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DEFENCE & AEROSPACE

REGULATORY UPDATES - QUARTER 1 OF 2019-2020

ELP DEFENCE & AEROSPACE QUARTERLY UPDATE

July 12, 2019

Following a brief lull in defence-related activities, primarily on account of the elections, the Ministry of Defence (MoD) has announced a slew of policy measures and new equipment acquisition programs. We expect the next few months to witness increased activity as India attempts to address its equipment shortage while simultaneously attempting to boost defence manufacturing and exports.

In this update, we collate and analyze the key legal, regulatory and policy developments in defence & aerospace sector over the preceding quarter.

POLICY & REGULATORY UPDATES

▪ SOP for utilization of Defence Lines of Credit

India's Ministry of Defence (**MoD**) has finalized a Standard Operating Procedure (**SOP**) to speed up the sale of military equipment to friendly countries such as Bangladesh, Vietnam, Afghanistan and others through defence Lines of Credit. The aim of this SOP is to shorten negotiations and the price discovery process of defence products for sale to foreign friendly countries.

Currently, this SOP is only applicable for Defence Public Sector Undertakings (**DPSUs**) and the Ordnance Factory Board (**OFB**). However, once its working is stabilized, it shall also be extended to private sector companies.

▪ SOP for certification under 'Defence Exports Promotion Scheme'

The Ministry of Defence issued an SOP to provide prospective defence exporters two mechanisms to request for a certificate from Directorate General of Quality Assurance (**DGQA**) or any other Department of Defence Production (**DDP**) notified agencies in respect of defence equipment or systems indicating 'Fit for Indian Military Use' or 'Tested and Certified against the Quality Requirements provided by the prospective Indian Defence Exporter/Manufacturer'. This SOP has been notified so as to improve the marketability of Indian defence products globally as well as reduce the red tape associated with such certification.

The two mechanisms provided under the SOP are:

- Where there is more than one vendor, the scheme provides for the prospective defence exporters to make a request for the certificate only if the system/component for which certification is sought is in use by the Indian armed forces. The certificate is then subsequently issued on payment of the requisite processing fees.
- Where the product is not required by the Indian armed forces but such product has export potential, the scheme provides such manufacturer with access to the testing infrastructure of the MoD for validation of the product, provided the product meets the criteria for such testing. The certification is then issued by the nodal agency upon successful completion of the test.

▪ Funding to Defence Attaches for export promotion

The MoD announced a scheme whereby Defence Attaches (deputies of the MOD sent to Indian embassies in foreign countries and responsible for various aspects of bilateral military and defence relations) shall be provided with funding to undertake numerous activities for the promotion of defence exports. The Government has drawn up a list of 85 countries where it wants to promote its defence industry and has empowered its Defence Attaches in such countries to promote exports of Made-in-India defence products from both public and private sectors. The amount of funding provided to such Attaches shall depend solely on the export potential of the countries in which they are situated. The funding so provided shall be valid for the following activities:

- Participating in fairs/exhibitions
- Publicity campaigns
- Market studies
- Organizing seminars
- Publication of publicity material like leaflets, flyers etc.
- Any other activities not specified in the scheme with prior approval of the Ambassador/High Commissioner of the mission

▪ Updated SOP for field trials

The Indian defence industry requires facilities for evaluation, testing and field trials of equipment developed by them. One of the main impediments holding back private industry is the non-availability of firing ranges to carry out the trials. Presently, minimal test facilities are available outside of Government owned infrastructure and it also may not be financially viable for companies to create their own huge testing infrastructure. To address this issue, the MoD has updated the SOP for allotment and utilization of Proof/Field Firing ranges for Indian private industry on payment basis. The overall coordination of the allotment of ranges will rest with the Additional Director General DQA (Armament).

As per the updated SOP the trials to be undertaken by the private defence industry can be broadly classified into two categories:

- Evolutionary ballistic trials - relating to all armament, ammunition and other explosives related examination. These trials are required to be conducted in DGQA, DRDO and OFB facilities
- All other types of trials (less ballistic trials) - relating to all types of tests other than those related to armament, ammunition and explosives. These trials encompass a wide variety of tests such as automotive trials, NBC trials, software development etc. and could require the DRDO/DGQA/OFB as well as the Service HQ controlled facilities.

RECENT TRENDS

▪ Launch of Defence Export Website

On May 27, 2019, the MoD launched a website with the sole purpose of promoting defence exports. The 'Defence Exports Promotion' portal serves as a single window for submitting an application for export authorization/license for SCOMET Category 6 (Munitions List items) under Arms Rules in the specified Form A X-A. The application is then processed by the Department of Defence Production and the export authorization is issued. The portal is also a medium to receive export leads for the benefit of defence exporters. It provides extensive data on various procedures and policies that defence manufacturers must adhere to in order to export their products.

▪ Routing of commercial proposals for export of defence equipment

In order to reduce the delay that arises when a company is engaged in defence exports, the MoD has issued a circular clarifying that DPSUs/OFB should submit commercial quotes/price offers directly to the country to which it seeks to export its goods. Previously, such DPSUs/ OFB would send their commercial quotes/price offers to the DDP who would be required to follow up with the importing country and bring the deal to fruition. This process caused an unnecessary delay and often led to the stalling of multiple export transactions. In light of the same, the MoD has advised that since these commercial quotes/price offers do not require any inputs from the DDP, they must be sent directly to the importing country or through India's Defence Attaché in such country. The DDP would send the commercial offer only in those cases where it is specifically asked to do so by the host country through a Government to Government channel. However, necessary export permission under the SCOMET rules would have to be taken, wherever applicable.

▪ Draft Open General Export License scheme

The MoD recently announced the development of an 'Open General Export License' ("OGEL") scheme to boost Indian defence exports, which is presently in the draft stage for public comments. Through this new license, the industry will be able to access international markets with easier export license procedures. The proposed OGEL envisages export of specified Munitions List items and software and technology from India to a stipulated list of countries subject to the terms and conditions mentioned in the license. These terms and conditions include registration with the Department of Defence Production, following of established Internal Compliance Programmes to be submitted to MoD, acceptance of on-site inspection, ensuring required reporting of exports to the MoD.

NEW DEALS/TENDERS

Sr. No.	Name of Platform	Amount	Description
1	8 Anti-Submarine Warfare Shallow Water Crafts (ASW SWC)	INR 6,311.32 crore (approximately USD 906 million)	Contract for acquisition has been signed between the Indian Navy and M/s GRSE, Kolkata on April 29, 2019
2	4,974 Radio Sets – CNR 900 M Tadiran Stations (Various configurations)	INR 1,148.15 crore (approximately USD 166 million)	Contract for procurement has been signed with M/s Elbit Systems on May 23, 2019
3	10 Boeing P-8I Poseidon aircraft for intelligence surveillance and reconnaissance operations and for Anti-submarine warfare	INR 22,500 crore (approximately USD 3.2 billion)	These aircrafts would be in addition to the eight aircrafts already acquired in 2009 for the Navy. The deal will have to be cleared by the Defence Acquisition Council (DAC) and the purchase will be through the Foreign Military Sales route. This is a government-to-government deal
4	6 P-75 (I) submarines	INR 45,000 crore (approximately USD 6.5 billion)	On June 21, 2019, the Indian Navy issued an Expression of Interest for shortlisting potential strategic partners for its construction under the 'Make in India' initiative

HIGHLIGHTS OF UNION DEFENCE BUDGET 2019

- The Defence Budget allocated for the financial year 2019-20, is INR 3,05,296 crores (this excludes defence pensions). While the defence budget has for the first time ever crossed the INR 3,00,000 crore mark, it represents a humble growth of 3.3% over the previous year's budget, with the rate of increase barely covering for inflation. The then Finance Minister (during the interim budget announcement) however did state that more allocations would be provided if required. During this year's budget announcement too, though the Hon'ble Finance Minister re-emphasized on defence being a national priority, there was no significant increase in the budget. MoD has set an ambitious target to achieve a turnover of:
 - INR 1,70,000 crores (approximately USD 26 billion) in defence goods and services
 - INR 35,000 crores (approximately USD 5 billion) in exports, by year 2025, which is considered to be highly ambitious without a commensurate budget outlay.
- To stay on track, MoD is now focussing increasingly on exports. It would be a challenge to achieve the production targets if Offset orders and MoD orders don't get finalised in a timely manner.
- The announcement of a National Research Foundation that will consolidate R&D funds under different ministries is a progressive step and will certainly help in aligning the national priorities on research. It is hoped that Ministry of Defence will be an important stakeholder in the NRF and will have sufficient funding available for allocation to both public and private enterprises in order to focus on defence as well as dual use technologies.
 - The budget further announced waiver of Basic Customs Duty for defence imports in cases where items are not manufactured in the country. The Government had vide notification No. 14/2016-Customs (dated 01.03.2016) withdrawn exemptions on payment of Customs Duty with a view to encourage domestic manufacturing in the defence sector. This present reinstatement of waiver of BCD only underpins the urgency to modernize and equip the armed forces with the necessary platforms, arms and ammunition. One can only hope that this exemption is applied cautiously and does not prove an impediment for indigenization of defence goods, either by Foreign OEMs or Indian enterprises importing equipment.

WORKSHOP ON 'DEFENCE EXPORT PROMOTION' @ NEW DELHI

The Workshop on 'Defence Export Promotion' was held by Federation of Indian Chambers of Commerce and Industry (FICCI) under the aegis of MoD with Economic Laws Practice (ELP) as the Knowledge Partner. This workshop had twin goals of ensuring that the participants (a) were aware of the plethora of government schemes and incentives available for defence export promotion, and (b) understood the legal and regulatory implications that businesses in this sector need to be mindful of. The primary topics of discussion included export compliance programs (including relevance of internal compliance programs); export promotion schemes; implication of various taxes in India and the available financial incentives for export promotion; and protection of IPR while exporting goods.

Brief take-aways from the workshop are as follows:

- Mr Sanjay Jaju, Joint Secretary (Defence Industrial Production), set the context of the workshop by stating that Government of India has set itself a target of achieving USD 5 billion of exports from the targeted USD 25 billion of defence production over next five years.
- Towards this, Government has rolled out many initiatives and schemes exclusively to facilitate defence exports, some which are Online Export Facilitation Portal, Lines of Credit to many countries for defence exports, Open General Export License, IPR Facilitation Cell, Testing and Certification by MoD for Indian products, etc. Each of these schemes were discussed in detail across sessions by MoD officials for the benefit of the audience.
- ELP Speakers spoke about key challenges and issues that may arise in growing the export business in the sector. Nuanced aspects on procedures and documentation for exports and international best practices to ensure compliant and seamless exports were discussed, including a discussion on import procedures of other countries (to give a sense of what Indian exporters should bear in consideration).
- There was a detailed session on tax implications and specific 'Dos and Don'ts' while exporting defence goods out of India, which conveyed the message of 'exporting Goods, not Taxes'. This was followed by a session on financial assistance and banking schemes that are available to the exporters – the speaker answered many questions on issues such as requirement of collaterals for availing funding assistance for M/SMEs.
- An important aspect concerning defence exports was the need of Intellectual Rights protection – along with the primary session on latest practices that can help the industry mitigate IP risk, MoD officials conducted a specific session to highlight the steps taken by MoD to help M/SMEs in facilitating IP filing and providing other related assistance.
- The final session discussed the export markets available to Indian companies and a few successful case studies/best practices adopted by other countries (and some Indian exporters).

For a copy of the presentations and further details, please contact Karishma Maniar at KarishmaManiar@elp-in.com.

OUR REFLECTIONS ON Q1 of 2019 - 2020

- Through numerous circulars and announcements liberalising defence policies of late, the Indian Government has clearly ramped up its efforts to promote the export of defence equipment in line with its ambitious target of achieving INR 35,000 crore defence exports by 2025. Presently MoD is authorizing SCOMET licenses to the tune of INR 11,000 crore (these are not actual exports, which are yet to be quantified).
- By creating the new export promotion website, the government has addressed one of the key concerns of domestic defence manufactures pertaining to the cumbersome and complicated export process. The website now serves as a one stop shop for all export requirements and regulations that a defence manufacturer needs to adhere to.
- However, serious effort on exports would need synergies between industry and the government. While, the government has lately shown remarkable agility in ironing out issues faced by Indian exporters, various aspects pertaining to IP protection and international export control norms (more so in the backdrop of recent sanctions) will be critical.
- Adequacy of defence budget (atleast 2.5-3% of the GDP) and timely placement of orders is critical for boosting the industry confidence for continuing investment in this sector. As of now, only a few M/SMEs are exporting defence components and sub-systems. However, our ultimate ambition is to export platforms, which can be only met if we focus on creating a Defence Industrial Base with end-to-end supply chain involving large contractors (both public and private) and M/SMEs.



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