

# Public Procurement in India

## Risks and challenges inherent in supplying to the government

### Introduction

The increasing volume of public procurement opportunities in India, coupled with the scale and magnitude of government projects, holds tremendous economic potential for both local and overseas companies. The recent uptick in procurement opportunity in India can be attributed to a variety of measures and initiatives.

For one, foreign investors are today being granted greater access to the breadth of India's market than ever before. The Parliament has recently approved a proposal to further liberalize investment and increase foreign direct investment inflow into India, easing investment caps and opening up previously restricted sectors to overseas investors.

The government's push towards modernising existing infrastructure and equipment has also resulted in a number of procurement opportunities, as have new initiatives such as "Digital India" and "Make in India" which are geared towards improved physical and social infrastructure, connectivity and local design and manufacturing capability.

Nonetheless, working with the government can be a mixed bag of opportunities and challenges, and business exposure to the public sector is not without legal and compliance risks. To this end, we have distilled a few key takeaways from our experience advising clients on public tender processes and vendor contracts with the government.

### Public Procurement Regime - Overview

There is no comprehensive central legislation exclusively governing public procurement in India. Instead, the public procurement regime comprises a framework of overlapping administrative rules and guidelines, sector-specific manuals and state-specific legislation.

At the core of the procurement framework lies the General Financial Rules ("GFR") initially implemented in 1947 and last modified in 2017. The GFR comprises comprehensive administrative rules and directives on financial management and procedures for government procurement. All government purchases must adhere to the principles outlined in the GFR, which includes specific rules on procurement of goods and services and contract management.

Additionally, the Manual for Procurement of Goods, 2017 contains guidelines for the purchase of goods, and the Delegation of Financial Powers Rules, 1978 delegate the government's financial powers to various ministries and subordinate authorities. All government authorities delegated with the financial powers of procuring goods in public interest will be responsible to ensure efficiency, economy and transparency, fair and equitable treatment of suppliers, and the promotion of competition in public procurement. These administrative guidelines are supplemented by manuals and policies governing procurement by individual ministries/departments, such as defence, telecom and railways.

The framework is checked (for compliance) and further layered with rules by authorities including: (a) the Central Vigilance Commission tasked with increasing transparency and objectivity in public procurement; (b) the Competition Commission of India which checks anti-competitive elements; and (c) the Central Bureau of Investigation engaged for investigation and prosecution of the criminal activities in the procurement process such as probity issues.

As between the procurer and the vendor, these rules above flow down via a tender process, award and contract.

## Challenges and Concerns

The principle underlying India's public procurement regime is the acquisition of materials and services of specified quality at the most competitive prices, in a transparent and non-arbitrary manner. Nonetheless, the absence of a central procurement regulation enabling procuring authorities with scope to tweak guidelines and contract format, leads to confusion on one hand and rigidity on the other. In fact, different agencies may even prescribe varying qualification criteria, financial terms, selection procedures etc. for similar public sector work.

Vendors supplying, directly or indirectly, to the Indian government must carefully navigate the convoluted procurement framework. Falling foul, inadvertently or otherwise, of any procurement conditions under the tender documents or the aforementioned rules and guidelines could result in the tender award being challenged / disqualified and the contract rescinded, and the vendor being blacklisted for upto 3 years.

In addition, supplying to the government may involve some unique risks and practical concerns, as captured below.

### 1. Parent Guarantees


- Procurement tenders typically reflect pre-specified criteria of minimum turnover, revenue, employee, size, etc. These requirements would effectively prevent a newly incorporated local subsidiary or special purpose vehicle of an overseas vendor from participation in the tender.
- In some cases, the procurer may permit participation on the basis of the financial and technical qualifications of the foreign parent, and subject to the foreign parent providing a financial and performance guarantee on behalf on the contracting entity.
- However, this may open up the overseas entity to financial and legal risks (mainly back to back liability for breach of performance) that may not have been contemplated when assessing whether to participate in the tender.
- Further, performance guarantees may also be sought from foreign suppliers who do not have a presence or track record of supply in India.

 **Evaluate carefully before exposing the global entity to financial and legal risks via back to back liability and performance obligations.**

### 2. Sub-contracting - Liability Flow Down


- It is not uncommon for overseas vendors to enter into sub-contracting or reseller arrangements with an Indian entity to avoid having to incorporate a local entity and/or to comply with sector-specific foreign investment restrictions. In such case, the main or prime contractor is the Indian partner.

- However, this arrangement may not successfully avoid liability flow down issues (including financial exposure) from the main contract with the end customer (i.e. government authority).
- While contractual risk can be apportioned inter se between the Indian prime contractor and the overseas sub-contractor, this will have limited bearing on the bid and the contract with the end customer. Further, in the event of breach by the prime contractor, the effectiveness of contractual and tortious recourse would ultimately depend on prime contractor's financial ability to make reparations to the overseas sub-contractor.
- Under some bid terms, the overseas sub-contractor has had to undertake a deed of joint and several liability co-extensive with the prime contractor, effectively exposing it to unlimited liability and direct recourse from the end customer under the main contract.
- Specific commercial requirements such as technical qualifications, timelines for production, escrow etc. will be specified under the tender terms, and these will flow down to the overseas sub-contractor on a back to back basis.
- Letters of comfort and/or corporate guarantees (resulting in direct recourse) may also be required from the overseas vendor assuring availability of after sales support, warranty fulfillment and spares.

 **Your scope of work and liability for breach may not necessarily be balanced vis-à-vis the end customer, even if you are the sub-contractor. Your liability exposure may be for the entire scope (and not just your share) of work.**

### 3. Transfer of Technology

- The ability of a vendor to retain control over its intellectual property ("IP") will depend on the extent of transfer of technology ("ToT") mandated under the tender documents and sector-specific guidelines.
- For instance, the requirement for "comprehensive ToT", or a stipulation that Indian entities must have "complete control" over technology transferred, may limit the vendor's ability to include restrictive conditions, ringfencing, end-use restrictions etc. under the ToT or licensing agreement.
- Even where restrictions on use, disclosure etc. are contractually mandated, contraventions of terms of use of IP / enforcement of IP rights in India can be difficult and costly.
- It is not uncommon for the procurer to require key technology blue prints or other documentation to be placed in escrow.
- Some bid terms may even entitle the customer (i.e. the government) to take over the assembly line where the supplier ceases manufacturing the relevant part.
- At an extreme (and though not commonly exercised) the government may, for sensitive sectors such as defence, also have "march-in rights" to take control over the IP for national safety and security considerations.

 **Ensure that your ToT agreement has sophisticated and detailed IP clauses that clearly delineate the scope of IP involved and set out all necessary rights and obligations (including provisions for jointly developed IP) to avoid any disputes in the future.**

### 4. Bottlenecks in the Procurement Process

#### Tender Process

- The tender process for certain sectors, such as defence, railways and telecom, is slow and complex. This stems in large part from prior procurements being challenged for impropriety and mis-tendering, resulting in lengthy and convoluted bid terms and multiple layers of scrutiny and protocols.

- Because of the risk of scrutiny, officers running the tender insist on following the convoluted tender process by the book. This means multiple exchanges of requests for deviations, clarifications and recorded meetings, all of which become a part of the tender documentation.

**❗ A dedicated team may be required in India to follow the tender process and see it through to its conclusion. Quite often, the most successful firms are those with the endurance to follow the tender process through.**

#### Delayed Decision-making

- Given the multitude of stakeholders involved, it is not unusual for decisions to be held up at more than one level. For instance, decisions pertaining to defence tenders may go through the relevant Armed Forces Wing, User Services Agency, Quality Control Agency, Maintenance Agency, Defence Finance etc.
- As above, the reluctance of government personnel running the project to deviate from tender terms and conditions (even where they are not fit for purpose) may often be at the cost of speedy and efficient decision-making.

**❗ The average time between the initial release of a request for proposal and the final contract award could take several months and in some cases (defence) years.**

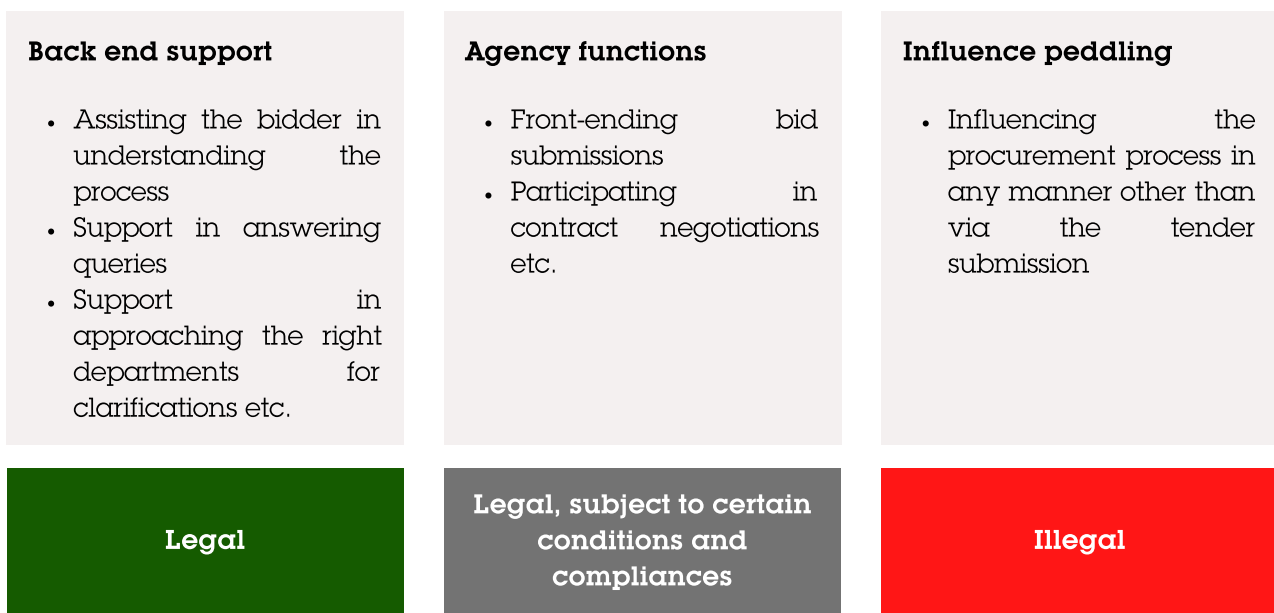
#### Limited Scope for Negotiation

- Upon the award of a tender, vendors are likely to have very limited scope for negotiating contractual terms.
- Post-tender negotiations are specifically discouraged under the CVC guidelines, and even negotiations with the lowest cost bidder (L1) can only be undertaken for reasons to be recorded in writing.
- This is problematic because there is often a disconnect between the experts who draft government contracts and those who are accountable for implementing the procurement project / program. The contract may focus on plugging financial leakages and securing aggressive warranty terms, and, upon implementation, may be found to be ambiguous, commercially unviable and onerous on the vendor.
- Further, any deviation by the vendor from the tender terms may be considered a breach, attracting penalties, blacklisting and potentially years of arbitration / litigation.

**❗ Most terms may have to be factored in as cost of business. Negotiations happen during the submission stage as clarifications or deviations.**

### 5. Use of Agents

- Given the complexities inherent in public procurement, local representatives or agents who are familiar with the process as well as with the customs and culture of India can play a role in assisting vendors in navigating it.
- However, permitted use of agents should not be automatically assumed. Vendors should carefully consult the tender documents as well as the procurement manual (if any) of the procuring authority to confirm any restrictions or requirements (such as registration) attaching to the engagement of agents.
- At the minimum, vigilance and integrity pact requirements may mandate disclosure of engagement and fees payable to the agent.
- Typically, the nature of functions undertaken by the agent would dictate the legality of their role:



- That said, agents have been embroiled in a number of bribery prosecutions in India and as such their engagement may still carry negative connotations, regardless of their tasks. For regulatory and perception risk management, when appointing agents:
  - a. undertake a thorough diligence of the proposed agent; and
  - b. include strict payment terms that are not linked to the award of the tender and specifically exclude transacting with an offshore account (to avoid allegations of corruption and investigations relating to foreign exchange violations).

**Structure your consultant / agent relationship carefully, and include strict compliance and monitoring mechanisms in the agency contract to avoid illegal or unethical acts from being undertaken ostensibly on your behalf.**

**6. Local Preference and Indigenisation**

- In its efforts to attract foreign investment and boost the flow of capital and technology into domestic manufacturing, the government has adopted measures to give procurement preference to locally produced goods and services.
  - a. Certain manuals of ministries and public sector units (PSUs) may mandate local presence by obligating foreign suppliers to enter into the tender contract and supply via a local (Indian) entity.
  - b. The Public Procurement (Preference to Make in India) Order, 2017 seeks to promote local production of good and services by granting purchase preference to local suppliers if they match the winning bid of a foreign supplier within a certain margin above the lowest bid price.
  - c. The push for local preference is particularly evident in sensitive sectors such as railways and defence where procurement requires a minimum amount of indigenous (or local) content, greatest procurement priority is allocated to tender submissions with the highest percentage of indigenous content and technology transfer and/or offsets may be mandated under tender terms.

These measures may mean supplying via a locally incorporated entity (such as a joint venture, consortium or subsidiary) or entering into re-seller, assembly, licensed manufacturing etc. arrangements with a local Indian partner.

The structuring route ultimately adopted will depend on sector-specific restrictions (such as 49% cap on foreign investment in telecom and defence entities) and the vendor's commercial objectives and sensitivities (such as retaining complete control over IP, leading contractual negotiations, boosting company "brand" through local presence etc.).

**Structure carefully, and evaluate structuring options prior to making bid submissions or responding to EOIs.**

## 7. Additional Considerations

- **Continuing Obligations:** Certain long term procurement contracts may have continuing obligations in the form of transfer of technology and warranty support from vendors. This could mean vendors are on the hook for supplying spares as well as technology upgrades / modifications (typically, free of cost) for the lifetime of the equipment.
- **Competition:** Vendors must ensure that transactions and supply chain pricing are undertaken on an arm's length basis, and that there are no vertical or horizontal agreements undertaken that may constitute violation of anti-cartel provisions.
- **Barriers to Innovation:** In the 2-part bid system typically followed for public tenders, once technical specifications are met, the contract is awarded to the lowest cost bidder (L1). However, this process does not give enough weightage to costs inherent in innovation (particularly relevant for contracts pertaining to state of the art technology).
- **Imports:** Sub-contracting arrangements, where a part / component of the product is supplied to the Indian partner from overseas (and support services such as after sales), will be viewed as an import of goods and services into India and duties will be levied accordingly. Generally, import of goods and services is a cumbersome and time consuming process and will need close supervision by the importer on record (which should be the Indian partner). We recommend that a complete import controls analysis be completed by specialist customs advisors prior to finalising an import-based structure.

## Concluding Thoughts

While vast opportunity exists for overseas entities looking to bid for Indian procurement projects, vendors should be mindful of the challenges inherent in public sector exposure.

Planning and evaluating structuring options in advance of bid submission is essential. Build in lead times, and be realistic about potential risks and financial exposure. Be extremely cautious when engaging agents - use them effectively, but only for the purposes allowed under the various regulations and guidelines. Finally, identify, and focus on, critical factors. Unlike private contractual arrangements, it may not be possible to check every internal "ideal position" box. Use the flags identified above to help organize key thoughts.

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