

OFFSET BENEFITS CONTRACTS AND RESOLUTION OF DISPUTES THE GREEK EXPERIENCE

Greece has been for more than fifteen years, an important buyer of defense material within the EU defense market. More specifically, during the period 1996-2009, Greece has ordered or purchased defense equipments within the meaning of the Decision 255/58 of the EU Council amounting to more than 35 bn Euros.

During the said period, the Greek Government has concluded offset agreements with the suppliers of the Armed Forces of a nominal value corresponding to 80%-120% of the contractual price of each main procurement with a non-Greek added value of more than 10M Euro.

I. The first period of Offset Contracts (1996-2006)

The majority of OB Agreement has been concluded in the said period and the conclusion of OB contracts was a mandatory prerequisite for the entering into force of the main procurement.

a. Categories of OB

OB agreements were divided in two categories:

1st category included transactions directly linked to the main procurement in the sense that part thereof was performed by the Greek industry.

2nd category including transactions which were not related to the main procurement but were of "defense" nature (i.e., performed by the Greek defense industry).

b. Eligible OB transactions

b1. The purchase of defense material manufactured in Greece or award of subcontracting works to Greek industries.

b2. The production within the Greek territory of complete products and/or of components of defense equipment. It is possible to include in such transaction the contribution of the foreign supplier in the investment for the establishment in Greece of a production unit for the manufacturing of such material.

b3. Direct investment in Greece by importing funds in Greece in order either to cover the share capital increase of an existing entity or the contribution for the establishment of a new company.

b4. The granting of equipment to the state owned industries.

b5. The granting of equipment and/or the rendering of services free of charge to the Hellenic Armed Forces, including defense material, software and in general material of critical importance for the Ministry of Defense.

c. The Crediting Method

The formula for the OB Crediting is of the following form:

$$C = N \times V$$

N is the coefficient (multiplier)

V is the value of the transaction (b1 to b5 above) as evidenced by the invoices and other documents issued by the Greek industry and/or the entities implementing the OB obligation of the supplier.

d. The Coefficients

The Coefficients vary and depend on the importance of the OB transaction.

More specifically, the transactions under:

- b1 are multiplied by 4
- b2 the maximum multiplier is 4

- b3 the maximum multiplier is 8 and if the investment is implemented in specific areas it may become 12
- b4 the maximum multiplier is 10
- b5 the maximum multiplier is 12 if the Greek industry participates in the performance of the transaction

It should be noted that most of the pending OB obligations of suppliers of the Hellenic Ministry of Defense are subject to the aforesaid rules. The credit value of the OB of the period 1996-2006 that have not been performed amount to approximately 1,5 bn Euros. Pursuant to the Law 4376/2016, the suppliers of the HMOD have a chance to fulfil their OB obligations arising under OB agreements concluded in the period 1996-2006 by replacing them with new eligible transactions. The aforementioned guidelines ruling the OB transactions of the period 1996-2006 will apply if there is a replacement of unfulfilled transactions in the sense of the Law 4376/2016 as discussed below.

II. The Second period of OB Contracts

OB Contracts concluded in the period 2006-2011 were ruled by the Law 3433/2006 and the Ministerial Decisions 121080/21-12-2006 and 248298/8-7-2008 of the HMOD. The eligible OB transactions were as follows:

1. Development of products by the local industry
2. Manufacturing of new material by the local industry
3. Purchase of defense material manufactured by the Greek industry.
4. Granting of defense material to the HMOD
5. Support of Civilian Tasks of the HMOD

III. The period after 2011

In 2011, Greece has transposed the Directive 2009/81/EU into Greek Law and OB are neither requirements for the effectivity nor part of the evaluation of defense procurements.

IV. Pending OB Obligations

A significant number of OB contracts concluded in the period 1996-2006 have expired and the suppliers have not fulfilled the totality of the OB transactions included therein. Greece has recently issued a new Law, namely L. 4376/2016 giving a second chance to Defense Material Suppliers to fulfil their OB obligations without being subject to any penalties.

Pursuant to the new law (article 3 of Law 4376/2016) the following actions must be taken by any interested party for the settlement of unfulfilled OB contracts:

- a.** The interested party must notify to the General Directorate for Defense Investments and Armaments (“GDDIA”) its intention to be subjected to the provisions of the new law;
- b.** Following such notification, which is not binding, the GDDIA shall inform the interested party of the extent of its outstanding obligations;
- c.** The interested party must then submit to the GDDIA, within four (4) months, a proposal for a new OB contract in order to fulfil its outstanding obligations. Within 3 months from the submission of the interested party’s proposal the Minister of Defense will decide whether the proposal is accepted following an opinion by GDDIA.

Companies which have outstanding OB obligations and do not reach a settlement (i.e. sign a new OB contract) under this new law, will be subject to the penalties set out in the OB contracts, usually amounting to 10% of the unfulfilled credit value.

Given that the expression of interest to be subjected to the provisions of this new law is not binding, companies may want to consider declaring their interest if only for the purpose of being informed of the exact obligations that are deemed unfulfilled by the Greek State. This will allow the assessment of the amount of penalties to be imposed in case a settlement is not reached.

In addition to the above, we would like to draw your attention to the following issues:

- a.** Any new OB contract will be governed by Greek law and any disputes arising thereunder shall be settled by the Greek courts. The new law explicitly forbids the recourse to arbitration

- b.** The proposal to be submitted for new OB contracts must follow the same rules as the initial OB contract apart from the coefficients which may not be greater than six. More specifically for OB transactions which do not include the delivery of items the maximum coefficient is four (4) and if deliveries are included the coefficient is six (6).

V. Pros and Cons of the new Law

The advantage is the avoidance of the recall of the letter of guarantee deposited to the HMOD for the good performance of the OB obligations. The main disadvantage is the abolishment of Arbitration. As discussed below, in accordance with my experience disputes arising either under defense contracts or under OB contracts associated with main procurements have been resolved in a very effective manner by International Arbitration. The Greek Government honours the Arbitral Awards issued on the said disputes and this is an additional evidence of the effectivity of the Arbitral procedure which should not be abolished. Regular Greek Courts are not familiar with the technical issues and the complexity of defense material and the time that will be requested in order to reach an irrevocable decision may exceed ten (10) years period.

In view of the foregoing it is doubtful the outcome of the new attempt of the Greek Government to replace the unfulfilled OB transactions with new OBs. Moreover it is doubtful whether the Greek industry is in a position to manufacture the defense material that the foreign industry will request as a replacement of the unfulfilled OBs.

VI. Disputes-Arbitration

A common dispute between the Suppliers of Defense Material and the Hellenic Ministry of Defense in connection with the OB agreements arises from the failure of the Greek industries to fulfil their contractual obligations. More specifically, there are many examples where the local industry has undertaken to perform part of the main procurement by virtue of an agreement with the supplier. Such transaction has been considered as eligible OB in the OB contract of the said supplier with the HMOD. In case that the Greek industry fails to perform or fails to deliver the items in a timely manner, the Supplier is subject to penalties in the main contract as well as in the OB agreement. If the OB agreement expires, the HMOD imposes liquidated damages amounting to 10% of the credit value of the unfulfilled OB obligation. The HMOD does not accept as an excuse the fact that the non-performance is attributable exclusively to the local industry and imposes penalties on the Supplier as if the latter were fully responsible for the non-performance.

We have also experienced the refusal of the HMOD to replace unfulfilled OBs even though the obligor notified the HMOD on the failure of the local industry to perform prior to the expiration of the OB agreement.

Even if the local industry which fails to perform the OB transaction is a State owned entity, the HMOD's attitude is that the Supplier (i.e. obligor of OB) is liable towards the HMOD for such failure. The penalty agreed in the OB contract, usually amounts to 10% of the unfulfilled OB credit value and it is imposed even if the obligor were not in default in connection with such failure or even if it requested a replacement of the unfulfilled OB in a timely manner.

In such cases, the recourse to arbitration is inevitable and according to our experience the Arbitral Court (mainly in ICC arbitrations) either reduces drastically the imposed penalty on the grounds of Section 409 of the Greek Civil Code providing that: *"If the penalty agreed upon is disproportionately large it shall at the request of the debtor be reduced by the Court to the*

appropriate extent. Any agreement to the contrary shall not be valid", or fully releases the obligor in case the HMOD remained silent in the application for replacement.

It is my determination from at least ten ICC arbitrations where our Firm was engaged (e.g. ICC 15960/GZ, ICC 13477/AVH, ICC 14099/AVH, ICC 15919/GZ, ICC 18316/GZ, ICC 20824/GZ) that the ICC Arbitration clause which is included in most OB contracts concluded in the period 1996-2006, constitutes a protection of the suppliers from the aforesaid formalistic application of penalties by the HMOD. The "settlement" of pending OB obligations proposed in the new law discussed hereinabove under par. V, sets out that the resolution of disputes is effected by regular Greek Courts. This change of competent courts is a disadvantage basically for two reasons:

- a) Because of the workload of Greek Administrative Courts will take approximately 10 years to have an irrevocable decision. In contrary, the average duration of an ICC Arbitration is 18 months.
- b) Greek Courts are not familiar with technical issues which are usually part of the disputes related to Defense contracts.

PROPOSAL

It is my determination that the Defense Material Suppliers who have not fulfilled their OB obligations, should make their proposal to the Greek Government through a Special Purpose Vehicle (SPV). Such SPV could be an international organisation that will act on behalf of the said entities. The purpose of the approach is to define the eligible OB transactions and to keep International Arbitration for the resolution of disputes.