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INTEGRITY OF INTEGRITY PACTS!

Uberrimae Fidei, the Doctrine of Utmost Good Faith is a covenant which impliedly applies to every financial transaction. This is a cardinal principle in the world of insurance law. The Doctrine of Utmost Good Faith legally obliges all contracting parties to enter, execute and perform their contractual obligations in an honest manner and not to mislead or withhold critical information from one another, which may have the effect of destroying or injuring the other party.

Though many developed countries have codified the Doctrine of Good Faith, however, the Indian Contract Act, 1872 (“**Contract Act**”) remains silent on this aspect. Though it is surprising that precedents on this aspect is scant on the Indian front, apart from insurance law domain. The High Court of Justice, United Kingdom, in *Berkeley Community Villages Ltd and another v. Pullen and others*, had the opportunity to interpret a contractual clause which was in the following terms: ‘*In all matters relating to this agreement the parties will act with the utmost good faith towards one another and will act reasonably and prudently at all times*’. It was observed that, “*obligation to observe reasonable commercial standards of fair dealing in accordance with [the parties’] actions which related to the Agreement and also requiring faithfulness to the agreed common purpose and consistency with the justified expectations of the First Claimant*”. Thus, it can be construed that the Doctrine of Good Faith axiomatically requires contracting parties to conduct their affairs in a fair manner.

In recent times, it has been observed in India, public sector enterprises and governments while entering into contracts insist upon the contractor to execute a separate Integrity Pact over and above the principal contract for the goods or services. It is necessary to delve a little into the history to excavate as to what led to these State-run organizations to execute an altogether separate contract commonly known as an ‘Integrity Pact’.

Transparency International is an organization that started a movement back in early 90’s to start an initiative against corruption. With their efforts, they have been successful in implementing the initiative in over 100 countries where governments, businesses and civil societies have adopted the tools developed overtime by Transparency International to curb the menace of corruption. One such important tool is the “Integrity Pact”, amongst others. It was observed by the organization, that governments across the globe in order to complete public procurement requirements often entered into commercial contracts with private players which opened an avenue for vast expenditures and with that came along the opportunities for unscrupulous parties to commit corruption. With the introduction of Integrity Pact, the contracts bound the government as well as private entities to take a formal oath to not engage in corrupt activities in any manner whatsoever, else risk legal obligations, which also maintains

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a level playing field for all involved. This has also been observed by the Hon'ble Bombay High Court² as well.

While the intent of executing such Integrity Pact serves a great purpose, however, from the precedents available on Integrity Pacts in India, it seems the true execution has been completely compromised by several state-run organizations.

Since several public sector undertakings have made execution of Integrity Pacts as a condition precedent for awarding tenders, the templates being used by such organizations can safely be said to be 'almost identical', if not verbatim identical.

Upon review of the available templates of Integrity Pacts, uploaded on several public sector undertaking websites, a few glaring issues have been observed i.e.

- a) Why the need for a separate contract, when the requirements of an Integrity Pact can be made a part of the contract being issued under a tender?
- b) Whether adjudication of disputes under the Integrity Pact are in consonance with the principles of natural justice?
- c) Whether barring any challenge to the decision made under the Integrity Pact falls foul with the Contract Act?

Firstly, though there is no bar on concerned parties to execute any number of contracts, however, as we all know '*too many cooks spoil the broth*'. In our considered view, when concerned parties, i.e. the government undertakings and the private players, enter into the main contract under the tender, they can very well adopt the requirements of the Integrity Pact in one single contract and avoid complications of multiplicity of contracts. The reason being two-fold, executing two separate contracts tend to create issues of complexity when overlapping of contracts happens and contracts overlapping with each other is only a happy breeding place for litigation and disputes to arise, which was not the intent of introducing Integrity Pacts by Transparency International.

A sound logic to this may be, that the contract under the tender and the Integrity Pact operate in different spheres, thus they may be better off kept as separate. This appears precisely to be the reason, that the 'template' being used by government bodies for Integrity Pacts often run head-on into the main contract executed under the tender, on several fronts. Hence there is an urgent need for the legal departments for such concerned Ministries of the Government to segregate the issues which are causing the overlap.

It has also been observed that breach of the contract under the tender as well as the Integrity Pact may have an impact on the invocation of performance bank guarantee which is provided by the contractor as a security. Thus, it may be suitable for an adequate segregation of such securities either being provided for the performance under the contract or as a security for upholding the norms under the Integrity Pact.

The sole purpose of the Integrity Pact is to ensure that the pure waters of transparency are not muddied with economic evils of corruption, bid rigging etc. But, the violation of the Integrity Pact wields the power to the State to take criminal action against such contractor in certain instances. Thus, rightfully the Integrity Pact excludes the applicability of arbitration to such

² Design Dialogues (India) Pvt. Ltd. v Bharat Petroleum Corporation Ltd. & Ors. 2016 (4) Bom CR 667

issues, as criminality is inarbitrable, which has been even upheld by the Hon'ble Bombay High Court³. But the conundrum would lie in issues where invocation of bank guarantees for violation of Integrity Pact as well as the main contract happen alongside, which would bring to light the issue of overlap between the two agreements. In such a situation, if the terms of the Integrity Pact were to be merged with the main contract itself, it would leave behind a lot of grey areas of overlap.

Secondly, in our considered view, adjudication under the Integrity Pacts in India touch upon the corner stone of being in foul with principles of natural justice on many fronts. The legal maxim “*nemo judex in causa sua*,” translates to “no person shall be a judge in his own cause.” It is a basic tenet of natural justice that a party who has any cause in a dispute should by no means be involved in the adjudication of the same, in order to ensure transparency and rule out biasness. However, from a thread bare understanding, the Integrity Pacts being executed by the Governmental agencies, clearly leave the adjudication of violation of Integrity Pact solely in their own domain which clearly is in breach of the fundamental principle of natural justice. The only alternative, at times, is by way of non-binding remedies such as approaching an ‘Independent Committee’ for any grievances. Though it is mandated that such committees must abide by principles of being impartial, surprisingly, the constitution of such committees is also undertaken by the concerned government agency itself, which again raises a lot of eyebrows.

Further, several decisions have now been passed by constitutional courts across the length and breadth of the country on the interpretation, violations and adjudications made under the Integrity Pact. If the numbers and averages of these decisions were to be stacked, the situation shows a pretty grim picture. In majority of the decisions, it has been observed that government bodies have been found to be in violation of principles of natural justice in the process of adjudication carried out against contractors. An overwhelming number of decisions passed by the Government bodies under the Integrity Pact have been quashed by the constitutional courts for being in violation of principles of natural justice, wherein the approach of the Government has been found to be arbitrary, high headed, opaque, not even providing opportunity of a fair hearing⁴.

This puts a huge question mark on the legality, or so to say the Integrity of Integrity Pacts itself i.e. whether they are only made for judging one-way traffic? Or whether even the Government bodies are also expected to comply with the same set of standards as required by the contractors?

Well the answer it seems lies in the famous saying ‘*power corrupts and absolute power corrupts absolutely*’. Seeing from the true intent of Transparency International to introduce the concept of Integrity Pacts in India, it seems to have lost its sense of direction as there are no eyes judging the conduct of the government, if it regulates its business in a transparent manner or not?

It is crucial to note that the penalties stipulated for violation of Integrity Pacts are severe, which includes, blacklisting, which has been understood by courts as a stigma for corporations which may cause civil death⁵. In such situations, the constitutional courts have observed that

³ Shahi Shipping Ltd. Vs. Oil and Natural Gas Corporation Limited. MANU/MH/3447/2018

⁴ Anchor Offshore Services Ltd. Vs. Oil & Natural Gas Corporation Ltd. and Ors. MANU/MH/0204/2016

⁵ Sarku Engineering Services SDN BHD vs. Union of India and Ors. MANU/MH/1373/2016

blacklisting decisions have been passed by government bodies without complying with the guidelines laid down by the Apex Court⁶ or applying basic principles of natural justice.

Lastly, the Integrity Pacts in India generally include a clause that the decision of the concerned Governmental body shall be final, and the contractor shall not challenge it before any court of law. Some Integrity Pacts template have also added clauses that such undertakings are being made after taking legal advise and shall not even object the issue of a fair hearing. In this regard, it is necessary to understand that, the contracts executed pursuant to a tender and agreements like Integrity Pacts are in the nature of ‘*take-it-or-leave-it*’ contracts. In such contracts, one party does not generally have the right to bargain, else risk the contract being offered to someone else. In a commercial world of shark tanks, one bidder’s loss is another bidder’s gain. Thus, left with no choice, contractors often enter into such contracts. However, what can be perceived as a matter of grave concern is where Government bodies incorporate such clauses, it entirely defeats the preamble of such Pacts for which it was introduced as it reeks of arbitrariness and is in complete contradiction to the purpose sought to be accomplished by Transparency International.

However, these clauses need to be analyzed within the realm of Section 28 of Contract Act. Under the Contract Act, any agreement which is in restraint of legal proceedings is a void contract rendering the fate of such contracts as un-enforceable. Thus, it is our considered view such clauses in Integrity Pacts which contractors are asked to execute and agree, with an iron fist, appear to be void to that extent which restrains a party’s right to legal proceedings. However, what was another surprising factor was though several courts have found the acts of the State to be in violation of principles of natural justice and have frowned upon such restrictive clauses under the Integrity Pact, however, none of the courts have passed a finding on this aspect, whether such agreements were enforceable, for playing foul under the Contract Act?

It would be apt to end this with the famous saying: “*Integrity is telling myself the truth. And honesty is telling the truth to other people*” – Spencer Johnson

⁶ Kulja Industries Ltd. v. Western Telecom Project BSNL. (2014) 14 SCC 731