DEFENCE PROCUREMENT IN INDIA – KEY LEGAL ISSUES

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DPP: Introduction & Scope

- DPP first introduced in 2002 to streamline procurement of capital equipment by the Indian Ministry of Defence (MoD).
- New Defence Offset Guidelines issued in 2012.
- DPP does not apply to defence purchases through Inter-Government Agreements.
- DRDO, DPSU and OFB follow their own procurement guidelines/manuals.
Categories of Procurement under DPP

- **Buy**
  - Buy (Global) i.e., Outright purchase from foreign vendor.
  - Buy (Indian) Outright purchase from Indian vendor.

- **Buy and Make (Global)**
  - Purchase from a foreign vendor followed by licensed production in India.

- **Buy and Make (Indian)**
  - Purchase from Indian company followed by licensed production/Indigenous manufacture in India.

- **Make**
  - High Technology systems to be designed, developed and produced in India.
Major Changes Under DPP 2013

- Introduction of Preferred Categorization in the following order:
  - “Buy (Indian)”
  - “Buy & Make (Indian)”
  - “Make (Indian)”
  - “Buy & Make with ToT”
  - “Buy (Global)”.

- Increased focus on Indigenous Content.

- Simplification of “Buy & Make (Indian)” approval process.

- Introduction of INCOTERMS.

- Maintenance ToT no longer through Nomination to DPSUs (Now through tender process).
Lack of transparency from AON to Award of Contract stage.

Extremely slow and cumbersome process.

Unending corruption allegations.

Rigorous offset requirement.

Unwillingness to negotiate – “take it or leave it” approach.

No uniform defence offset contract.
# Reasons For Slow Procurement

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<tr>
<th>Causes</th>
<th>Reasons</th>
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<tr>
<td>Corruption allegations</td>
<td>Several “big ticket programs” have been hit by corruption allegations.</td>
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<td>Political compulsions</td>
<td>Lack of political will to take strong decisions, compulsions due to unstable coalition politics - delays in decision making.</td>
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<td>Bureaucratic hurdles</td>
<td>Bureaucratic process from beginning to end stage long drawn. Due to recent scams, there is genuine fear amongst bureaucratic machinery to take decisions.</td>
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<td>Lack of Transparency</td>
<td>No transparency at any stage of the procurement process. Long drawn procurement process varies from 5-10 years for award of contract.</td>
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## Reasons For Slow Procurement

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<td>Re-bidding</td>
<td>Could be due to change in technical specifications or single vendor situation. Example: 2007 Euro copter deal, howitzer etc.</td>
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<td>Re-trial</td>
<td>Many programmes delayed due to re-trials - Trial evaluation carried out on a No-Cost, No Commitment (NCNC) basis. No urgency since Government neither bears the cost for trials nor is it committed to buy the products.</td>
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<td>Single Vendor situation</td>
<td>Arises when one or more participants in the programs get removed from the process for reasons other than technical or commercial compliance after the Technical Evaluations. Example- Blacklisting.</td>
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Defence Offset Policy

Defence offset Policy
Applies to acquisition of USD ≥ 50 m

Buy Global
Offset obligation- 30% of the estimated cost of acquisition.

Buy and Make with TOT
Offset obligation- 30% of the foreign exchange component.
Discharge of Offset Obligations

- Direct purchase of, or executing export orders for eligible products provided by Indian enterprises i.e. DPSU, OFB, pvt. and public sector Indian enterprises.
- FDI in JV with Indian enterprises.
- Investment in Kind in terms of ToT.
- Investment in Kind in terms of provision of equipment through non equity route.
- Provision of equipment and/or TOT to Government institutions.
- Technology Acquisition by DRDO in areas of High technology listed in Annexure VIII to Appendix D.
Banking of Offset Credits

- Pre approved banked offset credits will be considered for discharge of offset obligations subject to a max. of 50% of the total offset obligation.
- Banked offset credits shall remain valid for a period of 7 yrs (earlier maximum period was 2 ½ yrs).
- Credits not transferable, except between the main vendor and his Tier 1 sub-vendors within the same procurement contract.
- Vendor required to submit a list of such Tier 1 sub-vendor along with technical and commercial offset proposal.
- Credits for offset banking will be provided only for contracts entered on or after 1-9-2008.
Concept of Value Addition

- The concept of value addition determination first time introduced in DPP 2013 to determine the offset value.

- "Clause 5.9: The concept of value addition will apply only for direct purchase/export of eligible products. Value Addition will be determined by subtracting (i) value of imported components (i.e.) import content in the product and (ii) any fees/royalty paid."

- **Issues:**
  - MoD retrospectively applying the concept of determination of value addition to defence procurement contracts which were subject to the provisions of the earlier DPP's.
  - MoD seeking detailed information from Foreign OEM’s with respect to their contracts with their Indian offset partners (including DPSUs/OFBs) for calculating the indigenous/local content.
Concept of Value Addition

- Calculation/determination of indigenous content for the ENTIRE SUPPLYCHAIN will be a herculean task.

OEM's cannot be expected to determine value addition till this stage of the supply chain.
"it is not the roots which you can see that make you fall, it is the roots that you can not see"....

The problem is not as much with the provisions which are stated in the agreement, it is more with regard to what is not stated. In many cases the contract is silent on important issues, or do not regulate the same in detail - for example IPR, limitation of liability and so forth.

Top concern regarding the DPP is that the Standard agreement does not cover all those aspects which you normally would like to regulate in a more complex delivery of a system and so forth. MoD not flexible and unwilling to negotiate.
CAG View:

• “With India inking a flurry of defence deals, it has already attracted over $4.27 billion through defence "offsets" since 2007. The figure will zoom upwards with several mega defence deals in the pipeline. The $20 billion MMRCA (medium multi-role combat aircraft) project to acquire 126 fighters, for instance, specifies a 50% offset obligation on the foreign vendor.”

• After examining 16 offset contracts worth Rs. 18,445 crore, the CAG stated that the policy was floundering to strengthen self-reliance in defence preparedness.

• “MoD needs to ensure clarity in the offset provisions so as to leave little room for ambiguity in their interpretation. The monitoring mechanism also needs to be reviewed to ensure effective implementation”.
Ambiguity surrounding use of agents

- Language of agency clause - 
  does not permit the use of agents.

- Notification issued by VoD provides
  for regulation of use of agents.

- CEVs should exercise caution while
  entering into agreements, sub-contracts,
  or other contacts, etc.
Bofors Scam

- **BEFORE 1985:** defence deals were carried out by the GoI with the erstwhile Soviet Union on a ‘G2G’ basis.
  - Post 1985: India started exploring defence procurement with countries other than Soviet Union.
  - In March 1986, a US$1.4 billion contract between the GoI and Swedish arms company AB Bofors was signed for supply of 400 units of 155mm howitzers.
  - Shortly thereafter, the biggest corruption in the Bofors contract alleging the involvement of the then Prime Minister Mr. Rajiv Gandhi and several others of receiving kickbacks of approx. US$ 15m from middleman/agents.
  - This led to downfall of the Congress Government in 1989 General election as well as imposition of an absolute ban on agents involvement in the defence procurement.
Augusta-Westland (AW) VVIP Scam

- India scrapped the deal in Jan, 2014 - breach of pre-contract integrity pact by the company - allegations of payment of kickbacks to the tune of US$ 60 m.
- India encashed a guarantee of over US$ 40 m deposited by AW in a bank in India.
- Italian Court granted stay restraining GoI to encash another guarantee deposited in an Italian bank.
- Finmeccanica and its group companies ousted from participating in the DefExpo Feb, 2014.
- AW have not yet been blacklisted.
AW Repeat of Bofors

- Letter by key middleman Christian Michel written to the India head of AW in March 2008 produced in an Italian court names the Prime Minister Manmohan Singh, Ahmed Patel, Pranab Mukherjee, Veerappa Moily, Oscar Fernandes, MK Narayanan and Vinay Singh as key aides who need to be targeted to push the deal through.

- Many fear that the AW case could blow up into another Bofors Scam.
Need for change in policy

Offset is mandatory for major procurement projects worth > US$ 50m.

Govt. should reach out to foreign vendors to be able to fulfill their offset obligations in a more practicable manner, which includes:

- **Increase of FDI threshold from 26% to at least 51%**

  **Rationale:**
  - Increasing the ceiling of 26% equity into Indian companies will encourage cooperation/investment and exchange of information, sharing of technology between international manufacturers. It will lead to establishment of production facilities in India for key defence procurement programmes, thus reducing the need for import of critical technologies and defence equipment in the long run.
Need for change in policy

- **Define ‘State of Art’ technology under the FDI policy**
  
  **Rationale:**
  - Clear definition will allow OEM’s to share such technology with Indian JV partners.
  - Will eventually promote and assist Indian industries to manufacture indigenous content.

- **Requirement of clear Industrial Licensing (IL) Policy**
  
  **Rationale:**
  - To provide clarity on the “dual use products” which do not require Industrial licensing, the list of ‘dual use products’ should be made public.
  - Policies and guidelines relating to export of manufactured defence products should be clear and transparent.
  - Speedier and time bound processing of IL applications, which shall allow increase in the indigenous licensed production by the Indian industry.
Need for change in policy

- Need for broadening the scope of what can be counted as an offset, to include trade services, civil ship building etc.

  Rationale:
  - Indian Defence Industry alone will not be able to absorb the offset obligations.
  - India missing the opportunity to grow in business fields allied to Defence.
  - To maximise business opportunities for the MSME’s.

- Capping of financial penalties

  Rationale:
  - Current liability higher (upto 30% of the contract value) that the one commonly applied in defence contracts internationally.
Need for change in policy

- **Need for framing and implementing a stringent and effective anti-corruption law:**
  
  **Rationale:**
  - The current laws have failed to effectively curb corruption in defence deals.
  - An effective anti-corruption law will result in making the procurement process more **transparent, quicker and easier.**

- **Need for immediate passage of the Public Procurement Bill.**

- **More Dialogues/Formal communication between MOD and OEM/Suppliers/Vendors should be put in Place.**
  
  **Rationale:**
  - Will ensure better cooperation between the MoD and the Supplier.
DPP 2013: Major Changes
1. Introduction of Preferred Categorisation for Capital Acquisitions under DPP 2013

- The DPP 2013 provides for “preferred categorisation” in the following order:
  - “Buy (Indian)"
  - “Buy & Make (Indian)"
  - “Make (Indian)"
  - “Buy & Make with ToT”;
  - “Buy (Global)".

Any proposal to select a particular category must now state reasons and give justification for excluding the higher preferred category/ categories.
2. Simplification of “Buy & Make (Indian)” Procedure

- DPP 2013 attempts to simplify the Buy and Make (Indian) procedure by doing away inter alia with the requirement of short-listing the vendors through the ‘Project Appraisal Committee’ while keeping the validity of the AoN to two years permitting comprehensive consultations with the Industry.

3. Maintenance ToT (MToT) no longer through Nomination

- MToT has been hitherto reserved largely for OFB and DPSUs through the nomination process. DPP 2013 does away with nomination by Department of Defence Production and facilitates selection of MToT partners by Indian bidders. In Buy (Global) cases, it will now be possible for the Indian vendor to give Maintenance ToT to another Indian vendor of their choice. This measure is expected to have a positive impact on private sector participation in maintenance, repairs and overhaul work.
4. Increased focus on Indigenous Content
   - DPP 2013 aims at increased indigenisation and stipulates that indigenous content requirements will now extend all the way to the lowest tier of the sub-vendor. Hence, import content in the products supplied by the sub-vendors will not qualify towards indigenous content.

5. Speedier and Expeditious Defence Procurement
   - DPP 2013 stipulates to finalise the SQRs before the “Acceptance of Necessity” (AoN) stage has been accorded, and the validity of AoN has also been reduced from two years to one year. These measures are expected to increase transparency, expedite the acquisition process and will bring down the processing time of individual cases significantly.

6. Incorporation of Offset Policy Guidelines
   - DPP 2013 has incorporated the new offset policy guidelines which were promulgated in August 2012 and revision of the chapter on Ship-building which had been introduced in the DPP 2011.
DPP 2013: Major Changes

7. Extension of Time for Submission of Bid

- DPP 2013 stipulates (Para 33) that any request for extension of the bid submission date must be made at least two weeks prior to the bid submission date with adequate justification.

8. Introduction of INCOTERMS

- As per DPP 2013, the appendix F and G to the RFP i.e. the Payment Terms and Commercial Offer have been revised as ‘Commercial Clauses’ and ‘Evaluation Criteria of Price Bid Format’. These include use of the International Commercial Terms (INCOTERMS 2010), bringing payment terms for Indian Bidders on par with those for the foreign bidders, specificity in stages and modes of payment and removal of excise duty in determination of L-1.

- The financial powers of the Services Capital Acquisition Categorisation Higher Committee (SCAPCHC) have been enhanced from Rs. 50 Crores to 150 Crores and the powers of the Defence Procurement Board from 150 Crores to 300 crores for capital acquisition cases.

10. Powers to DAC

- Approval for all deviations from the Defence Procurement Procedure will henceforth be sought from the Defence Acquisition Council instead of the Defence Minister.
Various Stages of Bid Evaluation

- **RFI**
  - Offset Proposal
    - Technical Offset Offer
      - Offset Evaluation Committee
  - Undertaking to fulfil Offset Obligation
    - Technical Proposal
      - Technical Evaluation Committee (TEC)
        - Field Evaluations
        - Staff Evaluation
          - Commercial Proposal
            - Competent Financial
              - Competent Technical
                - Commercial Proposal
      - Review of main technical offer
        - Request for Proposal (RFP)