



# India's Defense Procurement: Responses to the New Scandal

INDIA AND THE UNITED STATES: THE EVOLVING LEGAL LANDSCAPE  
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# Coverage

- **The Finmeccanica (VVIP Helicopter) Scandal**
- **The Government's Response**
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- **Impact on U.S. Willingness to Invest**
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# The Finmeccanica (VVIP Helo) Scandal

- Since February, investigators in Italy and India have been pursuing a scandal involving the sale by the Agusta-Westland unit of Finmeccanica of 12 “VVIP” helicopters to India.
- Allegations have been made that bribes and agent fees amounting to \$65M were paid to secure the \$750M sale.
- A former top official of the Indian Air Force has been charged.
- “SQR” specifications may have been changed to sway the win.
- Middlemen are reported to have diverted \$ millions to bribes.
- Phony offset contracts allegedly were used to generate cash.

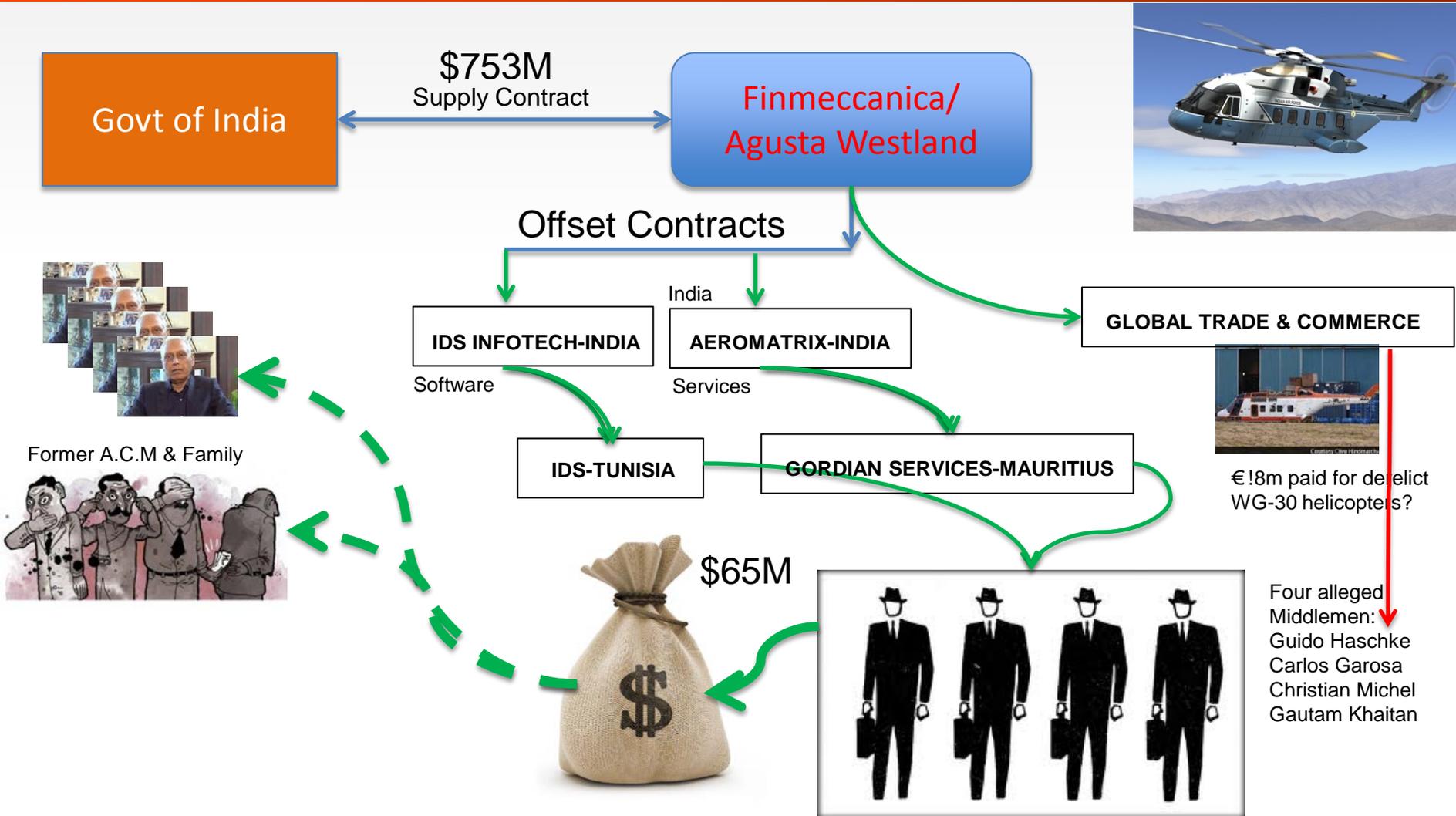
**The investigation again focuses world attention on India’s defense acquisition process – and on the continuing problems of corruption that affect government process in India.**

# Defense is Big Business in India

- Since 2009, India has purchased \$14.3 billion (Rs 78000 crore) to import weapons. India now is the world's largest importer of weapons. (Sipri)
- India's foreign military purchases are accompanied by "offset" obligations that require foreign sellers to purchase supplies and services from Indian sources worth at least 30% of the sale price.
- India has relied upon foreign sources for 65-70% of its defense hardware.
- The scandal casts harsh light on brokers, middlemen and consultants.
- Offset contracts worth >\$4 billion have been signed with foreign sellers
- The latest controversy shows how offset contract arrangements can be misused to become vehicles to flow funds for kickbacks and illegal purposes.

Also exposed is the risk that corruption distorts India's procurement process where illegal gratuities produce award to one competitor over others. This undermines the willingness of reputable suppliers to participate in the market.

# Alleged Abuse of Offset Contracts



# The Government's Response

- Government reaction initially was both swift and strong.
- Investigations were mounted by the Central Bureau of Investigation (CBI) .
- A criminal investigation has been initiated against the Air Force General and his family, following filing of a First Information Report (FIR).
- Prosecutions may follow under the Prevention of Corruption Act.
- The Ministry of Defence is pursuing contractual remedies including those afforded by the Integrity Pact that accompanies each defense contract.
- Under consideration are contract cancellation, demand to recover sums paid and potential debarment of companies involved.
- **On April 20, the MOD announced “Major Changes” to the DPP**
  - **These are to “Encourage Indian Defence Industry.”**
  - **Minister Antony: indigenization is the “ultimate solution to the scourge of corruption.”**
  - **Media coverage treats the DPP changes as the answer to the “VVIP scam.”**

# Announced DPP Changes of April 20

- Fifteen Changes were announced:
  1. **New prioritization for “Buy (Indian)”**
  2. Public release of long-term planning documents
  3. **Maintenance ToT no longer through nomination** (as favored PSUs)
  4. Advance consultations for “Make” Procedure
  5. Simplification of “Buy & Make (Indian) Procedure
  6. **Clear Definition of Indigenous Content**
  7. Ensuring faster progress in “Make” and “Buy & Make (I)” cases
  8. **“Defense Items List” clarified for DIPP industrial licensing**
  9. **MOD has clarified that “dual use” items do not require licensing**
  10. New Security Guidelines have been drafted
  11. Tax-related issues involving “deemed exports” have been resolved.
  12. Funds are set aside for MSME defense sector sponsorship
  13. SQRs are frozen before the AON and the AON validity period cut to 1 yr.
  14. Enhanced delegation of financial powers
  15. **DAC now decides DPP deviations rather than Defence Minister**

No doubt the MOD will realize political benefits from this press release that champions an intention to increase self-reliance in the defense sector.

Until the particulars are known, however, and the details of new guidance and rules are revealed, one can only speculate as to whether there are real benefits to Indian industry.

The conditions that have frustrated indigenous defense capability in India are not changed by these announced

# Reaction to the April 20 Announced Changes

- The DPP changes do not address the root causes of corruption.
  - No objective reason to believe a “Buy (Indian)” emphasis will eliminate official expectations of gratuities or end “*pay to play*” practices.
- No near-term surge of domestic defense purchases.
  - Time is needed for both the private and public sectors to achieve the necessary expertise to fully deliver on the new “Buy (Indian)” priority.
- Foreign participation remains crucial to India’s success.
  - Access to foreign technology and assistance is necessary if the Armed Forces are to receive timely supply of equipment comparable to that rival states will field.
- India’s private sector will remain cautious.
  - Private industry must have confidence that the Government will execute upon announced ambitions and fund programs that can be profitable.
- Stronger anti-corruption measures benefit all concerned.
  - Reputable domestic and foreign firms need reason for confidence they can participate in India’s defense sector with acceptable compliance risk.

# Impact on U.S. Willingness to Invest

- The Finmeccanica scandal will further discourage U.S. companies from doing defense business in India.
- U.S. companies are exposed to FCPA and the U.K. Anti-Bribery Act for acts all too routine (if not necessary) in India.
- The 26% FDI cap on defense sector investment causes U.S. companies to doubt they can impose compliance on JVs.
- (It is no consolation that absence of control may act as mitigating factors when facing FCPA prosecution.)
- The FDI cap also exposes crucial IP to risk or forfeiture because of insufficient enterprise authority.
- Some U.S. firms will abstain from the India defense market because of the poor relationship of risk to reward.

# Potential Positive Responses - I

1. India should be vigilant and enforce its existing laws, e.g., the Prevention of Corruption Act (PCA).
  - Action should be taken only after due investigation and fair process.
  - Section 7 of the PCA makes it a criminal offense for any public official to take “gratification.” Section 8 punishes perpetrators of bribery.
2. India should act to realize its contractual rights.
  - Under the Integrity Pact, India has a right to recover any sums paid to middlemen, agents or brokers to facilitate the illegal scheme.
  - India should consider its own interests as to cancellation or debarment.
3. India should strengthen its legal regime to fight corruption.
  - The PCA has been faulted, by international standards, for poor enforcement.
  - The Public Procurement Bill (PPP) 2012 should receive renewed attention.
4. India should not condemn all foreign suppliers because of the alleged conduct of one or a few.

# Potential Positive Responses - II

5. Defense procurement can be a “model” for new structures and procedures to reduce the opportunity for corruption.
  - Some of Indian bureaucracy anticipates facilitation payments and gratuities as an ordinary, if not deserved compensation for performing their duties.
  - This culture cannot be reconciled with the compliance obligations of ethical international business. Nor should it be tolerated for defense expenditures.
6. India could consider creating special authorities and bureaucracies to pilot new methods to avoid corruption.
  - The Government might create centralized authority to coordinate required business licensing and approvals for defense ventures.
  - MOD civil servants could be given extended assignment and higher pay.
  - Discretionary decisions should be made only with consensus and transparency.
7. Indigenization should be tempered with realism.
  - Making India inviting to foreign participation will help achieve defense aims.

# Potential Positive Responses - III

8. The sectoral limit on FDI in defense industries must be increased to at least 49%.
  - The present cap of 26% deters international companies from JVs with Indian partners because they cannot assure compliance with anti-corruption regimes.
  - Higher FDI will facilitate needed transfer of technology; companies have been reluctant to share crucial IP with ventures where they have only a small interest.
9. The national Government needs to face and fix barriers to effective foreign business participation in defense.
  - The practice of “compulsory licensing” is a poorly disguised way of extracting facilitation payments and other gratuities from foreign companies.
  - This insidious practice must be eliminated in the defense sphere.
10. Existing foreign-owned India companies should be welcomed.
  - India’s national goals are advanced if existing foreign-owned ventures in India can realize offset credit for bona fide software and solution development.

# Integrity Considerations: Background Materials

# Integrity Considerations: Contract Requirements

- **Pre-Contract Integrity Pact**

- A binding agreement for all proposals above Rs 100 Cr (~\$22M) to ensure procurement process and that there is accountability.
- Both parties promise that neither they nor any of their officials will offer or accept any kind of illegal gratuity during the procurement process.
- Earnest money deposit is Rs 1 Cr (\$220,000) where estimated cost is between Rs 100 - 300 Cr (\$22M - \$66M) and Rs 3 Cr (\$660,000) if above Rs 300 Cr.
- Violation may lead to legal and other actions that include:
  - Termination of negotiations
  - Cancellation of contract if signed
  - Call on Bank Guarantees
  - Debarment
- Independent monitors are appointed in consultation with the C.V.C (an independent statutory body mandated to look into complaints about violation of the Integrity Pact)

# India's Anti-Corruption Regime

- **Prevention of Corruption Act**

- Prohibits and penalizes corruption of public servants
  - No exception for “facilitating payments” (as in FCPA)
- Applies to the maker and recipient of a bribe; abetment also an offense
- Public servants may neither accept nor retain any “gratification” as a motive or reward from taking/forbearing from an official act
- Private persons may not accept or obtain any gratification as motive or reward for “inducing” any public servant, “by corrupt or illegal means” to take or forbear from an official act
- Offenses are punishable by imprisonment and/or fine

- Well-publicized investigations by Central Vigilance Commission (CVC) and Central Bureau of Investigation (CBI)

**Despite this anti-corruption regime, there is widespread public perception that corruption remains endemic. Companies must proceed with wariness, discipline and process**

# Integrity Considerations: U.S. & U.K. Laws

- **U.S. Foreign Corrupt Practices Act (FCPA)**

- Anti-bribery provisions prohibit bribes (or offers to bribe) made to foreign officials, political parties, etc., “whether made directly or through a third party for the purpose of obtaining or retaining business or securing a business advantage.”
- Accounting provisions require accurate books and records and adequate accounting and financial controls – no allegations of bribery are required
- Sanctions include criminal and/or civil penalties, loss of export licenses, debarment or suspension

- **U.K. Anti-Bribery Act (UK)**

- Three offenses (bribery, taking a bribe, bribing a foreign official) apply to UK nationals or residents, entities incorporated in the UK, or foreign persons acting in the UK
- A strict liability offense (failure on the part of a corporation to prevent bribery) applies to UK entities and to entities “carrying on business” in the UK, even if incorporated elsewhere

- **Comparing the FCPA and the Anti-Bribery Act**

- The Bribery Act applies to bribes offered or given to any person; the FCPA applies only to corruption involving foreign officials; no exception for “facilitating payments”
- No “corrupt intent” is required for the offense of bribery of a foreign official
- Subject to the defense of “adequate procedures,” an offence is present under the Bribery Act for failure to prevent bribery

# Integrity: Practical Consequences

- **Fear of accusation produces risk-adverse official conduct**
- **“Web” of Overlapping Requirements Presents Challenges**
  - India’s acquisition rules are complex; objective of Armed Forces may be uncertain, but risks are present in the use of outside experts
  - Not at all clear who may contact GOI officials, when or about what ...
- **Corruption consequences constrain engagement by OEMs**
  - Conduct which may be “ordinary” by local mores can violate the FCPA and/or the UK Bribery act
  - 26% FDI limit raises questions of “discipline” or control over JV acts
  - FCPA applies both to “controlled” and “affiliated” entities – and agents
- **Public/ media attention deter some from defense sector work**
  - Losing bidders have initiated CVC investigations – e.g., Scorpene
  - Pre-award “clearance” has been sought from CVC (single source)
  - Reward of MOD contracts may not justify reputational risk

# Speaker Biography



Robert S. Metzger received his B.A. from Middlebury College and is a graduate of Georgetown University Law Center, where he was an Editor of the *Georgetown Law Journal*. He was a Research Fellow, Center for Science & International Affairs, Harvard Kennedy School of Government.

For the ABA Section on International Law, he serves as a Vice-Chair, Aerospace & Defense Industries Committee, and as a Member of the Steering Group of the India Committee. Mr. Metzger is a member of the International Institute for Strategic Studies (IISS), London. Academic publications on international security topics include articles in *International Security*, the *Journal of Strategic Studies* and *Indian Defence Review*.

Mr. Metzger advises leading US and international companies on key public contract compliance challenges and in strategic business pursuits. His transactional practice includes international projects, joint ventures, direct and FMS sales to foreign governments, advice on offset obligations and assistance with compliance counseling. In litigation, he has represented companies before administrative agencies as well in federal and state courts

## SELECTED EXTERNAL PUBLICATIONS

- “Defence: Work with Uncle Sam,” *The Economic Times (India) (Op-Ed)*, Feb. 5, 2013.
- “Making India’s Offsets Work for India,” *Indian Defence Review*, Vol. 28:1 (Jan-Mar 2013).
- “Doing Aerospace Business in India,” Presentation to Aerospace Industries Association, General Counsels Forum, October 2012.
- “India’s Revised Offset Guidelines,” Presentation to DIOA/GOCA Fall 2012 Conference, Brewster, Mass, September 2012.
- “U.S.-India Defence Cooperation: Towards an Enduring Relationship,” *Indian Defence Review*, Vol. 27 (2), April-June 2012.
- “A ‘Work in Progress’ – The Evolving U.S.-India Defense Supply Relationship,” *Indian Law News (ABA Section of International Law)*, Vol. 2, Issue 3 (co-author).