasons for recommending procurement on STE: Wherever applicable, the Indentor should communicate to the Procuring Agency the reasons for recommending STE.

STE to be sent only to OEMs and registered firms: STE should generally be sent to the OEM or to a registered firm.

Procurement on the basis of the Proprietary Article Certificate (PAC)

PAC Tendering: Certain items, particularly equipments, are the propriety product of a manufacturing firm. Such items are only available with that firm or their dealers, stockists or distributors as the detailed specifications are not available for others to manufacture the item. Situations may also arise when, for standardization of machinery or ensuring compatibility of spare parts with the existing sets of equipment, as per the advice of the competent technical expert, goods and services have to be obtained from a particular source. In such situations, a Propriety Article Certificate (PAC) may be issued to the original equipment manufacturer (OEM) and items procured on PAC basis from that particular firm or its authorized dealers,

stockists or distributors. While PAC is issued only in respect of the concerned OEM, the item may be bought from any dealer, stockist or distributor specified in that particular PAC on the basis of the information provided by the OEM, provided the purchase is accompanied by a proper manufacturer certification. PAC once issued will be valid for two years from the date of issue unless cancelled earlier by the CFA.

Repairs/servicing on the basis of PAC: The provisions of above paragraph would also apply to repairs and servicing of equipment through the sole dealer/servicing agency, authorized by the OEM, if the main equipment was purchased on the basis of PAC.

Caution to be exercised while granting PAC: PAC bestows monopoly and obviates competition. Hence, PAC status must be granted after careful consideration of all factors like fitness, availability, standardization and value for money. Many OEMs do not manufacture assemblies, subassemblies and components but outsource these items. Hence, such items may be available at cheaper prices with the actual manufacturers. The procurement officers must, therefore, keep abreast of the proper source knowledge and procure items from the right source to protect the interest of the State. However, the spares have to be sourced from OEM or OEM approved/recommended manufacturers only in order to make the OEM responsible for the malfunctioning of the main equipment in which the spares have been fitted.

The PAC Certificate should be as per the following format.

Proprietary Article Certificate

(Description of Goods/services): _____

It is certified that:

i. The goods are manufactured/services are provided by ……... (name of the OEM)
ii. No other make or model/service provider is acceptable for the following reasons:
    (a) ...…….
    (b) …….
    (c) …….
iii. M/s …… (name of the firm) are the authorized dealer/stockist/distributor of the OEM/original service provider.
iv. Concurrence of integrated finance to grant this PAC has been obtained vide _____.
v. Grant of this PAC has been approved by _____ as the competent authority, vide…….

(Signature with date and designation of the Officer signing the PAC)

Single and Two Bid Systems

Single Bid system: For stores available commercially off-the-shelf (COTS) and LP items, where qualitative requirements and technical specifications are clear, single commercial bid system may be followed. This system may also be followed for other procurements of non-complex nature. No sample should be called for in single bid system at the RFP stage.

Two bid system: For purchasing high value plant, machinery, equipment, IT and communication systems and for turnkey projects, etc., which are of a complex and technical nature or for procurement of items which have indeterminable parameters, such as shade, tone, make-up, feel, finish and workmanship, etc., bids should normally be obtained in two parts as follows:

(a) Technical bid consisting of all technical details along with commercial terms and conditions; and
(b) Financial bid indicating item-wise price for the items mentioned in the technical bid and all other commercial terms and conditions.

Description of the user requirement: The RFP should lay down user requirements in a comprehensive, structured and concrete manner and should be broad based. The user requirements should be expressed in terms of functional characteristics. Its formulation must not prejudice the technical choices by being narrow and tailor-made. Specific Quality Assurance requirements, if any, should be included in the RFP.

Manner of submission of bids in two bid system: The technical bid and the financial bid should be sealed by the bidder in separate covers duly superscribed and both these sealed covers are to be put in a bigger cover which should also be sealed and duly superscribed. The technical bids are to be opened and evaluated in the first instance. At the second stage, financial bids of only the technically acceptable offers should be opened for further evaluation and ranking before awarding the contract.

Performance parameters: The performance parameters should be verifiable and provide for the minimum essential military requirements. Fulfillment of essential parameters mentioned in the RFP would be the basis for further consideration by TEC (Technical Evaluation Committee).

Cost of Tender and Bid Security/Earnest Money Deposit

The cost of the Tender document: Tender sets in respect of Advertised (Open) Tender Enquiry will be sold on payment of the prescribed price given below.

	Estimated value of the Tender	**Price of the Tender Set (Rs.)**
1.	Upto Rs 50 lakhs	100
2.	More than Rs 50 lakhs but upto Rs 1 crore	250

3.	More than Rs 1 crore but upto Rs 5 crores	500
4.	More than Rs 5 crores	1000

Note: Cost of drawings and specifications will be extra. This may be decided in consultation with integrated finance at the time of issuing the RFP.

Bid security: To safeguard against a bidder's withdrawing or altering his bid during the bid validity period in the case of advertised or limited tender enquiry, Bid Security (also known as Earnest Money Deposit) is to be obtained from the bidders. The bidders should be asked to furnish the bid security along with their bids.

Amount of Bid Security: Amount of bid security should ordinarily range between two percent to five percent of the estimated value of the goods to be procured. The exact amount of bid security should be determined judiciously while processing the proposal for CFA's approval and indicated in the RFP.

Form of Bid Security: The bid security may be accepted in the form of Account Payee Demand Draft, Fixed Deposit Receipt, Banker's Cheque or Bank Guarantee from any of the public sector banks or a private sector bank authorized to conduct government business, as per Form DPM-13, safeguarding the purchaser's interest in all respects.

Validity of the Bid Security: The bid security is normally to remain valid for a period of forty-five days beyond the final bid validity period.

Refund of Bid Security of Bidders: Bid securities of the unsuccessful bidders should be returned to them at the earliest after expiry of the final bid validity and latest on or before the 30th day after the award of the contract. The Bid Security of the successful bidders should be returned, without any interest whatsoever, after the receipt of Performance Security from them as called for in the contract.

Exemption from Submission of Bid Security: Bid security is not required to be obtained from those firms who are registered with the Central Purchase Organization (e.g. DGS&D), National Small Industries Corporation (NSIC) or concerned Departments or Ministries of the Government of India. Bid security need not be asked for if the value of the tender is Rs two lakh or less.

Forfeiture of the Bid Security: The bid security/earnest money will be liable to be forfeited if the bidder withdraws or amends, impairs or derogates from the tender in any respect within the validity period of his tender. No separate order is required for forfeiture of Bid Security which follows on default and should be credited at once to the Government Account.

Tendering Process

Expression of Interest: In those cases where specifications of the desired goods or services are not clear or the sources are not known and it is considered desirable to resort to pre-

qualification of suppliers, a notice calling for expression of interest/information may be issued and pre-bid conference may be held with the firms which fulfill the criteria prescribed in the notice to firm up the Qualitative Requirements (QRs)/specifications before issuing the Request for Proposal.

Preparation of the Request for Proposal/Tender Enquiry: The Request for Proposal (RFP), also called Tender Enquiry (TE), is the most important document in the procurement process. The RFP should be prepared with due care and with complete details of the items or services required, terms and conditions including payment terms, and clear instructions to the bidders. The RFP should contain full and clear specifications, scope of requirement and the evaluation criteria, both for technical bids and commercial bids. RFP should be vetted by integrated finance in those cases where financial powers are to be exercised with their concurrence.

Reference to Brand Names in the RFP: Standards and specification, quoted in bidding documents in generic terms shall promote the broadest possible competition while assuring the critical performance or fulfillment of other requirements for the goods. Reference to the brand names, catalogue numbers, etc. in the RFP should be avoided.

Format of RFP: The suggested format for the RFP for indigenous procurement of goods and services as defined in Chapter 1 of Defence Procurement Manual is given at Appendix 'C'. The specimen format is based on various instructions contained in Defence Procurement Manual and, therefore, it should generally not be changed, except for minor changes relating to the text to suit the requirement of a specific proposal or deletion of clauses that may not be applicable in a particular case. It must be borne in mind that no clause should be incorporated in the contract/supply order if it was not mentioned in the RFP as inclusion of clauses in the contract which did not figure in the RFP would amount to unfair denial of opportunity to other suppliers.

Receipt of tenders

Tender Box: In order to ensure that the bids are received by the purchaser in time, a tender box is to be placed in an easily accessible but secured place, duly locked and sealed, clearly indicating the name of the department. The words "Tender Box" should be written on the box in bold font.

Delivery of Bids by Hand: In cases where the tenders are required to be submitted by hand, it may be ensured that the names and designation of at least two officers are mentioned in the bid documents. The information about these officers should also be displayed at the entrance reception of the premises where tenders are to be deposited so as to ensure convenient approach for the bidders.

Amendment to the RFP and Extension of Tender Opening Date

Amendment to the RFP: Sometimes situations may arise necessitating modification of the tender documents already issued (in Limited Tender Enquiry cases) or already put on sale (in Advertised/Open Tender Enquiry cases) due to change in the required quantity or specifications. In some cases, after receiving the documents, a tenderer may point out some genuine mistakes necessitating amendment in the tender documents. In such situations, it may become necessary to amend/modify the tender documents suitably prior to the date of submission of bids. Copies of such amendment/ modification should be simultaneously sent to all the selected suppliers by registered/speed post/ courier/e-mail in case of Limited Tender Enquiry. In case of Advertised/Open Tender Enquiry, copies of such amendments/ modifications should be dispatched simultaneously free of cost by registered/speed post/courier/e-mail to all the parties who may have already purchased the tender documents and copies of such amendments are also required to be prominently attached to the unsold tender documents (which are available for sale), including the tender documents put on the website.

When the amendment/modification changes the requirement significantly and/or when there is not much time left for the tenderers to respond to such amendments, and prepare revised tender, the time and date of submission of tenders are also to be extended suitably, along with suitable changes in the corresponding time-frames for receipt of tender, tender validity period etc and validity period of the corresponding EMD/Bid security. Depending on the situation, such an amendment may also need fresh publication adopting the same procedure as for publication of the original tender enquiry.

Extension of Tender Opening Date: Even in those cases where extension of tender opening date does not become necessary because of the amendment to the RFP, the Competent Financial Authority, with the concurrence of integrated finance, where required as per delegation of financial powders, may extend the date of opening of the tender as specified in the RFP but such extension should not exceed the total delivery period envisaged in the RFP. Any further extension would require approval of the next higher CFA. Such extensions and amendments should be published in the same journals/newspapers in which the original RFP was published and must be given publicity through the website if the original RFP was hosted on the website.

Extension of Tender Opening Date After Due Date of Opening: In exceptional circumstances, date of opening of the tender may be extended within a reasonable period after the due date of the opening of tenders for reasons to be recorded in writing, with the approval of the higher CFA and in consultation with the IFA, where financial powers are to be exercised with the concurrence of integrated finance.

Tender Opening

Opening of Tenders Under Single Bid System: The following procedure should be followed for opening of tenders:

(a) All the tenders received on time should be opened in the presence of authorized representatives of the tenderers at the prescribed time, date and place by the official/Tender Opening Committee, to be nominated by the CFA in advance. The authorized representatives, who intend to attend the tender opening, would be required to bring with them letters of authority from the tenderers concerned.

(b) The tender opening official/committee should announce the salient features of the tenders like description and specification of the goods, quoted price, terms of delivery, delivery period, discount if any, whether EMD furnished or not and any other special feature of the tender for the information of the representatives attending the tender opening.

(c) After opening, every tender should be numbered serially, initialed, and dated on the first page by the official(s) authorized to open the tenders. Each page of the price schedule or letter attached to it shall also be initialed by them with date, particularly the prices, delivery period etc., which should also be circled and initialed indicating the date. Blank tenders, if any, should be marked accordingly by the tender opening officials.

(d) Alterations in tenders, if any, made by the tenderers, should be initialed with date and time by the official(s) opening the tenders to make it perfectly clear that such alterations were present on the tenders at the time of opening.

(e) Wherever any erasing or cutting is observed, the substituted words should also be encircled and initialed with date and time to make clear that such erasing/cutting of the original entry was present on the tender at the time of opening.

(f) The tender opening official(s) should prepare a list of the representatives attending the tender opening and obtain their signatures on the list. The list should contain the representatives' names and the corresponding tenderers' names and addresses. The authority letters brought by the representatives should be attached with this list. This list should be signed by both the tender opening official(s) with date and time.

(g) An on-the-spot report containing the names of the tenderers (serial number wise) salient features of the tenders, as read out during public opening of tenders should be prepared by the tender opening official(s) duly signed by them with date and time.

(h) The tenders, which have been opened, the list of the representatives attending the tender opening and the on-the spot report should be handed over to the nominated officer of the procuring agency and acknowledgement obtained for the same.

Opening of tenders under two bid system: The procedure laid down in the preceding paragraph should be followed mutatis mutandis under two bid system also but only the technical bids should be opened in the first instance. Commercial bids of only QR-compliant

tenderers should be opened only after evaluation of the technical bids and approval of the TEC report by the CFA. The commercial bids of other tenderers, who are not found to comply with the QRs as above, will be returned to the tenderers, in sealed and unopened condition as received.

Evaluation of Technical Bids

Opening of Technical Bids: Where quotations are invited as separate technical and commercial bids, initially only the technical bids are to be opened in the presence of the tenderers or their duly authorized representatives.

Evaluation of Technical Bids: After opening of the technical bids, technical evaluation is to be carried by a duly appointed Technical Evaluation Committee (TEC).

Technical Evaluation Committee (TEC): TEC, wherever formed, should invariably have representatives of the user, designated inspecting agency, maintenance agency, procurement agency and CFA, apart from the Chairman. Finance representative need not be associated with the TEC.

Objective of the TEC: The main objective of the TEC is to prepare technical matrix showing how the technical parameters of bids received compare with the parameters mentioned in the tender document/RFP. If the offers conform to essential parameters they should be accepted.

Preparation of Compliance Report by TEC: The TEC should prepare a compliance statement bringing out the extent of variations and differences, if any, in the technical characteristics of the equipment/ tendered item(s) offered by various vendors with reference to QRs and compliance or noncompliance with the essential parameters. If considered necessary, the TEC may invite those vendors who meet essential parameters for technical presentation/clarification.

Format of the TEC Report: The TEC report should be prepared in the format as given at Form DPM-24. The following aspects should be kept in mind by the TEC:

(a) The basic profile/character of technical offer must not be permitted to be changed.
(b) Opportunity for revision of minor technical details should be accorded to all vendors in equal measure to ensure fair play.
(c) No extra time should be given to any vendor to modify his offer to make it QR compliant.
(d) Original commercial quotes must remain firm and fixed and no loading/unloading in price should be permitted during TEC's discussion with the vendor.
(e) No conditional offer should be accepted which is not in conformity with the specifications mentioned in the RFP.

Mandate of the TEC as regards commercial aspects: The TEC is not authorized to discuss commercial aspects of the case. However, the TEC should prepare a compliance statement in respect of commercial terms and conditions, such as bid security, warranty, etc., included in the technical bid as per the RFP.

Association of IFA: Whenever two bid system of tendering is followed, technical evaluation of the bid becomes a vital step not only for ascertaining conformity of the technical bids with the technical specifications mentioned in the tender, but also to bring all bidders on a level playing field in respect of qualitative requirements. While technical evaluation is to be carried out by the TEC and integrated finance need not be associated at this stage, CFA may, if considered necessary, evolve a system of associating the IFA or his representative in examination of the TEC Report in regard to compliance with the commercial terms and conditions before opening of the price bid. TEC report, once finalized, should be sent to CFA for acceptance.

Approval by the CFA: The TEC report should be approved by the respective CFA. TEC report may be accepted by Defence Secretary and Special/Additional Secretary in those cases where Raksha Mantri and Defence Secretary respectively are the CFAs.

QR-compliant Offers: Those offers which meet the essential parameters as per the TEC report, duly approved by the CFA, should be considered by the Commercial Negotiation Committee (CNC) which, in turn, should evolve methods for benchmarking of price and holding internal meetings to finalize approach for conducting negotiations with the L1 vendor, if considered necessary by the CFA, in consultation with the IFA where powers are to be exercised with the concurrence of integrated finance.

Revised Commercial Bids in Two Bid System: In case of procurement involving two-bid system, it may not be practicable to incorporate all possible details in the technical specification(s), thereby requiring elaborations/clarifications during technical discussion. This may necessitate submission of revised commercial bids consequent upon discussion during TEC/CNC. If the original price bids have not been opened, it would be advisable to give equal opportunity to all technically acceptable vendors to give their revised commercial bids in a sealed cover. The CNC would take into account the revised commercial bids to arrive at L1.

CFA's Approval for Obtaining Revised Commercial Bids: Before calling for revised commercial bids where original price bids have not been opened, approval of CFA should invariably be taken, after consulting integrated finance, where required as per delegation of financial powers. It is absolutely essential to give equal opportunity to all qualified vendors.

Evaluation of Commercial Bids

Preparation of the Comparative Statement of Tenders: After opening of the commercial bids (of QR-compliant tenderers in the case of two bid system and after approval of the TEC report by the CFA), the procuring agency should prepare a comparative statement of tenders (CST). The comparative statement of tenders should be prepared with due care showing each element of cost (basic cost, taxes, levies, etc.) separately against each tenderer. The CST should be prepared soon after opening of the commercial bids and got vetted by the IFA as to its correctness, where financial powers are to be exercised with the concurrence of integrated finance.

Commercial Evaluation: Evaluation of commercial bids is the core activity in any purchase decision. If the correct evaluation of quoted rates, freight, insurance, taxes, duties and other expenses involved is not carried out as per the criteria incorporated in the RFP, purchase decision may become deficient and faulty.

Commercial Negotiations: It is not mandatory to hold commercial negotiations in each case, particularly in open and limited tender cases, where the response has been substantial and the L1 price is found to be very close to the reasonable price, if such an assessment had been carried out prior to opening of the commercial bids. However, commercial negotiation may become necessary to ensure that the interest of the State is fully protected and the price paid is reasonable. Commercial negotiations are invariably conducted in case of single tender situations, including PAC cases, or when price is considered high with reference to assessed reasonable price, irrespective of the nature of tendering. Such negotiations are invariably conducted by a duly appointed Commercial Negotiation Committee (CNC), which should invariably include a finance member, unless the negotiation is carried out by the committee CFA itself.

Composition of CNC: Apart from the Chairman, there should be representatives of the User, Integrated Finance, designated Inspecting Agency, Maintenance Agency, Directorate concerned with post-contract management and the CFA, wherever applicable. CFA may nominate any other member, like a costing expert, in case of high value single vendor offers while constituting the CNC.

Chairman of the CNC: The CNC may be headed by an officer one rank below that of the CFA. The CNC may be headed by a Joint Secretary where Raksha Mantri or Defence Secretary is the CFA. The CFAs in the Ministry of Defence may also authorize an officer from the Services Headquarters to be the chairman of a CNC, particularly in those cases where the proposal was initially processed under the delegated powers but on opening of the tenders the cost was found to have exceeded the financial powers delegated to the CFAs in the Services Headquarters.

Price Reasonableness: The basic objective of the CNC is to establish reasonableness of price being paid by the Government. This is a complex task and many factors need to be considered. However, factors like the last purchase price (LPP), movement of price indices, the market intelligence regarding cost of the item or similar items, material composition, cost analysis of raw materials, technological complexities involved, whether the items are of current production or otherwise, maintenance requirements, requirement of spares and warrantee etc. need to be considered while examining price reasonableness.

Responsibility of the CNC: Wherever negotiations are conducted by the CNC, minutes of the CNC meetings should be recorded clearly and expeditiously. CNC should determine L1 and make unambiguous and specific recommendations giving reasons for making the recommendations. Detailed record of discussions regarding compliance with tendered QRs, price and contract clauses held during the CNC should be prepared and placed on record in the form of minutes of the meeting. All the members of the CNC should sign the minutes.

Acceptance of CNC's recommendations: The recommendations of the CNC should be processed on file by the Procuring Agency for the approval of the CFA with the concurrence of the IFA, wherever required as per the delegation of powers.

Lack of competition

The following situations would imply lack of competition:

(a) The number of acceptable offers is less than two.
(b) Ring prices have been quoted by all tenderers (Cartel formation).
(c) The product of only one manufacturer has been offered by all the tenderers irrespective of the number of quotations.
(d) Store under purchase is chronically in short supply against which the number of acceptable offers never exceeds two.

Resultant Single Vendor Situation

There are cases when only a single quote or a single valid acceptable quote is received even against LTE or OTE. This situation may arise in single bid tendering as well as in two-bid tendering before or after technical evaluation. This results in a single vendor situation indicating lack of competition. In such situations, the following aspects will be examined:

(a) Whether all necessary requirements such as standard tender enquiry conditions, industry-friendly specifications, wide publicity, sufficient time for formulation of tenders had been taken care of while issuing the RFP;
(b) Whether the RFP had been properly dispatched and duly received by the prospective vendors to whom these were sent.

(c) Whether the SQRs, particularly in the LTE cases, could be reformulated and made more broad based to generate wider competition.
(d) Whether time and criticality of requirement permits reformulation of the SQRs.

If the examination reveals that (a) and (b) had been complied with and (c) an (d) are not feasible, the proposal may be processed further treating it as a case of OTE or LTE as the case may be with the approval of the CFA. In case, however, there is any doubt about the tendering process or it is considered feasible to consider reformulation of SQRs without compromising on operational requirement, the RFP should be retracted and re-issued after rectifying the deficiencies and/or reformulating the SQRs.

Re-tendering

Re-tendering may be recommended by the CNC and approved by the CFA with the concurrence of integrated finance, where original sanction was accorded with the concurrence of integrated finance, with utmost caution, generally under the following circumstances:

(a) Offer(s) do not conform to qualitative requirements and other terms and conditions set out in the RFP.
(b) There are major changes in specifications and quantity, which may have considerable impact on the price.
(c) Prices quoted are unreasonably high with reference to assessed reasonable price or there is evidence of a sudden slump in prices after receipt of the bids.
(d) Where there is lack of competition and there are clear and reasonable grounds to believe that the lack of competition was due to restrictive specifications, which did not permit many vendors to participate. In such cases, which should, however, be rare as the specifications should normally be formulated with due care and after pre-bid conference, wherever required, CFA should consider if there is a possibility of reviewing the specifications to facilitate wider and adequate competition.

Withdrawal of offer by L1: In case the lowest tenderer withdraws his offer, re-tendering should be resorted to as per the instructions issued by the Central Vigilance Commission. While retendering RFP may not be issued to the vendor who had backed out and EMD, if any, of such a firm should be forfeited.

Procurement of bare minimum quantity in case of re-tendering: In cases where it is decided to resort to re-tendering due to unreasonableness of the quoted rates but the requirement is urgent/inescapable and re-tendering for the entire quantity is likely to delay the availability of the item(s) jeopardizing the essential operations, maintenance and safety, negotiation may be held with the L1 bidder for supply of a bare minimum quantity. The balance quantity should, however, be procured expeditiously through re-tender, following the normal tendering process.

Signing of Contracts/Placing of Supply Orders

Once the CNC recommendations are accepted by the CFA or approval accorded by the CFA in those cases in which no CNC is held, the contract should be signed or the supply order placed, as the case may be, immediately. It must be ensured that the contract/supply order is as per the approved terms and conditions and the rates are correctly shown as finally negotiated and accepted by the CFA. Contracts/supply orders should be vetted by the IFA, wherever required as per delegation of financial powers, prior to acceptance of the purchase proposal by the CFA. Copies of the contract/supply order should be sent to all concerned, including the IFA, the audit authority and the paying authority, and their acknowledgement obtained. The format for Contract and Supply Order is given in Appendix E and D of the Defence Procurement Manual respectively.

Cartel Formation/Pool Rates

Sometimes a group of tenderers quote identical rates against a rate contract tender. Such Pool/Cartel formation is against the basic principle of competitive bidding and defeats the very purpose of open and competitive tendering system. Such practices should be severely discouraged with strong measures. Suitable administrative actions like rejecting the offers, reporting the matter to Registrar of Companies, MRTP Commission, National Small Industries Corporation etc. should be initiated against such firms, on case to case basis, as decided by the competent authority. Ministries/ Departments may also examine the desirability of bringing such unhealthy practice to the notice of the concerned trade associations like FICCI, ASOCHAM, NSIC, etc. requesting them, inter alia, to take suitable strong action against such firms. New firms should also be encouraged to get themselves registered for the subject goods/services to break the monopolistic attitude of the firms forming cartels. All requests for making reference to outside agencies, such as Registrar of Companies or trade associations, are to be made to the Ministry of Defence.

Procedure to be Followed for Procurement of Stores Involving Validation/Testing

Circumstances in Which the Procedure is to be Followed: Due to constant changes in technology, various weapons, equipments, ammunition, etc., which are already in service, need to be replaced by newer variants or upgraded/refurbished/re-equipped/modified/ overhauled to incorporate advancements in technology. This may necessitate validation trials/testing of upgraded/refurbished/re-equipped/modified equipment, if considered necessary by the Service Headquarters concerned. The procedure set out in this paragraph would be applicable to cases processed at the level of the Ministry of Defence/Service Headquarters only and should be suitably indicated while seeking AON. Such cases will not be treated as new introduction into Service.

Categories of Cases: The cases to be processed under the provisions of this paragraph would generally fall into the following category:

a) Procurement of upgraded new versions of equipment, ammunition, vehicles, etc., which are classified as stores that can be procured from the revenue head, provided these conform to the existing laid down QRs and meet the prescribed performance parameters or certain enhanced parameters which have been incorporated as an amendment to the existing QRs.

b) Upgradation, refurbishment, re-equipment, modification, Technical Life Extension, Overhaul, etc. of weapon platforms/systems/aggregates which can be carried out under the provisions of this Manual and as per the existing orders. The upgradation, refurbishment, re-equipment, modification, overhaul, etc. may be carried out at OEM's premises abroad or in India, or partially in India and partially at OEM's premises abroad, or even at a venue such as a Repair Overhaul Plant (ROH) where the requisite facilities are available, which may neither be in India nor at the OEM's premises, provided it is certified by the OEM as having the technical capacity/capability.

Procedure to be Followed for Procurement of Stores: For procurement of items mentioned in paragraph 4.19.2 (a) above, the Service Headquarters should decide whether a validation process would be required and, if so, it should be indicated in the proposal. If such validation process (trial/testing) is considered necessary, the scope and duration thereof should also be finalized and indicated in the RFP. It should be mentioned in the RFP that the vendors which are found technically compliant would be required to provide specified quantities of the item on 'no-commitment-no-cost' basis for trial evaluation/testing. The period within which the Vendor must submit the equipment/sample after being found technically complaint must be indicated in the RFP. The Technical evaluation will be a two-stage process. After the technical bids are opened, the TEC will short-list the vendors, which are technically compliant, and the TEC Report will be approved by the CFA. Thereafter, the technically compliant vendors will go through the process of evaluation/testing. The evaluation/testing should ideally be completed within a period not exceeding eight months from receipt of the equipment/sample from the vendors. The Validation Trial/Testing report will be again ratified by the TEC and approved by the CFA.

Opening of Commercial Offer After Trial Evaluation/Testing: The commercial offer should be opened only after acceptance of the TEC/ Validation Trial/Testing Report of those vendors who have been recommended as technically compliant. The commercial offer should normally have a validity period of twelve months from the date of submission of the offer to ensure that the offer is still valid when the commercial bid is opened, commercial negotiations held and the order placed. A shorter validity period may be prescribed commensurate with the period of trial/testing.

Dispensing with Trial Evaluation/Testing: For equipment available commercially off-the-shelf (COTS), which are upgrades of in-service items and have requisite IS/BIS or equivalent certification, the Service Headquarters may accept the equipment on the basis of self-certification by the vendor without going through the validation/testing process, provided it is

confirmed by the QA Agency/AHSP or any other technical agency concerned. However, in such cases also TEC Report should be approved by the CFA.

Procedure to be Followed for Upgradation, Refurbishment, Re- Equipment, Modification, Technical Life Extension and Overhaul: For upgradation, refurbishment, the vendors should be short-listed with the prior approval of the CFA and with the concurrence of integrated finance and the short listed vendors may be provided an opportunity to survey the weapon platform/systems, etc., which is to undergo upgradation/refurbishment/reequipment/ modification/Technical Life Extension/Overhaul prior to issue of the RFP. In case the upgrade, refurbishment, etc. is to be done in India, the vendors should certify the capability and confirm the adequacy of the facility to the satisfaction of the Service Headquarters. If required, a Detailed Project Report (DPR) may be got prepared by the Service Headquarters after obtaining the AON but before issuing the RFP with a view to defining the scope and other technical details of the upgrade/OH programme.

Special provisions to be made in the RFP: The RFP for upgradation, refurbishment, etc. should invite technical and commercial offers separately and may also have a provision for pre-bid conference prior to submission of the offers so that the technical and other issues could be clarified to vendors. The RFP should ask the vendors to specify the location of the plant/factory where upgradation, refurbishment, etc. will be undertaken and whether the vendor owns the facility. If the facility is not owned by the vendor, a certificate of agreement between the OEM and the plant owner would be required to be submitted by the vendors along with their offer. There should be a provision in the RFP that one lead equipment (where there are more than one number) will be tested by the vendor along with the representatives of the Service Headquarters (either in India or abroad) before the balance equipments are taken up for upgradation, refurbishment, etc. In case of a single weapon platform, there should be a provision for concurrent testing along with the upgradation, refurbishment, etc.

Approval of the Final TEC Report and Opening of Commercial Offer: The TEC Report should be approved by the CFA and the commercial offer of the vendors who have been recommended as technically compliant should be opened only thereafter. This would be applicable in respect of cases covered by earlier paragraph.

Validity of the Offer: The commercial offer should have a validity of up to eighteen months from the date of submission of the offer, depending on the period required for completing the technical evaluation, so as to ensure that the offer remains valid till the time the order is placed/contract signed.

Assessment of the Vendor's Facility: If required and considered necessary, a composite delegation of representatives of the User Department, CFA and integrated finance may be deputed to visit the plant/factory of the vendor finally recommended by the CNC to assess

the capability/capacity of the selected vendors to carry out upgradation, refurbishment, etc. before commercial negotiations are finalized and approved by the CFA.

Instruction to Bidders

Subject to other specific provisions in the Defence Procurement Manual, the broad instructions for the prospective bidders are as follows:

(a) Eligibility: A firm registered with any Procurement/Registering Authority for the manufacture/supply of the tendered goods/services would be eligible to bid. An unregistered firm may get itself assessed for capacity/competency to manufacture/supply the tendered goods/services to become eligible to participate in tendering.

(b) Clarification regarding contents of the Bidding Documents: A prospective bidder who requires clarification regarding the contents of the bidding documents shall notify the purchaser in writing and the purchaser will respond in writing to the clarifications sought not later than fourteen days prior to the date of opening of the tenders. Copies of the query and clarification by the purchaser shall be sent to all prospective bidders who have received the bidding documents.

(c) Quotations to be submitted under original memos: Bids should be forwarded by vendors under their original memo /letter pad, inter alia, furnishing the TIN No., VAT/ CST No., Bank Address with EFT account No. and the complete postal and e-mail address of the firm.

(d) Amendment of Bidding Documents: At any time prior to the date of submission of bids the purchaser may, whether at his own initiative or in response to a clarification requested by a prospective bidder, may modify bid documents by amendments. The amendments shall be notified in writing to all prospective bidders. In order to afford prospective bidder a reasonable time to take the amendment into account in preparing their bids, the purchaser may, at his discretion, extend the deadline for submission of bids.

(e) Bid Validity: A bid shall remain valid for ninety days in case of single bid RFP and one hundred twenty days in case of two-bid system**,** unless otherwise specified, from the date of the opening of the tender. A bid valid for shorter period can be rejected by the purchaser, as being nonresponsive. In exceptional circumstances the purchaser may request the consent of the bidder for an extension to the period of bid validity. Such requests shall be made in writing. The bid security provided shall also be suitably extended. A bidder accepting the request and granting extension shall not be permitted to modify his bid.

(f) Late Bids: In the case of advertised tender enquiry or limited tender enquiry, late bids (i.e. bids received after the specified date and time for receipt of bids) should not be considered and returned unopened to the bidder.

(g) Modification and Withdrawal of Bids: A bidder may modify or withdraw his bid after submission provided that the written notice of modification or withdrawal is received by the purchaser prior to deadline prescribed for submission of bids. A withdrawal notice may be sent by fax but it should be followed by a signed confirmation copy to be sent by post and such signed confirmation should reach the purchaser not later than the deadline for submission of bids. No bid shall be modified after the deadline for submission of bids. No bid may be withdrawn in the interval between the deadline for submission of bids and expiration of the period of bid validity specified. Withdrawal of a bid during this period will result in Bidder's forfeiture of bid security.

(h) Clarification regarding contents of the Bids: During evaluation and comparison of bids, the purchaser may, at its discretion, ask the bidder for clarification of his bid. The request for clarification shall be in writing and no change in prices or substance of the bid shall be sought, offered or permitted. No post bid clarification on the initiative of the bidder shall be entertained.

(i) Agents of the supplier: One agent cannot represent two suppliers or quote on their behalf in a particular tender enquiry. Such quote should be rejected.

Instruction to the Purchase Officers

Subject to other specific provisions of the Defence Procurement Manual, the broad instructions for the purchase officers are as follows:

(a) Preliminary Examination: Purchaser shall evaluate the bids to determine whether they are complete; whether any computational errors have been made; whether required sureties have been furnished; whether essential documents such as the technical literature and Agency Agreement in the case of medical stores, etc., as specified in the RFP have been furnished; whether the bid documents have been properly signed; and, whether the bids are generally in order.

(b) Discrepancy in quoted price: If there is a discrepancy between unit price and the total price, the unit price shall prevail. If there is a discrepancy between words and figures, the amount in words shall prevail. If a supplier does not accept the correction of the errors, his bid should be rejected and the bid security may be forfeited.

(c) Trivial errors: Trivial errors such as omission to (i) enter the rates in words, (ii) initial any alteration in rates or (iii) sign both the tender and the schedules(s) may be corrected, initialed and dated both by the officers opening the tenders and signed and dated by subsequently by the tenderer.

(d) Responsiveness of the bid: Prior to detailed evaluation, the purchaser should determine the substantial responsiveness of each bid to the bid documents. A substantially responsive bid is the one which conforms to all terms and conditions of the bid documents without material deviations. Deviations from or objections or reservations to critical provisions like Bid Security, Warranty & Guarantee,

Applicable Law, Taxes and Duties and non-submission of documents such as valid Agency Agreement and technical literature in the case of medical stores should be deemed to be a material deviation.

(e) Evaluation and comparison of substantially responsive bids: The evaluation and comparison of responsive bids shall be done on the prices of the goods offered inclusive of all levies & taxes, such as VAT, Excise Duty and other charges such as Packing & Forwarding, Freight and Insurance etc., as indicated in the price schedule of the Bid document but exclusive of Octroi/Entry Tax, which is to be paid extra as per actual, wherever applicable.

(f) Award Criteria: The purchaser will award contract to the successful bidder whose bid has been determined to be substantially responsive and has been determined to be the lowest evaluated bid, provided further that the bidder is found to be technically, commercially and financially acceptable and whose goods have been type-approved/validated by the purchaser. The purchaser reserves the right to counter offer price(s) against price(s) quoted by any bidder.

(g) Waiver of QRs/parameters: There should be no waiver of parameters after the issue of RFP as this may result in denial of opportunity to firms which could have met the revised essential parameters, had this been reflected in the RFP ab initio. This is particularly relevant in single vendor/resultant single vendor cases where waiver of essential parameters after issue of RFP and receipt of tenders would be prejudicial to the interest of other firms which might have submitted their bids as per the revised parameters but could not because of the essential parameters mentioned in the RFP.

(h) Pre-bid conference: To obviate the possibility of the RFP fetching no response, resulting in a single vendor situation or resulting in generation of limited competition, technical specifications should be firmed up in a prebid conference in two-bid tender, particularly where the goods/services to be procured are not available commercially off-the-shelf or are of complex and highly technical nature. No fresh commercial bids should be invited after opening of technical bids.

CONTRACTUAL BIDDING

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

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

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

Bidding Process:

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

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

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

<u>Procurement notice</u>

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

Prequalification

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

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

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

Shortlisting

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

In some cases the public sector has sought to encourage candidates to bid by agreeing in advance to make a payment to each losing bidder that would partially reimburse it for the costs of bid preparation. Such payment could be made from money that the Authority would receive from the winning bidder (once again, specified in advance). The size of the payment

has to be calibrated to discourage frivolous bids. Practice varies widely between countries. The Authority should ask their advisers about current market practice in the relevant sector and jurisdiction.

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

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

- the business activities of the consortium (e.g. how many projects of a similar nature, the consortium has implemented over a specified number of years);
- financial information (e.g. thresholds involving turnover and net worth);
- legal information about the PPP consortium, including any relevant litigation involving the companies; and
- the quality of personnel to be involved in the project.

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

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

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

Online Bidding:

Introduction

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

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

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

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

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

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

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

The On-line Bidding Process

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

1. Bidders are pre-qualified using the criteria expressed at the outset by the contracting authority.
2. Pre-qualified bidders will be invited by the client to submit a 'technical' proposal containing everything (except the price) and to participate in the auction on a specific

date and at a specific time. Specifications and instructions on how to participate in the auction will be provided in advance of the event. Bidders will be advised after prequalification that an e-Auction will take place.

3. Client will provide software and practice/training as necessary.
4. Client will review the technical proposals and resolve any qualifications and apply weighting, if appropriate. In the case of weighted bids the prices submitted at the e-Auction stage may be subjected to an overall weighting, which takes into account criteria other than price alone, so the display bid will not purely be based on price alone.
5. The on-line bidding exercise will usually be conducted on behalf of the client by an IT service provider. It is usually specified that bidders can only bid downwards and the minimum decrement is usually specified.
6. The bidding exercise will have a specified opening and closing time. The e-Auction will close when no new bids are received and the closing time has expired. If however, a new (lower) bid is received just before the scheduled closing time, the allocated bidding time will be extended.
7. The bidders' identities will be kept confidential during the event although the number of bidders will usually (but not always) be apparent from the screen.
8. The client may sometimes display an opening bid price; this will be an indicative guide to bidders. From this point onwards, all bids will progress downwards during the duration of the e-Auction. The client may set the e-Auction parameters so as not to allow bidders to start their bidding higher than the opening bid price.
9. Each bidder will receive feedback on its own ranking in relation to the other bidders.
10. Each bidder will be able to submit as many new bids as they wish up to the closing time of the e-Auction; the rankings will be revised accordingly.
11. All bidders will be notified of their results.
12. The client will have an opportunity to review the bids to ensure that quality, service and other value-adding considerations are met.
13. Once the review process has been carried out, the contract will be awarded to the successful bidder against the criteria that were established at the outset.

<u>Advantages and Disadvantages of On-line Bidding</u>

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

Advantages:

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

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

Disadvantages:

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

- e-Auctions do not appear to take into account the current innovative industry practices for procurement in the construction industry. The perception of on-line bidding is based upon 'lowest price' rather than the 'best value' initiative as set out in 'Re-Thinking Construction', although the client has the opportunity to set the criteria against factors such as quality and performance. 'Re-Thinking Construction' also seeks to discourage tendering as wasteful, recommending instead the development of partnering and team working arrangements; e-auctions could continue to reinforce industry fragmentation at the expense of such arrangements.
- The time pressure to submit a bid lower than that shown on the screen may lead to errors of judgment. Contracts subsequently awarded under the on-line bidding process may therefore, create an even greater likelihood of errors, disputes, bad faith and an increased risk of claims than in traditional tendering processes.
- Where there is insufficient weighting, there may be a risk of 'cut-throat' pricing by bidders where corners may be cut and quality compromised.
- As with all procurement processes, there may be jurisdictional issues to be clarified.
- Because of the time pressure, it is very difficult (if not impossible) in real time to include the bids of the entire supply chain in the bidder's bid.
- The process can lack transparency when it comes to evaluation procedures by the client where those procedures are not seen by the bidders.
- The process might still discourage firms from taking part because of the perception that the process depends solely on low price bidding.

- Bidders may not be given the opportunity to negotiate or discuss their contract terms prior to taking part in the e-Auction; nor may they have time to check with their insurers to ensure that the contract will be covered under their policies. This may therefore, result in many uninsured risks.
- Unscrupulous clients could introduce ghost bidders. Further information on this can be found in an e-Ethic statement issued by the CIPS.

Is On-line Bidding Right For You?

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

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

Conclusion

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

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

On-line bidding for construction products and services should be considered a method for purchasing only if it is used in a proper context, within a sound procurement process, and under the right expertise. It still carries some adversarial aspects embedded in any on-line

bidding process, and lessening those aspects and their impacts will come through better guidance and practice codes for implementing the on-line bidding method.

Reliance Airport Developers Private Limited vs. Airport Authority of India

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

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

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

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

Factual Background:

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

In May 2004, the Congress (I) led-UPA5 government came to power and commenced the process of privatization of the Mumbai and Delhi airports by inviting bids from interested

parties. It was delayed until September 2005. Then again, the bidding process became controversial. While some players left the fray because of certain bid conditions, others were rejected by the evaluators. The bid results that were announced in December 2005 led to public outcry and dissatisfaction. Allegations of lack of transparency and apparent favoritism were made. Subsequently, the GoI appointed several committees to lend credibility to the much maligned process

Arguments and Judgment:

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

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

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

The Evaluation by EC v Evaluation by GETE

The primary stand of the appellant in this case was that the EGOM/ GOI should have accepted the recommendations of the EC and should not have asked the GETE to make further examination. According to RAL, GETE did not examine the queries relating to GMR as raised by the IMG and the reduction of technical qualification from 80% to 50% that it made, was impermissible- especially when at all stages EGOM had emphasized that there shall not be any compromise with quality. Also, RAL imputed that uniform pattern of assessment has not been followed by GETE. In the initial assessment, only the GMR and the appellant had crossed the bench mark. If in respect of one airport GMR was given the option of matching the financial bid of the appellant, in respect of the other airport similar option should have been given to the appellant who was at the relevant point of time and even now

willing to match the financial bid of GVK. Appellant had scored over 80% on the development side and fell short of merely 6% less than 80% on the management side. The award of contract to the third ranked bidder i.e. GVK who had scored only 59% on the development side and whose bid had been adversely commented upon by all committees was against public interest. RAL forcefully contended that GETE's evaluation of appellant's bid was wrong and it should not have interfered with EC's evaluation. GETE's report, which was totally subjective in nature, was never independently examined by EGOM.

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

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

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

detailed manner. This kind of a situation throws up questions of administrative expediency, flexibility, and new limitations on the scope of judicial review. The Court should have delved deeper and sought answers for these questions, rather than leaving them untouched as was done in this case.

Were the RFP norms well adhered to?

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

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

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

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

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

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

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

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

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

The researcher does not fully agree with this stand off the court, for if a committee is constituted of the members of government, this fact alone does not ensure its fairness and

justness. Such a committee cannot be held to be outside the pruview of judicial review. Also, a committee made up of technical experts does hold a greater say on matters as relating to this case.

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

BIDDING PROCESS UNDER DEFENCE PROCUREMENT MANUAL

Goods/ services should be procured by adopting one of the modes of bidding given below except for the cases in which the goods/services can be procured without bidding.

Modes of Bidding

Generally the following modes of bidding will be followed for obtaining bids:

a) Open Bidding Mode (OBM)
b) Limited Bidding Mode (LBM)
c) Single Bidding Mode (SBM)
d) Proprietary Bidding Mode (PBM)

Open Bidding Mode (OBM)

Open Bidding Mode (OBM) should be the preferred mode for procurement of common use item, with generic/ commercial specifications, which are readily available off-the-shelf in the market from a wide range of sources. All procurements of goods and services where estimated cost is more than Rs. 25 lakh and Rs. 10 lakh respectively should generally be made through this mode subject to exceptions provided in this Chapter. However, OBM may also be resorted to in case of procurements where estimated cost is less than the values specified above if considered advantageous.

Open Bidding Mode involves wide publicity through advertising media (press, trade journals, website, etc.) to ensure extensive competition. RFP will necessarily be hosted on DRDO website (www.drdo.gov. in) and Central Public Procurement (CPP) Portal in addition to other means of publicity. RFP notifications will also be sent to Director General of Commercial Intelligence and Statistics, Calcutta for publication in Indian Trade Journal (ITJ) and to the DAVP, New Delhi for publication in leading national newspapers. In case of exigencies of work, besides publication of RFP notification in ITJ, Director may issue RFP advertisements directly for inviting offers through the leading national newspapers at DAVP rates, if considered expedient, after recording reasons for the same on the file.

Simultaneously, attention of renowned prospective bidders may also be drawn to the RFP notification to enable them to offer the quotations after obtaining the RFP documents from the Lab/Estt concerned or website.

In case a need is felt, Lab/Estt may also approach Foreign Embassies in India and Indian Embassies/ Defence Attaché abroad by sending them a copy of RFP notification with the list of prospective bidders to seek offers/ assistance through their liaison.

In case the RFP are downloaded from the website by the bidder, it will not be charged. However, if the bidder wants it from the Lab/Estt, it will be supplied at rates tabulated below which include postal charges. RFP will be supplied free of cost to MSEs registered with National Small-Scale Industries Corporation (NSIC) and other such agencies as decided by the Govt. Lab/Estt will not be responsible for any postal delay.

Sl. No.	Mode of Access to RFP	Price (Rs.)
1	If downloaded from website	Free of cost
2	If supplied by Lab/Estt	Rs. 500

OBM will also be followed for items where limited bidding, irrespective of its estimated value, has not resulted in creation of expected competition and getting the best offer.

Limited Bidding Mode (LBM)

This mode of bidding may be chosen where estimated value of goods and services to be procured is up to Rs. 25 lakh and Rs. 10 lakh respectively. RFP will be floated to more than six firms registered for that category of goods/ services with the Lab/Estt. In case the number of firms registered with the Lab/Estt is less than seven, the central database of registered vendors on DRONA would be referred for identification of other potential sources. In exceptional cases, CFA may consider issuance of RFP to lesser number of potential bidders after recording the reasons in file. The following aspects will be kept in mind while issuing RFP:

Vendor selection for the purpose of LBM must be done with utmost diligence so as to give fair opportunity to the vendors who are registered with R&D Labs/Estts and the Government designated agencies as mentioned in Chapter 2 of this Manual.

Un-registered vendors may also be considered for the purpose of LBM with the explicit approval of CFA. However, their registration would be mandatory before placement of order on them.

RFP documents are not transferable.

Help of Foreign Embassies in India and Indian Embassies/ Defence Attaché abroad may be sought, if required, for the procurement of imported items.

Special circumstances for LBM: Purchase through LBM may also be adopted even where the estimated value of the procurement is more than the specified values with the approval of CFA under the following circumstances:

a) When the sources of supply are definitely known/ available (established through OBM/ EOI in last one year) and possibility of fresh sources beyond these is remote.
b) When it is not in the public interest to call for open bidding due to reasons of security or when superior authorities have issued specific instructions in this regard.
c) When Government policies designate specific agencies.
d) When the requirement of stores is urgent and reasons for such urgency are justified by the indenter. Urgency of such cases will be specifically monitored till the placement of order.

Demand approval accorded by CFA would include the names of the vendors to whom the RFP will be sent.

RFP will be issued to all vendors as approved by CFA.

E-Publishing of RFP on LBM on the CPP Portal will be ensured unless approval of the Secretary Defence R&D has been obtained with the concurrence of Addl. FA (R&D) & JS. Unsolicited offers received as a result of e-publishing would not be considered for the instant procurement but the response would be given to the Vendor Registration Committee for consideration for future procurements.

Inadequate Response in OBM and LBM

Quotations received (in single bid system) or technically qualified (in two bid system) from at least three firms are considered adequate to process the procurement. Receipt of less than three quotations (in single bid system) or technically qualified quotes (in two bid system) will be considered as inadequate response.

In cases where RFP on LBM was issued to only two potential bidders with the prior approval of CFA, quotations received (in single bid system) or technically qualified (in two bid system) from only one firm will be considered as inadequate response.

Single Bidding Mode (SBM)

Procurement from a single source may be resorted to with the approval of CFA as per delegation of financial powers. In such cases, detailed justification as per format DRDO.DM.03 will be submitted for the approval of CFA. Procurement on SBM may be resorted to under following circumstances:

a) In case of emergency.
b) On account of operational/ technical requirement.
c) Non-proprietary items, when only single response is available, in spite of competitive bidding.
d) Items to be purchased from a Government specified source.
e) Where any other mode of bidding is not considered appropriate in the interest of national security.
f) Procurement on SBM for technology intensive projects: For technology intensive projects/ programs in progress, the materials/ components required are available only with a few qualified manufacturers/ vendors of repute. In such cases, flexibility will be allowed to effect purchases on SBM.
g) Where a source has been developed by DRDO for supply of components, sub-systems or systems, SBM may be considered when larger quantities are required in the production phase to ensure scale up and incentivize indigenous vendors.

Award of Proprietary Article Certificate (PAC) Status

PAC status can be awarded to a firm under following conditions:

a) Certain goods/ services are proprietary products of a particular manufacturing firm having the Intellectual Property Rights (IPR) and the detailed specifications are not available with others to manufacture/ provide the same. Such goods/ services have necessarily to be obtained from the Original Equipment Manufacturer (OEM) or its sole authorized dealer/ stockist/ distributor on the basis of the information provided by the OEM. A PAC may be issued in favour of such OEM as per format DRDO.DM.02, on the advice of the competent technical experts (from within Lab/Estt or outside).
b) PAC status can be awarded to the firm selected and qualified as development partner in execution of a development contract when associated subsequently for fabrication/ up-gradation/ modification thereof. Orders will be placed on PAC basis till such time an alternative source is developed.
c) PAC status can also be awarded to source services/ spares/ maintenance of equipment from OEM/ authorized dealer.

Caution to be exercised while granting PAC: PAC bestows monopoly and obviates competition. Hence, PAC status should be granted only after careful consideration of all factors like fitness, availability, standardization and value for money. The spares should be sourced from OEM or OEM approved/ recommended manufacturers/ dealers only in order to make the OEM responsible for the malfunctioning of the main equipment in which the spares have been fitted.

Authority for Award/ Cancellation of PAC Status: At the time of award of PAC status to a firm, the concurrence of the finance shall be taken. The general declaration of PAC status would be approved at the minimum level of Lab Director/ Programme Director with the concurrence of Integrated Finance. The PAC status, once granted, will remain valid for two years from the date of issue unless cancelled earlier by the Competent Authority. The PAC award can be cancelled by the issuing authority in consultation with their Integrated Finance.

Procurement on PBM Basis

Procurements on PBM basis will be made from firms awarded with PAC status or their sole distributor on the following conditions:

a) Only a particular firm is manufacturer of required goods/ services.
b) In execution of a development contract from the firm selected and qualified as development partner when associated subsequently for fabrication/ up-gradation/ modification thereof till such time an alternative source is developed.

c) In order to ensure compatibility of spare parts/ components with the existing sets of equipment as per the advice of the competent technical experts.
d) When there is a need for standardization of machinery and equipment with existing holding.
e) Repairs and servicing of equipment purchased may be got done through the OEM approved service provider.

In cases, where OEM has more than one authorized dealers/ stockists/ distributors/ service provider, orders would be placed on them on competitive basis. The CFA for such purchases would, however, be determined in accordance with PAC mode of bidding.

Earnest Money Deposit (EMD)/ Bid Security

EMD, also known as Bid Security, is taken to safeguard against withdrawal/ alteration of bid by the bidder during its validity. Requirement of EMD prevents non-serious vendors from making infructuous offers. All un-registered bidders responding to RFP will be required to furnish EMD for an amount as indicated in the RFP. In the two bid system, EMD would be deposited along with techno-commercial bid. EMD would be received and returned in INR only.

EMD will be a fixed amount between 2% to 5% of the estimated cost of the proposed procurement, suitably rounded off. The following organizations/ firms are exempted from submission of EMD:

a) Bidders registered with DRDO, Min of Defence, NSIC and DGS&D.
b) DPSUs, Other Govt. Organizations.
c) KVIC, Kendriya Bhandar/ NCCF.
d) Micro and Small Enterprises (MSEs) as per their registration.

In case of small value purchases (up to Rs. 2 lakh)/ development contracts/ Single Bid/ PAC case, CFA may waive the requirement of EMD at the time of demand approval.

EMD may be accepted in the form of Bank Draft drawn in favour of the Director of the Lab/Estt, Fixed Deposit Receipt, Banker's Cheque or a Bank Guarantee in acceptable form as per DRDO.BG.01, from any of the nationalized Banks, private sector bank authorized for Govt. transactions for safeguarding the Buyer's interest in all respects. In case of foreign bidder, EMD will be accepted in INR only.

The EMD should remain valid for a period of 45 days at least beyond the bid validity period.

EMD will be refunded in full without any interest to the unsuccessful bidders after finalization of the TCEC/ supply order. For successful bidder, this amount will be refunded without any interest after receipt of applicable Performance cum Warranty Bond.

Forfeiture of EMD: EMD will be forfeited in following cases:

a) If the bidder withdraws/ amends/ derogates from the bidding process in any respect within the period of validity of bid.
b) If the successful bidder fails to furnish required Performance cum Warranty Bond.

Preparation of Notice Inviting Bid (NIB)

In case of OBM, notice inviting bid will be published in the journals/ newspapers, as per DRDO.BM.01. It should contain salient features of the requirement in brief to give a clear idea to prospective bidders about the requirements. Superfluous or irrelevant details should not be incorporated in the notice inviting bid, as they will needlessly increase the cost of advertisement.

The notice should normally contain the following information:

a) RFP reference number.
b) Nomenclature of the goods and quantity.
c) Cost of the RFP document.
d) Amount and form of bid security/ earnest money deposit.
e) Address of the website from where the RFP document could be downloaded.
f) Place(s), cost and timing of sale of RFP documents.
g) Place and deadline for receipt of bids.
h) Place, time and date for opening of bids.
i) Any other important information.

Copy of NIB may also be sent to known potential bidders to invite their attention.

Publicity through the Website

All RFP notifications should invariably be posted on the DRDO website and CPP portal unless exempted. The website address should also be given in the OBM notification advertised through the Indian Trade Journal (ITJ) and the National newspapers.

All RFPs on OBM would be e-published on DRDO website and CPP Portal.

RFPs on LBM/ SBMand PBM would also be e-published on DRDO website and CPP Portal. In case Labs/Estts feel that e-publishing a particular RFP may jeopardize the procurement, they would require explicit approval of Secretary Defence (R&D) with the concurrence of Addl. FA (R&D) & JS. Such exemptions may be considered for procurements that are sensitive in nature. Labs/Estts would submit the proposal to DMM, DRDO HQ stating reasons for not e-publishing duly approved by their DG Cluster/ CC R&D for the waiver.

In case there is no requirement of Non-Disclosure Agreement (NDA), the complete RFP document should be posted on the website to enable the prospective bidders to download

document for bid submission. Cases where NDA is required, the complete RFP document would be issued after signing of NDA.

RFP documents must be secured to avoid possibility of modification and restriction of access to bidders.

Preparation of the Request For Proposal

Request For Proposal (RFP) is the most important document in the procurement process. The RFP will be prepared by MMG with due care and should contain complete details of the items or services required, qualification criteria for vendors wherever applicable, standard terms & conditions, special terms & conditions, evaluation criteria, price bid format and clear instructions for submission of bids. MMG may consult Indenter and Quality Assurance Cell (QAC) of the Lab/Estt, wherever required, while finalizing the RFP.

All RFPs must invariably carry a clause that the Government reserves the right to cancel the procurement process at any stage and accept or reject any bid, fully or partially, without assigning any reasons.

RFP should also specify that Indian bidders should quote only in Indian currency and foreign bidders may quote in a currency, specified in the RFP, with the understating that payment in foreign currency is subject to regulations by the Reserve Bank of India.

The RFP should ask the foreign bidder to quote the FOB/ FCA cost. However, for the purposes of comparison of bids, the foreign bidders will also be asked to quote CIF/ CIP cost up to a specified place of delivery. It would also be clarified that if the CIF/ CIP cost is not indicated, their bid will be loaded by 10% of FOB/ FCA cost to arrive at the CIF/ CIP price for purpose of bid evaluation. Quotation from Indian bidder shall be sought on FOR (destination) basis.

No preferential terms and conditions will be indicated in the RFP for any category of bidders except as provided under Govt. policy given in Chapter 2 of the Defence Procurement Manual.

The evaluation/ loading criteria with respect to important terms having financial implications like payment terms etc. need to be specified in unambiguous terms so that the evaluation of bids after opening of bids could be made in a transparent manner without any subjectivity.

Format of RFP

The suggested format for the RFP for procurement of goods/ services is as per DRDO.BM.02. The specimen format is based on various instructions contained in this Manual. The RFP consists of following seven parts:

Part I contains General Information and Instructions for the Bidders about the RFP such as the time, place of submission and opening of bids, validity period of bids, etc.

Part II contains Standard Terms and Conditions of RFP which have legal implications and will form part of the contract/ supply order with the successful Bidder(s). Therefore, neither deviation from the text given in the clauses nor deletion of any of these clauses should be admitted. In case a deviation from these clauses has to be considered/ allowed, approval of DRDO HQ will be required.

Part III contains Special Terms and Conditions applicable to this RFP and which are supplementary conditions applicable to a specific RFP. A conscious decision needs to be taken to incorporate the relevant clauses from this set. The wordings of these clauses can also be appropriately modified to suit a particular case. These conditions will also form part of the contract with the successful bidder(s).

Part IV contains Vendor Qualification Criteria such as minimum level of experience, past performance, technical capability, manufacturing facilities etc. to be met by the bidders. This part is case specific and should be included only if required. This part is not normally recommended for the procurement of Commercial-Off-The-Shelf (COTS) items. It may be invoked with the approval of CFA for large works, major plants and machinery, complex information technology systems, medical equipment, sophisticated weapon systems, telecom equipment and other special goods. In the absence of this part, no vendor would be disqualified on the basis of capacity/ capability.

Part V contains Details of the store(s)/ service(s) required e.g. Technical Specifications, Delivery Period, Mode of Delivery, Consignee Details etc.

Part VI contains Evaluation Criteria of bids which can be suitably amplified/ modified to suit the specific requirements of each case.

Part VII contains Format of Price Bid which can be set to get the desired cost break-up as per requirements. All bidders will be requested to indicate time-wise and currency-wise amount required as per the price bid in the given below. In case, a bidder does not provide time-wise cash flow details in the price bid, the amount quoted in the price bid will not be discounted for comparison purposes.

Time	Currency					Total Cash Flow
	US Dollar	Euros	Pound Sterling	Rupees	Other (Specify)	

General Guidelines

The common factors to be kept in mind while inviting bids are:

Indenter may propose the mode of bidding and the system of bid submission to be adopted for each purchase, however CFA is the competent authority to decide on the mode of bidding and system of bid submission for the procurement as per the delegation of financial powers.

As far as possible, procurement of items shall be sourced from original manufacturers unless the original manufactures themselves decline to entertain RFPs and redirect the inquiries to their authorized distributors/ dealers. This may happen when the procurement is too small to elicit attention of original manufacturers or due to their contractual obligations. Adequate care must be taken to discourage mere traders, especially in procurement of expensive items, after careful consideration of aspects like aftersale-services/ support/ maintenance and manufacturer's warranty against manufacturing defects.

Due date & time of submission and opening of bids will be clearly mentioned in the RFP. Time gap between submission and opening of bids should generally be kept within 24 hours. In two bid system, only techno-commercial bid will be opened on the date of opening.

The day selected for opening of bid should be a working day. Monday or day followed by a series of holidays should be avoided, as far as possible.

Normally, the reasonable time to be allowed for submission of bids should be four to eight weeks from the date of publication of the NIB or availability of the bidding document for sale, whichever is later. Time likely to be taken to secure and study specifications/ drawings by the firm will be taken into account, wherever applicable to decide the reasonable time for submission of bid. Reduced time frame for submission of bids may be adopted in the case of emergent procurement of stores/ services and emergent repairs by use of FAX, etc.

Realistic validity period of the bids will be specified in the RFP. This period will be fixed keeping in view the nature of stores and other administrative formalities. A bid shall remain valid for 90 days for single-bid system and up to 180 days for two-bid system from the date of opening of bid, unless otherwise specified.

RFP will be signed for and on behalf of 'President of India'.

Only relevant clauses from different parts of RFP template, as applicable, will be included in the RFP. Non-applicable clauses would be struck off to obviate any confusion in the mind of bidders.

All correspondence with vendors in respect of the RFP and supply order, etc., will preferably be done through MMG only.

The RFP must reflect all special conditions/ clauses required to be incorporated in the contract/ supply order.

Any Purchase preference/ Product Reservation Policy of Govt. applicable to the procurement must be mentioned upfront in the RFP.

In case samples are also required for techno-commercial evaluation, it should be mentioned in the RFP that the bidders found technically compliant would have to provide specified quantity(ies) of the item on 'no-cost-no-commitment' (NCNC) basis for trial evaluation/ testing. The period within which the bidder must submit the equipment/ sample, after being found technically compliant, must be indicated in the RFP. Such provision should be included only after obtaining approval of CFA as per delegation of powers.

In case pre-bid conference is required with the prospective bidders for better understanding of the RFP requirements, the same shall be mentioned in the RFP with the date, time and venue.

Reference to Brand Names in the RFP

Standards and specification, provided in bidding documents in generic terms shall promote the broadest possible competition while assuring the critical performance or fulfillment of other requirements for the goods. Reference to brand names, catalogue numbers, etc. in the RFP should be avoided.

Vetting of RFP by Integrated Finance

To the extent possible Labs/Estts are advised to use the standard RFP as per DRDO.BM.02. In case of any deviation from the standard text, CFA may get the RFP vetted by Integrated Finance. Waiver of clauses such as Performance cum Warranty Bond, Liquidated Damages (LD) and Bank Guarantees, where applicable, to safeguard Free Issue Material (FIM) would be termed as deviation from the procedure and will be dealt as per para 1.10 of the Defence Procurement Manual.

RFP should be vetted by Integrated Finance for the cases beyond delegated power of the Director of Lab/ Estt.

Dispatch of RFP Documents

RFP shall be dispatched as per the mode of bidding approved by the CFA.

In LBM/ SBM/ PBM, the copies of the RFP should be sent directly by speed post/ registered post (with AD)/ courier/ e-mail/ fax to firms which is/ are approved by the CFA for the goods/ services being procured. Copies of the RFP should also be sent by speed post/ registered post (with AD)/ courier to the firms to whom these were initially sent by fax/ e-mail.

In case of dispatch of RFP on LBM by means other than speed post/ registered post with AD, it would be ensured to keep the proof of delivery in the file.

In case of OBM, the RFP may be dispatched by speed post/ registered post/ courier to the firms after receipt of fee as per para 6.4.4 of the Defence Procurement Manual.

Simultaneously, e-publication of RFP on CPP portal will be ensured unless waiver from Secretary Defence (R&D) with the concurrence of Addl. FA (R&D) & JS for doing so has been taken.

Pre-Bid Conference

Pre-bid conference with the bidders will be held as per the date, time and venue specified in the RFP or as separately notified. After pre-bid conference, necessary clarifications (if any) to the RFP would be notified to all prospective bidders in case of RFPs not hosted on website and in other cases, it would be hosted on website.

Amendment to the RFP and Extension of Bid Opening Date

Amendment to the RFP: Situations may necessitate modification of the bidding document already issued due to change(s) in the required quantity or specifications/ conditions etc. Further, sometimes a bidder may point out some genuine mistake in the RFP necessitating amendment. In such cases, it may become necessary to amend/ modify the RFP suitably prior to the date of submission of bids. Change in the quantity affecting the CFA status would require approval of appropriate CFA.

Approval of Amendment: If there is no change in mode of bidding and no significant departure from functional parameters/ specifications, amendment to RFP would require approval of Director/ Program Director or else approval of CFA will be obtained. Concurrence of integrated finance would be taken in all cases except where amendment is restricted to Part I of the RFP or where demand was approved without concurrence of integrated finance as per the delegated powers.

a) Integrated Finance would recommend the amendment to the Director/ Program Director after analyzing the financial implications due to proposed amendments and would indicate any changes in the source or in the standard/ special terms and conditions.
b) Director/ Program Director would take into account the recommendations of Integrated Finance, examine the justification given, essentiality of change and recommend/ approve the amendment.

Methodology of Communicating Amendments in RFP: Copies of such amendment/ modification would be simultaneously sent to all the prospective bidders by registered post/ speed post/ courier/ e-mail in case of LBM/ SBM/ PBM. In case of OBM, copies of such

amendments/ modifications would be dispatched simultaneously free of cost by registered/ speed post/ courier/ e-mail to all the parties who may have already purchased the RFPs and copies of such amendments are also required to be prominently attached to the unsold bidding documents (which are available for sale), including the RFPs hosted on the website. Such amendment/ clarification would be hosted on website at least a week before the last date of submission of bids.

Extension of Bid Submission/ Opening Date

When the amendment/ modification changes the requirement significantly and/ or when sufficient time is not left for the bidders to submit/ revise their bids, the time and date of submission of bid should be extended suitably. Suitable changes in the corresponding time-frames for receipt of bids, bid validity period etc. and validity period of the corresponding EMD/ Bid security should also be made. Any extension of bid submission/ opening date, for whatever reason, shall be communicated to the prospective bidders as described in the above para.

Receipt of Bids

A box, locked and sealed, will be placed at the security gate or any other secured convenient place in the Lab/Estt to facilitate uninhibited access to the bidders to drop their bids. This box will be removed from the place or made inaccessible to the vendors at the time of closing, as specified in the RFP. The key of the box will be kept in the personal custody of a responsible officer. Bids received through couriers/by post will be immediately put into the box without opening.

The bids received from Indian bidders by fax/ e-mail, except in cases of PBM/ SBM will not be accepted. However, for imported items, the bids received from foreign bidders by fax/ e-mail may be considered if the same are received before expiry of the notified date and time. In such cases, bids received in the Director's office may be kept in his personal custody and placed before bid opening committee.

Bid Opening Committee (BOC) will collect all the bids from the box and other places e.g. central dak receipt section, etc. at the appointed time of closing of bids.

Withdrawal of an Offer or Proposal : A bidder may modify or withdraw his bid after submission provided written notice for modification/ withdrawal is received prior to the deadline prescribed for submission of bids. No bid may be withdrawn or modified in the interval between the deadline for submission of bid and expiration of the period of bid validity specified. Withdrawal of bid during this period will result in forfeiture of EMD. If bid is withdrawn by the agency exempted from submission of EMD, the registering authority will be intimated.

Late Bid

All bids or modifications received thereto, beyond the due date and time of submission of bid, shall be marked as 'Late' and will not be considered. These bids would be returned to the respective bidders unopened.

Scrapping of Bidding Process

Scrapping of bidding process may be resorted to with the approval of the Director under intimation to the CFA in the following circumstances:

a) Cancellation of the demand by the user.
b) Change in basic specifications of stores.
c) Non-receipt of offers as per specifications laid down.
d) Sudden downward market trend.
e) Prices quoted being very high/ unreasonable.
f) Large/ manifold variation in prices quoted by bidders etc.

Opening of Bids and Evaluation

Bids will be opened by Bid Opening Committee constituted as under:

Bid Opening Committee (BOC): Director of Lab/Estt will nominate officials of BOC as per following constitution for opening of bids on the date and time specified in the RFP:

Sc. 'C'/ TO 'C' or above	Chairman
Vigilance/Security Officer or his rep	Member
Duty Officer of the day	Member
MMG rep	Member Secretary

Any two of the committee members besides Chairman may open the bids.

Role of BOC: BOC will identify and categorize the bids received as under:

a) Single Bid System:
    i. For non-CNC cases: Bids will be opened by BOC and handed over to MMG for preparation of Comparative Statement of Bids (CSB) as per above para.
    ii. For CNC cases: Bids will not be opened by the BOC. Such bids will be handed over to MMG for safe keeping till they are opened by the CNC and bidders would be informed in advance.
b) Two Bid System: BOC will open techno-commercial bids only and hand it over to MMG for techno-commercial evaluation by the TCEC. Price bids will not be opened

by BOC and the same will be handed over to MMG in a separate cover, sealed and signed by BOC for further action.

Bid Opening Procedure

Prior to the date and time of bid opening, BOC will ensure that all bids received in time are available for its consideration.

All relevant bids received on time should be opened by the BOC in the presence of authorized representatives of the bidders at the time, date and place prescribed in the RFP. The authorized representatives, who intend to attend the bid opening event, would be required to bring with them letters of authority from the concerned bidders.

BOC should announce the salient features, as applicable, of all opened bids like description and specification of stores, quoted price, terms of delivery, delivery period, discount if any, whether EMD furnished or not and any other special feature of the bids for the information of the representatives attending the bid opening event.

After opening of bids, every bid should be numbered serially, initialed with date on the first page by the officials of the BOC. Each page of the price bid or letter attached to it shall also be initialed by them with date, particularly the prices, delivery period, details of discount offered, and any other financial terms including taxes and duties, which should also be encircled and initialed indicating the date. Blank bids, if any, should be marked accordingly by the BOC.

All bids received and opened will be entered in the bid register indicating the names of the firms, RFP reference number, file number and other pertinent details.

In case of alterations/ crossings and cuttings in quotations made by the bidders, substituted words should be encircled and initialed with date and time by the officials of BOC to make it perfectly clear that such alterations were present on the bid at the time of opening.

All late bids will be declared non-responsive and returned to the bidders unopened.

BOC will prepare a list of the representatives attending the bid opening event and obtain their signatures on the list. The list should contain the representatives' name and the corresponding bidders' name and their addresses. The authority letters brought by the representatives should be attached with this list. This list should be signed by officials of BOC with date and time.

The list of representatives attending the bid opening event, the bid register along with the bids which are opened or otherwise will be handed over to MMG.

In two bid system, only the techno-commercial bids would be opened in the first instance. The BOC would sign on all the envelopes containing price bids and hand over the same to MMG in a sealed and signed cover.

In two bid non- CNC cases, price bids of only those firms who have been declared technically compliant by TCEC will be opened by BOC and handed over to MMG for preparation of CSB as per above para. Technically qualified bidders would be called to witness opening of the price bids.

Inadvertent Opening of Price Bid Before Schedule

Due care must be taken to avoid opening of 'price-bid" before schedule or its opening along with "techno-commercial bid" in a two bid system as it is a serious matter. In such case opened price bid would be sealed again in a separate envelope by the committee under the signatures of bid opening officers. The incident would be recorded in the bid opening register. Chairman BOC will report the matter to the Head of the Lab/ Estt highlighting the circumstances and reasons. In case Head of the Lab/Estt is satisfied that it is an inadvertent opening of price bid, MMG would inform the affected bidder about the incident and give him a fixed and reasonable time to represent. In case, objection is raised by the bidder by the specified date, the case will not be processed further without bidding afresh, otherwise, bid processing will continue with the original price bids.

Preliminary Examination of Quotes

The purchase cell/ officer should examine the quotations to determine whether they are complete in all respects, and check for any computational errors which will be rectified on the following basis: If there is a discrepancy between the unit price and the total price that is obtained by multiplying the unit price and quantity, the unit price shall prevail and the total price shall be corrected. If there is a discrepancy between words and figures, the amount specified in words shall prevail.

Handling Cartel Formation/ Bid Rigging/ Ring Prices

Sometimes a group of bidders quote identical rates against RFP on competitive bidding. Such Pool/ Cartel formation is against the basic principle of competitive bidding and defeats the very purpose of open and competitive bidding. Such practices should be severely discouraged with strong measures and brought to the notice of DMM. Suitable administrative actions like rejecting the offers, reporting the matter to Registrar of Companies, Competition Commission of India (CCI), and National Small Industries Corporation (NSIC) etc. should be initiated against such firms, on case to case basis, as decided by the competent authority. However, this does not cover DGR empanelled security service providers.

Procedure in Case of Inadequate Response

In some cases response may be inadequate consequent to open/ limited bidding. This situation may arise in single bid system as well as in two bid system before or after technical

evaluation indicating lack of competition. In such situations, following aspects may be examined before proceeding further:

(a) Is it possible to redefine the specifications and make them broad based/ industry friendly for wider competition? (Yes/ No)
(b) Whether time and criticality of requirement permits reformulation of the specifications. (Yes/ No)
(c) Whether proper vendor selection has been done in case of LBM or wide publicity has been given in case of OBM. (Yes/ No)
(d) Whether vendor qualification criteria / special terms and conditions of RFP were very restrictive. (Yes/ No)
(e) Review if sufficient time was given to the bidders to respond while issuing the RFP. Whether the RFP had been properly dispatched and duly received by the prospective bidders to whom these were sent. (Yes/ No)

The above examination would be done, based on the information provided by the user, by TCEC for two bid system and a Committee (comprising of indenter, technical expert from other Group and Rep. MMG) for single bid system. If the examination reveals that answer to (a), (b) and (d) are no, and answers to (c) & (e) are yes, recommendations of committee would be processed as per para (a) and (b) below. Otherwise, case will be re-floated i.e. in case of any doubt about the bidding process or it is considered feasible to reformulate specifications/ terms and conditions of RFP/ vendor qualification criteria without compromising the requirement, the RFP should be retracted and re-issued after rectifying the deficiencies.

a) Receipt of two quotations (in single bid system) or technically qualified (in two bid system): Approval of CFA as per delegation of financial powers for OBM/ LBM procurements would be obtained for processing the procurement case further.
b) Receipt of only one quotation (in single bid system) or technically qualified (in two bid system): Such cases, the mode of bidding should be changed to Single Bid without PAC and appropriate approval of CFA as per delegation of financial powers would be obtained for processing the procurement case further.

However, cases with inadequate response, beyond the delegated powers of Secretary Defence (R&D), would require 'in-principle' approval of Secretary Defence (R&D) with the concurrence of Addl. FA (R&D) & JS for further processing the procurement case. Approval of CFA shall be taken at the time of obtaining Expenditure Sanction.

Re-Floating of RFP

Re-floating will be resorted to only in exceptional circumstances as it entails additional costs as well as delays the procurement process. Approval of CFA would be taken as per

delegation of financial powers for refloating of RFP. It should be done with utmost caution under the following circumstances:

a) Offer(s) do not conform to qualitative requirements and other terms and conditions set out in the RFP.
b) There are major changes in specifications and quantity, which may have considerable impact on the price.
c) Prices quoted are unreasonably high with reference to estimated cost or there is evidence of a sudden slump in prices after receipt of the bids.
d) Where there is lack of competition and there are clear and reasonable grounds to believe that the lack of competition was due to restrictive specifications, which could have restricted participation. Such cases should, however, be rare as the specifications must be formulated with due care.
e) Before re-floating, Lab should consider if there is a possibility of reviewing the specifications/ special terms and conditions/ vendor qualification criteria to meet the objective.
f) Withdrawal of offer by L1: In case the lowest bidder withdraws its offer, re-floating should be resorted to as per the instructions issued by the Central Vigilance Commission. While re-floating, RFP will not be issued to the bidder who had backed out and EMD, if any, of such a firm should be forfeited.
g) If the objectives for re-floating are not met when fresh bids are received, Director for non CNC cases or CNC may take stock of the situation keeping in view changed market conditions, repercussions of further delay, any other factors and recommend accordingly.

Preparation of Comparative Statement of Bids (CSB) in NON-CNC cases

The CSB will be as per the format given at DRDO.BM.04. The Part I of CSB will record details of bids received and indicate their compliance vis-à-vis terms and conditions of the RFP. Bids without material deviations would be considered in Part II. Part II of CSB will indicate all details of offers, i.e., nomenclature, price, payment terms, statutory levies, duties, insurance, packing & forwarding charges, installation & commissioning charges, training charges etc., as given in the quotations. In case of variation in payment terms quoted by the bidders, the Net Present Value (NPV) method of evaluation may be followed for purposes of comparison as indicated in RFP. For a fair comparison and to determine the real cost of procurement, details as given in the quotations such as delivery ex-godown or FOR destination, transportation, inspection costs etc. will be reflected in the CSB. In case cash flow involves more than one currency, these should be brought to a common denomination in Rupees by adopting exchange rate (RBI reference rate) as on the date of opening of price bids. The CSB will be signed by the Head of the User Group and Head MMG. Assessment of L1 will be done on the basis of criteria stated in the RFP and negotiation, if required, will be carried out only with L1. The case will be further processed as per para 6.42 of this Manual

onwards. Deviations, if any, from the prevailing procedure and/ or from RFP would be clearly recorded in the CSB.

Evaluation of Techno-Commercial Bids

In the two-bid system, a thorough evaluation of techno-commercial bids will be carried out by a duly appointed Techno-Commercial Evaluation Committee (TCEC). The evaluation of techno-commercial bids must be done within the framework of RFP.

Techno-Commercial Evaluation Committee (TCEC) A TCEC will be appointed by the Director/ Program Director comprising of following officers:

Sc. 'F' or above (from other than user group)	Chairman
Technical Expert (Sc. 'D' or above from other than user group)	Member
Rep MMG	Member
Rep QAC Member Rep User Group	Member Secretary

In addition, the Constituting Authority may include technical experts from sister Lab/Estt and/or outside experts from other Govt. Dept/ Academic Institutions to derive technical advantage based on their expertise.

Finance rep need not be associated with the TCEC. However, in cases where commercial terms are to be normalized before opening of Price Bid, a rep from finance will be co-opted by the Chairman/ Constituting Authority.

Evaluation of Technical Bids: The main objective of the TCEC is to prepare compliance matrix showing how the technical parameters of bids received are compliant with the parameters mentioned in the RFP. TCEC can accept better specification being offered after recording the gist of deliberations and reasons/ justification for the same provided it is acceptable to the user. This kind of changes would not be used to reject any bidder. It is reiterated that TCEC's job is to evaluate the technical bids from the viewpoint of "compliance to RFP" or "non-compliance to RFP". It is not open to TCEC to set aside the RFP and start making a de novo exercise of finding, which technical bid is acceptable and which is not.

Normalization of Commercial Terms: TCEC should also evaluate the commercial terms such as payment terms, warranty/ guarantee, taxes & duties, End Use Certificate (EUC), export license, installation & commissioning, and training etc. to ensure compliance of RFP in the bids submitted. Normally commercial normalization after opening of bid should be avoided, however, where it becomes essential to bring uniformity, finance rep will be involved. All technically acceptable bidders may be offered uniform commercial terms. If necessary, they may be given equal opportunity to revise/ amend their price bids as per the normalized

commercial terms. TCEC minutes should appropriately record the same. If, in spite of the efforts made by the TCEC, variations persist in commercial terms; this will not form the basis for rejection of technically acceptable offers except in case of EUC. Where EUC has to be submitted, TCEC should scrutinize the format provided by the technically accepted bidders for its acceptability. TCEC can refer the EUC format to the Directorate of International Co-operation (DIC), DRDO HQ in case need is felt for the same. The decision to reject the bid on the basis of EUC can be taken only with the concurrence of DIC.

bImportant Guidelines for the TCEC

For the purpose of proper assessment/evaluation, the TCEC will prepare a techno-commercial CSB as per format at DRDO.BM.05 bringing out the comparison between the specifications/ other terms asked for and that offered by vendors. While preparing TCEC minutes, value of technical parameters/ specifications as quoted by bidders along with compliance/ non-compliance status must be clearly indicated against all parameters/ requirements stated in the RFP.

The TCEC is empowered to invite/ interact with bidders, who have responded to the RFP, for technical presentation/ clarification if considered necessary. Confirmation of clarifications received in such meetings/ interactions may be obtained in writing from respective bidders.

Revision of Bids

For minor revision in the technical parameters/ specifications emerging during the technical evaluation of bids by TCEC or clarification received from the bidders, which does not affect the basic functional requirement of the product, equal opportunity must be given to all bidders to re-submit their bids to ensure fair play.

The original price bid must remain firm/ fixed and no price revision should be permitted during TCEC. However, while procuring/ developing complex systems/ products, it may not be feasible to incorporate all possible details in technical specifications. During the techno-commercial evaluation process, in case any changes in original technical specifications are being made, all the participating bidders should be asked to indicate separately the financial impact from the original quote in terms of addition or deduction from the quoted price, either by amount or percentage in a sealed cover, instead of calling for fresh price bids. This is done to retain the sanctity of the original price bid and should be considered only as supplement. It is mandatory to record this in the TCEC minutes. Once the modified price bids are received, both original and modified price bids are to be opened, compiled and evaluated on a common platform.

In case major changes become necessary, the TCEC may recommend re-floating of RFP with revised specifications.

Rejection of Technical Bid

TCEC must be guided by the sole consideration that only those bidders whose products are technically deficient in terms of the qualifying criterion stated in the RFP are excluded. The reasons for such rejection of any offers should be clearly recorded in the TCEC minutes. While doing so, all efforts should be made to retain as many bidders as possible in the fray without compromising on the technical requirements.

TCEC should identify all line entries whether quoted as essential items or optional items whose prices need to be included for price evaluation of the bids. Selection of these entries should be done only as per the requirement given in the RFP. Exclusion/inclusion of such entries (as the case may be), should be recorded with absolute clarity in TCEC minutes to facilitate preparation of CSB by CNC/MMG.

Acceptance of TCEC Recommendation

The TCEC will scrutinize the bids as per the guidelines given above and submit its report for consideration and acceptance to the Constituting Authority.

Commercial Negotiation Committee (CNC)

All purchases where estimated cost is over Rs. 10 lakh, except for Repeat Orders, SWOD and supply orders against rate contracts shall be scrutinized by the CNC and would be processed for approval of CFA along with the recommendations of CNC. The basic objectives of CNC are to study the recommendations of TCEC besides ensuring transparency, fairness and negotiating the price.

The estimated value will be the criteria for deciding the level of CNC. In case the negotiated value exceeds 10% of the limit of the level of CNC, recommendations of higher CNC will be required.

Compositions of 'Standing CNCs' have been specified for procurement under delegated powers as per details given below:

a) Project Cases within Delegated Powers of Financially Empowered Boards:
    i. Rep of Chairman of concerned Board Chairman
    ii. (ii) Financial Concurring Authority/ Rep Finance Member
    iii. Chairman, TCEC (for Two Bid System) Member
    iv. Head User Group/ Rep Member
    v. Head (MMG)/ Rep Member Secretary
    - An officer of the level of Scientist 'G', Lab Director and DG (Cluster) would chair CNC as reps of Chairmen of PJMB, PMB and Apex Board respectively. For PJMB, nomination of Chairman will be done by Lab Director. If officer of

Scientist 'G' level is not available, the senior-most officer next to the Lab Director would preside over the CNC.

- Secretary Defence (Fin)/ FA (DS) would be represented by Addl. FA (R&D) & JS, posted in Defence (R&D) for Apex Board sanctioned procurements. IFA R&D and DyIFA/ Jt IFA would be associated with procurements sanctioned by PMB/ PJB.

b) All Other Cases within the Delegated Powers of Secretary D R&D:

i. Rep of CFA (Not below the level of Scientist 'G'/ Equivalent) Chairman
ii. (ii) Financial Concurring Authority/ Rep Finance Member
iii. Chairman, TCEC (for Two Bid System) Member
iv. Head User Group/ Rep Member
v. Director MM, DRDO HQ/ Rep Member
vi. Director Lab/Estt Member
vii. Director (Admin) of Cluster/ Rep Member
viii. Head (MMG) of Lab/Estt Member Secretary

- An officer of the level of Scientist 'G', Lab Director and DG (Cluster)/CC R&D would chair CNC as reps of Lab Director, DG (Cluster)/CC R&D and DG (DRDO)/ Secretary Defence (R&D) respectively. For cases within the delegated powers of Lab/Estt Director, nomination of Chairman will be done by Lab Director. If officer of Scientist 'G' level is not available, the senior-most officer next to the Director would preside over the CNC.
- Secretary Defence (Fin)/ FA (DS) would be represented by Addl. FA (R&D) & JS, posted in Defence (R&D). Where Fin Rep under IFA scheme is not available locally, rep of local CDA (R&D) will be Fin Rep for cases with estimated cost up to Rs. 1 crore (Till full scale implementation of IFA system).
- Directors of Lab and DMM at DRDO HQ would be a member for cases beyond the delegated power of DG (Cluster)/ CC R&D.
- Director (Admin) of Cluster would be member for cases beyond the delegated power of Lab/ Estt Director.

Constitution of CNC for cases beyond the Delegated Powers of Secretary Defence (R&D), Financially Empowered Boards and for cases not covered above: In all cases beyond the delegated powers of Secretary Defence (R&D) and financially empowered boards, Secretary Defence (R&D) would constitute CNC, on case to case basis, in consultation with Secretary Defence (Fin)/ FA (DS). Besides finance member, it may comprise of concerned DG (Cluster), CC R&D (R&M), Lab/ Program Director. Head MMG will be the member secretary. For complex/ large value procurements having long term/ strategic implications, a special procurement committee/ CNC may be set up having cost experts, external experts and members as considered appropriate. Constitution of CNC would be processed by the Lab through concerned DG (Cluster) for the approval of Secretary Defence (R&D).

The Chairman CNC may co-opt any other expert member from the Lab/Estt or any other organization. Care should be taken that CFA for the procurement is not nominated as Chairman of the CNC.

Actions Prior to CNC Meeting

Scheduling of CNC meetings: The date and venue of these meetings will be approved by the Chairman, preferably in consultation with the designated members else, the latter should be informed at least 15 days in advance.

Labs/Estts shall ensure the validity of demand approval, quotations and availability of approved TCEC report before scheduling CNC meeting.

Reasonable price/ benchmark price needs to be worked out prior to opening of price bid in all modes of bidding but mandatorily in LBM/SBM/PBM cases to ensure reasonableness of quoted prices. Such assessment ought to be done prior to opening of price bid to ensure complete objectivity and transparency of this process. If required, an independent cost estimation committee may be set up by the Director or Chairman of CNC to determine the reasonable price/ benchmark prior to opening of the price bid.

Documents to be provided to the Members of CNC

a) Technical brief
b) CNC information as per format DRDO.BM.03
c) Demand approval by CFA
d) Report of TCEC with technical & commercial CSBs
e) Other briefing papers, if any

The member secretary will issue notice, indicating date/ time and venue for scheduling of the meeting. He will compile and send agenda papers, duly supported by documents to all members so as to reach them at least 10 days in advance. All qualified bidder(s) will be informed well in advance to enable them to be present on the day of price bid opening/ CNC meeting.

Guidelines for Conducting CNC Meeting

Price Reasonableness: The basic objective of CNC is to establish reasonableness of price being paid by the Buyer. This is a complex task and many factors need to be considered. Detailed guidelines for determining the reasonable cost are given in Chapter 8 of this Manual.

Scrutiny by CNC: In order to derive maximum advantage for successful materialization of the procurement within time schedule at the most favourable rate and payment terms, the CNC will examine the following points before opening the price bids:

(a) Description of the item and basis of estimation.
(b) If requirement is for project, PDC of the project.
(c) Likely availability of funds.
(d) Likely cash outgo during current financial year.
(e) If the mode of bidding is 'Limited', bids were invited from registered vendors else, approval of CFA has been taken.
(f) Validity of bids.
(g) Reasonableness of estimated price.
(h) Registration status of Indian agent where required, commission payable and currency in which payable.
(i) Mode of inspection/ inspection facilities available.
(j) Facilities for installation and commissioning are available/ covered in the firms' quotations.
(k) Requirement of specialized training, if any.
(l) Warranty period and availability of post-warranty facilities.
(m) Payment terms.
(n) Delivery period.
(o) Availability of FIM in the agreed time frame.
(p) Other commercial terms e.g. taxes and duties, packing and forwarding charges, mode of dispatch, transit insurance cover, place of delivery, etc.

Opening of Price Bids: The price bids of the technically accepted bids will be opened in front of rep of bidders present. Such opening of price bids should only be done when the CNC is fully convinced that no issues are left which need to be settled prior to opening of bids. All opened price bids will be signed by the CNC members.

Comparative Statement of Bids (CSB) for CNC Cases: The comparative statement of bids should be prepared with due care showing each element of cost (basic cost, taxes, levies, etc.) separately for each bid. The CSB will be as per the format given at DRDO.BM.06 The CSB will indicate all details of offers, i.e., nomenclature, price, payment terms, statutory levies, duties, insurance, packing & forwarding charges, installation & commissioning charges, training charges etc., as given in the bids. In case of variation in payment terms quoted by the bidders, the Net Present Value (NPV) method of evaluation may be followed for purposes of comparison as indicated in RFP. For a fair comparison and to determine the real cost of procurement, details as given in the bids such as delivery ex-godown or FOR destination, transportation, inspection costs etc. will be reflected in the CSB. In case cash flow involves more than one currency, these should be brought to a common denomination in Rupees by adopting exchange rate (BC selling rate of SBI) as on the date of opening of price bids. The CSB should be prepared after opening of the price bids and will be vetted by the finance rep for its correctness. The CSB will be signed by the member secretary and finance member. Assessment of L1 will be done as per the criteria stated in the RFP.

Commercial Evaluation

Evaluation of price bids is the core activity in any purchase decision. If the correct evaluation of price bids is not carried out as per the criteria incorporated in the RFP, purchase decision may become deficient and faulty. Detailed guidelines on establishing reasonability of prices and ranking of bids are given in Chapter 8 of Defence Procurement Manual. CNC will also take into account the provisions of purchase/ price preference as given in Chapter 2 of Defence Procurement Manual and RFP in terms of policy directives issued by the Govt. from time to time.

Commercial Negotiations

It is not necessary to hold commercial negotiations in each case, particularly in open and limited mode of bidding, where the response has been substantial and the L1 price is found to be very close to the reasonable price, provided such assessment had been carried out prior to opening of the price bids. However, commercial negotiation may become necessary to ensure that the interest of the State is fully protected and the price paid is reasonable. Commercial negotiations are invariably conducted in case of single source situations, including PAC cases, or when price is considered high with reference to assessed reasonable price, irrespective of the mode of bidding. Such negotiations should be conducted by CNC or a duly appointed committee, which should invariably include a finance member, unless the negotiation is carried out by the committee CFA itself.

The cost of post-warranty maintenance contracts for high value complex equip¬ment will be included in the initial price-negotiations by the CNC to seek price concession. However, it will not be included in determination of L1 unless the evaluation criteria in RFP are based on Life Cycle Cost of the product. 6.43.2 When negotiations are considered necessary, only the firm with the lowest acceptable bid as per evaluation criteria will be called for negotiations by CNC. The following points may be borne in mind while negotiating:

(a) Performance cum Warranty Bond: To ensure due performance of the contract till the warranty period, Performance cum Warranty Bond is to be obtained from the successful bidder(s) awarded the contract irrespective of its registration status. Performance cum Warranty Bond should be for an amount of five to ten percent of the contract value (excluding of taxes and duties) for safeguarding the Buyer's interest in all respects. In case of Indian bidder, Performance cum Warranty Bond may be accepted in the form of Bank Draft, Fixed Deposit Receipt, Banker's Cheque or a Bank Guarantee. For foreign bidders, it may be accepted in the form of Bank Guarantee or Stand-by Letter of Credit. It should remain valid for a period of sixty days beyond the date of completion of all contractual obligations, including warranty obligation. Performance cum Warranty Bond is returned to the Seller on successful completion of all its obligations, including warranty

obligation, under the contract. In case the execution of the contract is delayed beyond the contracted period and the Buyer grants the extension of delivery period, with or without liquidated damages, the Seller must get the BG revalidated, if not already valid.

(b) Free Issue of Material (FIM) as Raw Material: Lab/Estt will analyze the availability/ source of supply of the FIM and the time frame etc. before accepting any terms related to it. Bank Guarantee of the matching value would be taken to safeguard the FIM to be issued to the Seller. In specific cases where cost of the FIM exceeds the cost of the order, it will be ensured that BG is taken from the Seller for the order value and insurance cover is taken by the Buyer for the balance amount through Nationalized Insurance Agency or their subsidiaries. Requirement of BG or Indemnity Bond may not be insisted upon and should be at the discretion of CFA for Govt. Departments/ PSUs.

(c) Stores issued as FIM for Repair/ Maintenance etc.: Stores issued for purposes such as equipment or vehicle for painting/ repair/ fixture mounting etc. to the firm would be safeguarded through a comprehensive insurance cover taken by Lab/Estt through a Nationalized Insurance Agency or their subsidiaries.

(d) Liquidated Damage (LD): The Buyer reserves the right to impose LD in case of delay in supply attributable to the Seller at the rate of 0.5% per week or part thereof for stores which the Seller has failed to deliver within the period agreed for delivery in the contract subject to maximum of 10% of the total order value (excluding taxes & duties). In certain categories of procurement, LD can also be levied on the Seller on the basic cost of the stores supplied partially within the scope of the order/ contract that could not be put to use due to late delivery of the remaining stores.

(e) Bank Guarantees (BGs):

i. For Indian Sellers: Applicable BGs may be accepted from a public sector bank or a scheduled private commercial bank in the format prescribed by RBI.

ii. For Foreign Sellers: Applicable BGs may be accepted in the prescribed format from an Indian Public Sector/ Schedule Private Commercial Bank or a First Class International Bank of repute, acceptable to the Buyer. Guidelines on verification of BGs from Foreign Banks through SBI are given in Annexure 'B' of Defence Procurement Manual.

iii. Indemnity bond may be accepted only from Government Departments/ DPSUs/ PSUs in lieu of BG.

(f) Any waivers from requirement of Performance cum Warranty Bond, BG for FIM and LD Clause would be considered as deviation from the prescribed procedure and will be dealt as per para 1.10 of Defence Procurement Manual.

Payment Terms

The payment terms should normally be in accordance with those indicated in the RFP. Any change of payment terms from those specified in the RFP can alter L1 determination. As such CNC must take into account the time value of money as per Discounted Cash Flow (DCF) Technique given in Chapter 8 of this Manual while agreeing to any change and record the justification for accepting any variation in payment terms from the RFP. The broad payment terms are as under:

Normal Payment Term: The normal terms of payment are 100% within 30 days after receipt & acceptance of stores in good condition or the date of receipt of the bill whichever is later. In cases where installation is required and is covered in the scope of the order, not more than 80% payment will be released on receipt of goods and balance will be paid after installation and commissioning. However based on the merit of the case, payment up to 100% against proforma invoice/ delivery may be agreed for consumable stores such as chemicals, gases, etc., when insisted upon by the bidder.

Advance Payment: Ordinarily, payments for services rendered or supplies made should be released only after the services have been rendered or supplies made. However, it may become necessary to make advance payments in the following types of cases:

a) Advance payments are demanded by bidders for maintenance contracts such as servicing of airconditioners, computers, other costly equipment, etc.
b) Advance payments demanded by bidders against Project with long execution time, development contract, fabrication contracts, turnkey contracts, etc.
c) Where envisaged earlier and decided to provide advance payment, the quantum should be incorporated upfront in the RFP.
d) Quantum of Advance: Such advance payments should not exceed the following limits:
    i. 15% of the basic contract value for the procurement of COTS/ general use stores;
    ii. (ii) 30% of the basic contract value for developmental contract; fabrication contract; turnkey contract or suck like contracts where mobilization of resources is required;
    iii. Basic amount payable for six months in case of maintenance contracts;
    iv. For projects sanctioned by GOI through CCS or EC/PC of NCA route, advance payments would be considered as per the necessity in line with Delegation of Financial Powers in vogue.
    v. Wherever justified organizations such as NICSI, MTNL, RailTel, BSNL etc. which function under the aegis of government departments and

payment to Air Consolidation Agent towards custom duty for clearance of goods from customs authorities will be allowed up to 100% advance payment whenever insisted upon either in one-go or in stages approved by the CFA based on recommendation of CNC.

e) Securing the Advance: While making any advance payment, adequate safeguards in the form of bank guarantee or indemnity bond for PSU/ Govt. Dept. in favour of the Director of Lab/Estt of appropriate value (~110% of advance amount), should be obtained from the Seller. Sample format of bank guarantee and indemnity bond are given in forms DRDO.BG.02 and DRDO.BG.03 respectively. Requirement of BG or Indemnity Bond may not be insisted upon and should be at the discretion of CFA for Govt. Dept/ reputed academic institutions such as IITs etc. or for low value orders up to Rs. 2 lakh to reputed private firms when no other mode of payment is acceptable to them. However, following points must be ensured:
    i. Since, advance paid to the Seller is prone to be used by them for the purpose other than the one for which it is disbursed, adequate steps must be taken to ensure that advance is disbursed against anticipated cash out flow and the Seller is not benefited unduly by the way of retention of advance when no cash outflow is anticipated.
    ii. (ii) The vendors should be informed that the advance given would become interest bearing in case of termination of order/contract due to their default or if it is used for the purposes other than this contract as per the terms stated in the RFP.
    iii. Delivery Period (DP) extension for the default of the Seller would make advances paid interest bearing.

Stage/ Part Payments Where progressive payments are anticipated, the same shall be agreed against identified and verifiable milestones. The same should broadly be as per the RFP. All progressive payments, where stores of equivalent amount are not received, should be secured. In cases, where the stage payment is not mentioned in the RFP, the same may be approved by the CFA on the recommendations of CNC.

Pro rata payment: In case the bidder requests for pro rata payment, the same may be approved by the CFA on the recommendations of CNC.

Payment to Foreign Firms: Payment to foreign Sellers may be done through Letter of Credit/ Direct Bank Transfer. Details are given in the Annexure ‘B’ of this Manual.

Deviation from Standard Terms of Payment: CFA can approve any of the payment terms mentioned above. Deviations from the above mentioned terms will, however, be allowed in exceptional circumstances on the specific recommendations of CNC and will be dealt as per para 1.10 of Defence Procurement Manual.

Apportionment of Quantity

Where it is Pre-decided: The total order quantity would be split in the ratio as indicated in the RFP. Ratio of splitting would be preferably in favour of L1. All efforts would be made to negotiate a reasonable price with the L1 bidder and, thereafter, counter offers would be made to L2, L3 etc. sequentially at the rate & terms and conditions accepted, except duties and taxes, by L1. If none of the other bidders agree to match the negotiated rate & terms and conditions of L1, except duties and taxes, then the order may be placed on L1 for the full quantity, else alternative source may be explored through separate bidding process.

Where it is not Pre-decided: If L1 does not have the capacity to supply the entire quantity, the balance order may be placed on L2, L3, etc. sequentially at the rate & terms and conditions, except duties and taxes, negotiated with L1 in a fair, transparent and equitable manner. In case the bidders are not in a position to execute the total order quantity, then alternative source may be explored through separate bidding process for the balanced quantity.

Buy-Back Offer

When it is decided with the approval of the competent authority to replace an existing old item(s) with a new and better version, the department may trade the existing old item while purchasing the new one. For this purpose, a suitable clause is to be incorporated in the bidding document so that the prospective and interested bidders formulate their bids accordingly. Depending on the value and condition of the old item to be traded, the time as well as the mode of handing over the old item to the successful bidder should be decided and relevant details in this regard suitably incorporated in the bidding document. Further, suitable provision should also be kept in the bidding document to enable the purchaser either to trade or not to trade the item while purchasing the new one. In such cases, the RFP should call for the bidders to quote the price of new equipment and buy-back offer for the existing equipment explicitly in their bid. CFA/ CNC may assess a benchmark price for the item to be traded off in buy-back process. On buy-back cases, L1 would be decided on the basis of net cash outgo excluding taxes and duties. Lab/Estt will follow the security guidelines in vogue while trading the old item against buy-back offer.

Concluding CNC Meeting (For CNC Cases)

Detailed minutes of the CNC meeting will be recorded, highlighting the deviations, if any, from prevailing procedures and/ or from the RFP along with recommendations made by the committee as per DRDO.BM.07. The gist of CNC recommendations must appear on the page containing signatures of the members. The minutes of the CNC must be issued duly signed by all the members and cleared by the Chairman.

In case the CNC is unable to conclude the negotiations satisfactorily, it may recommend to CFA to refer the case for negotiations by the next higher CNC. The minutes of every CNC

meeting convened for a particular procurement should be recorded and signed by all the members.

Dissenting Opinion

Dissenting opinion, wherever expressed, will be recorded in the CNC minutes and the same will be referred to CFA for decision.

Letter of Intent (LOI)

At times, it may be necessary to follow up the negotiations with the issue of a LOI or fax acceptance due to imminence of expiry of the bid or for any other reason. LOI amounts to final acceptance of the offer. It is, therefore, imperative that all-important and relevant aspects such as description of stores, quantity, price, delivery period, etc. are properly reflected in the advance communication. It will be ensured that in such cases there is no variation between the LOI and the formal supply order issued subsequently. The advance communication should specifically confirm acceptance of the offer and state that the formal supply order showing full details will follow. The formal supply order will be issued without any avoidable delay.

LOI is a legally binding document and should be issued on the recommendations of CNC if the negotiated amount does not exceed the estimated cost in demand approval and no deviation from the prevailing procurement process has been made so far.