

The Indian Ministry of Defence ("MOD") has released updated guidelines for capital acquisitions by the defence sector in the form of the draft Defence Procurement Procedure ("DPP") 2020. The DPP 2020 is aimed at increasing indigenous manufacturing and reducing timelines for the procurement of defence equipment.

The draft was released for stakeholder comments, which are currently under consideration by the MOD. The information in this update may be subject to revision upon the finalisation of the DPP 2020, and we will keep you informed of further developments.

## Highlights and key changes to existing guidelines



### Conceptual changes

#### » Qualifications for "Indian vendor" updated:

"Indian vendors" must now be both owned and controlled by resident Indians. Previously, local incorporation was sufficient to constitute an "Indian vendor" with no ownership/control restrictions specified under the DPP.

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- » Re-examine your India structure to determine whether you continue to qualify as "Indian vendor".
- » Assess the benefit of qualifying as "Indian vendor" (loss of shareholding and control) against retaining 74% foreign shareholding, as has been recently permitted for the defence sector under foreign exchange laws.

#### » New procurement categories introduced:

- » **Buy (Global - Manufacture in India):** Purchase of equipment from the overseas manufacturer, with 50% of the manufacturing being undertaken by a subsidiary in India.



### Significant changes to the standard form contract

#### » Bank guarantees (BG):

BG will now be based on the contract value with taxes and duties deducted. Multiple BG from public and private sector banks (including local branches of foreign banks) have been allowed. This may reduce bottlenecks previously faced by foreign OEMs in procuring BGs.

#### » MOD termination rights:

Significantly expanded and introduced the right to terminate in "public interest". The government can take over partially built assets upon termination, and debar the vendor in the event of refusal.

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- » "Public interest" has not been defined or elaborated upon, and this could provide the government with far-reaching termination rights.

- » **Leasing category:** Leasing with periodic rental payments from either an Indian or foreign manufacturer. Likely to be preferred where there are time constraints for procurement, smaller quantity required, operational necessity, asset is required for a limited time etc.

#### » Indigenous content:

Higher indigenous content (i.e. local) requirements for each procurement category, apart from Buy (Global).

#### » New procurement concepts introduced:

These include performance-based logistics and comprehensive maintenance contracts. These details must be filed along with the tender submission for the main equipment.



## » Consequences of vendor default:

Termination and takeover of goods, debarment, liquidated damages, invoking BG etc. are all available to the MOD at its discretion.

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- › The multiplicity of options with no clarity as to which recourse is linked to a specific default, could result in tremendous uncertainty for the vendor.

## » Right over the seller's IP:

The government has the right to acquire the seller's IP (upon remuneration) for the unlimited use/exploitation of the equipment during its life cycle and beyond.

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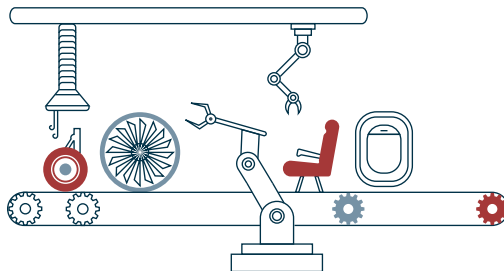
- › No restrictions have been specified on the exploitation of the IP acquired or as to the type of contracts this right applies to (for instance, only jointly-developed IP or only "Make" contracts).

## » Post contract management included:

Envisages a different contracting agency and contract operating agency to ensure a smooth transition from pre to post contract.

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- › It will be interesting to see how these agencies coordinate with each other and with the vendor to ensure a seamless transition.



## Major changes to offset guidelines

- » Indirect discharge of offsets is permitted on a case to case basis

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- › However, there is currently no clarity as to whether offsets can be met by a group company.

- » Details of offset products and Indian offset partners can be confirmed even after execution of the contract, allowing some flexibility.

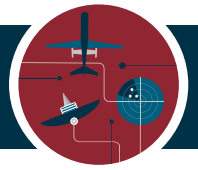
- » No offset obligations are applicable to Inter-Government Agreements and Foreign Military Sales contracts.

- » Changes to offset credits:

- › Higher multipliers proposed for Transfer of Technology (with ToT to the Defence Research and Development Organisation carrying the highest multiplier of 4)
- › Reduced offset credit for products/systems and components (so as to facilitate greater participation of Indian Industry by incentivising complete defence products over components)
- › Investments incentivised through higher multipliers.

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- › Both equity and non-equity investment is contemplated. However, the parameters of calculating offset credit for the non-equity route is currently unclear. Investment in defence manufacturing is subject to physical completion and verification of audited accounts, which could impact valuation. The timing of issuance of credits also needs to be clarified.



- » Notable exclusions:
- » Services (apart from MRO for aircraft and helicopter) and civil aviation have not been included under DPP 2020 as a means of discharging offset obligations.

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- » Consider whether your offset discharge strategy requires re-assessment.
  - » Concept of offset banking (i.e. subsequent application of previously accumulated credits) removed on account of the ambiguity in its application.
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- » The ability to leverage an Indian supply chain for banking credits to satisfy offset obligations in the future will now fall away.

- » The period for discharge of offsets no longer specifically includes the warranty period under the contract.

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- » Previously, discharge of offsets could be completed within 2 years of the period of performance of the main procurement contract, which included the warranty period under the contract. The amendment effectively limits the time available to discharge offsets.

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