

ELP DEFENCE & AEROSPACE QUARTERLY UPDATE

January 31, 2019

POLICY AND REGULATORY UPDATES

A. DRAFT DRONE POLICY 2.0

The Ministry of Civil Aviation constituted a task force which has introduced the draft Civil Aviation Regulations 2.0 (“**CAR 2.0**”) to supplement the existing Drone policy of India. This draft regulation, likely to be notified by March 2019, appears to deal with the advanced problems that are bound to arise from the use of unmanned aerial vehicle (“**UAVs in India**”). The policy envisages drone operations beyond visual line-of-sight beyond the currently stipulated 400ft which vastly expands the number of commercial applications and usage of drones in businesses. Working on the premise that permitting such operations would be vital for India’s progress as an economy, the policy addresses the various ways in which such UAVs can be used for commercial purposes and introduces the concept of a Drone Corridor i.e. an exclusive airspace for drone use, as well as designated areas dedicated to facilitating take-off and landing of the UAVs known as Droneports. While this policy is still in draft phase, it aims to lead India towards a path of technological advancement and modernisation and is in line with the best practices globally.

In an effort to promote the use of drones and encourage all UAV manufacturers to showcase their drone capabilities, the Government of India (“**GoI**”) is organizing a "Drone Olympics" at the upcoming Aero India 2019 under which various drone competitions shall be held and the winners will be honoured with medals and cash prizes.

B. LICENSING REQUIREMENTS

Manufacturing in defence sector is governed through industrial licensing under the Industries (Development and Regulation) Act, 1951 (“**IDR Act**”) and Arms Act 1959/Arm Rules 2016. The Ministry of Home Affairs (“**MHA**”) has revised the schedule of items requiring Industrial License under Arms Act/Arms Rules according to which “tanks and other armoured fighting vehicles” and “arms and ammunitions and allied items of defence equipment (other than small arms of caliber 12.7 mm and above)” are only licensable under Arms Act, 1959/Arms Rules 2016. The other defence items viz. defence aircrafts, warships of all kinds and allied items of defence equipment have now been de-notified from Arms Rules 2016 due to their non-coverage under the said rules. They have been notified by Department of Industrial Policy & Promotion (“**DIPP**”) along with other licensable defence items under the IDR Act, 1951 and would now only require an industrial licence.

C. DRAFT SCHEME FOR SELF-CERTIFICATION OF QUALITY (GREEN CHANNEL POLICY)

At present, supplies provided by DPSUs and private vendors are subjected to Quality Assurance by the Directorate General of Quality Assurance (“**DGQA**”) as per contracted norms.

The draft self-certification scheme is a further impetus to manufacturers in the defence sector. Self-certification is the process adopted by Government of India through the DDP, to delegate the responsibility of certifying the quality of products onto the manufacturer. Self-certification reflects the purchaser’s confidence in the supplier’s sustained capability to manufacture without defects and ability to assure quality.

This scheme lays down the requirements, criteria and assessment procedure for awarding self-certification status to DPSUs as well as private vendors. The self-certification status awarded is product specific and the desirous DPSU and/or private vendor is required to apply to the concerned Authority Holding Sealed Procedures (“AHSP”), with data of the items supplied by them in the last three years including a comprehensive assessment report as per the Quality Management Systems and Performance Matrices. Based on the recommendations of the assessment team, self-certification will be granted by the DGQA.

In light of the Government reiterating self-reliance in the manufacturing of defence products, self-certification scheme aims to encourage companies to assume direct responsibility to sustain and improve the standard of the quality of goods provided by them, as well as reduce the burden on the DGQA. The scheme is still in the draft stage and is awaiting final comments from the various departments and ministries.

D. PRIVATE SECTOR PARTICIPATION IN ‘BUY & MAKE’ PROGRAMS

The Department of Defence Production (“DDP”) recently issued guidelines on the ‘Eligibility Criteria for Indian Private Firms as the Production Agency’. These guidelines are applicable to the ‘Buy & Make’ category of defence procurement where an Indian company is appointed as the Production Agency (“PA”) for the Make part of the purchase.

Traditionally a public firm – Defence Public Sector Undertaking (“DPSU”) – was being appointed as a PA; however, since the promulgation of Defence Procurement Procedure (“DPP”) 2016, the foreign Original Equipment Manufacturer (“OEM”) is given the discretion of selecting a PA from public or private firms in India. DDP was required to provide the criteria for such private firms so that they may qualify for selection, and finally two years after the DPP 2016, it has released the same. The DDP has issued General, Technical, Financial and other such parameters that every private firm must comply with, so as to be eligible as a PA.

These guidelines finally realise the goal envisioned in the DPP – allowing private firms to be appointed for the Make part of every purchase under the ‘Buy & Make’ category and thus, serving to level the playing field between public and private OEMs.

E. NOTIFICATION OF PRODUCTS UNDER THE PUBLIC PROCUREMENT (PREFERENCE TO MAKE IN INDIA) ORDER

The Public Procurement (Preference to Make in India) Order, 2017, which was issued to promote the ‘Make in India’ initiative, provides a list of products that must be domestically produced and specifies the minimum percentage of local content each product must contain in order to be acquired by the various ministries of the Government. Further to this order, the Government has announced an additional number of products to be acquired by the numerous ministries, some of them being gyro units, transmission control valve assembly, electric motor dual switch amplifiers, inter communication system, integrated platform management system, lenses, renewable energy technologies such as small hydro power, wind power, solar power projects, biomass cogeneration and all pharmaceutical formulations in different dosage forms and strengths.

The Government continues to bring an increasing number of products under the scope of its Public Procurement Order, requiring each of them to have a certain percentage of local content, thereby ensuring that the objective of its Order i.e. ‘Make-in-India’, remains in sight and within touching distance.

DEFENCE TRENDS

A. INAUGURATION OF THE TAMIL NADU DEFENCE CORRIDOR

In the context of India's 'Make in India' initiative, Defence Minister Nirmala Sitharaman recently inaugurated the Defence Corridor established in Tamil Nadu. This corridor, first announced in last year's annual budget, has been established to enable aerospace and defence manufacturers to set up their factories in an area conducive to growth for the sector. With the development of this corridor, in addition to the Uttar Pradesh Defence Industrial Corridor that was launched in August last year, the Government is taking strides towards its target of defence self-reliance by 2025. The development of these defence corridors will facilitate a well-planned and efficient industrial base that will lead to increased defence production in the country. It encourages foreign OEMs to enter the Indian market, providing them with an ecosystem of complimentary industries, and allowing them to expand their foothold in India in an organic manner.

B. INDIA'S PATH TO SELF-RELIANCE

India's Secretary of Defence Production Ajay Kumar recently announced that the country's defence export is likely to double to INR 10,000 crores (approx. USD 1.4 billion) by the end of the current financial year. India has been steadily progressing in its goal of self-reliance, doubling its defence exports over the last three years. As of 2016, India's total defence exports were roughly INR 1,500 crore (approx. USD 200 million). By 2017, the figure had reached INR 4,500 crore (approx. USD 630 million) and last year, by November, this had risen to INR 7,500 crore (approx. USD 1.05 billion). Estimates indicate that by March 2019 India's defence exports are going to cross INR 10,000 crore (approx. USD 1.4 billion) – a milestone achievement. This has been possible due a two pronged approach of simplifying entry into the defence sector through sustained policy reforms and de-licensing of nearly two third of the defence items (especially on the component side).

NEW DEALS

- A. Contract for procurement of 66 'Air Defence Fire Control Radars' with maintenance and transfer of technology was signed between the Indian Army and M/s Israel Aerospace Industries Ltd, Israel on October 29, 2018 for a total cost of INR 4576.75 crore (approx. USD 640 million)
- B. Contract for procurement of 4 large survey vessels was signed between the Indian Navy and M/s Garden Reach Shipbuilders & Engineers Ltd, Kolkata on October 30, 2018 for a total cost of INR 2435.15 crore (approx. USD 310 million).
- C. Contract for upgrading 100 40mmL-70 guns was entered into between the Indian Army and M/s Bharat Electronic Ltd, Chennai on November 14, 2018 at a total cost of INR 340.36 crore (approx. USD 48 million).
- D. Contract for procurement and setting up of D level repair facility for Underwater Surveillance System, ESM & External Communication System for Scorpene (P-75) submarines was entered into between the Indian Navy and M/s Thales DMS, France at an approximate cost of INR 409 crore (approx. USD 58 million).
- E. On December 01, 2018, the Defence Acquisition Council ("DAC") accorded approval for the acquisition of defence equipment for roughly INR 3,000 crore (approx. USD 420 million) . This was a follow up of the decision of the Cabinet Committee on Security for procurement of four P1135.6 follow-on ships. The DAC also granted approval for procurement of indigenous BrahMos missiles for two Indian Navy ships, to be built in Russia. This supersonic BrahMos missile will form the primary weapon on board these ships.

OUR REFLECTIONS

- A. While India has now joined a growing list of countries that have adopted a formal policy on drones, it is attempting to stay ahead of the curve by immediately releasing subsequent regulations that would deal with the commercial applications of such drones, allowing operations beyond the visual line of sight. This new draft policy attempts to pave the way for commercial operations and could very soon lead to automation of manual labour such as transportation of materials, landscape surveillance, monitoring of rail and/or road traffic, etc. India with its large demographic dividend and one of the fastest growing economies offers an opportunity unmatched by any other country.

- B. With elections just around the corner, the defence industry officials are attempting to bring about a drastic change in the way the defence sector functions, so as to show positive results in lieu of their targets of self-reliance. A number of policies and schemes have been touted to improve the current scheme of things and to bring about the smooth functioning of business in this sector. However, what India currently needs is less bureaucracy and more action. Finalisation and implementation of these draft policies are the need of the hour. Delays that may be brought about due to conflict of political ideologies would only serve to hamper India's progress. As we approach the new financial year and budget session, it remains to be seen whether the defence sector will get the much-needed boost it has been waiting for.

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