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DEFENCE & AEROSPACE REGULATORY UPDATE

Quarterly Update

ELP DEFENCE & AEROSPACE QUARTERLY UPDATE

November 06, 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

▪ Notifications regarding Open General Export Licenses

In lieu of the Government's mandate to facilitate ease of doing business and simplify defence exports, the Department of Defence Production (**DDP**) operating under Ministry of Defence (**MoD**) has recently published two notifications for the issuance of an Open General Export License (**OGEL**) for intra company transfer of technology as well as for export of parts and components for a few of the Munition List items found in Category 6 of the SCOMET List. These notifications serve to reduce the paperwork and requirement of multiple licence applications, otherwise required for export of such items within the same parent company, thereby ensuring such exports can be carried out in a smaller time frame.

In case of an intra company transfer of products (parts & components) or technology, the export must be by an Indian subsidiary to its foreign parent company and/or subsidiaries of the foreign parent company for [Categories 6A003a, 6A003c, 6A005, 6A010, 6A013, 6A021 and 6A022](#). Further, such export must be based on certain documentation between the parent company and the Indian subsidiary which is an important criterion for issuance of OGEL. One such stated requirement for the exporter is to have an established Internal Compliance Programme (**ICP**) of its own or that of its parent company's. This notification is only applicable for exports to Belgium, France, Germany, Japan, South Africa Spain, Sweden, UK, USA, Canada, Italy, Poland and Mexico and excludes any exports to Special Economic Zones (**SEZ**) of such countries.

▪ Proposed changes to the Defence Procurement Manual

The MoD has recently released a draft Defence Procurement Manual (**DPM**), marking the first version revision to the DPM since 2009 (so far amendments to DPM 2009 have only been announced). The DPM contains principles and procedures relating to revenue procurement of goods and services for the defence services, organizations and establishments. The MoD has carried out significant changes to the 10-year-old document, taking into account modern day advancements and changes to several macro policies and procedures.

While a significant number of amendments have been made to the entire DPM, majority of the changes are focused on tendering and the way in which bids are evaluated by the procuring entity. Public procurement forms a very important part of Government activity and reform in public procurement has been one of its top priorities. The changes being introduced in the DPM fall within the Governments mandate of ensuring ease of doing business in India. Key proposed amendments made in this draft DPM relate to ICT procurement, two-stage bidding, introduction to electronic reverse auctions, Government e-Marketplace (**GeM**), procedure for registration of suppliers, etc. However, we re-emphasize that this document is still in the draft phase and will only come into force once it is formally notified.

▪ Customs & GST relief to certain imports in the defence sector

In 2016, MoD had issued a notification withdrawing exemptions on customs duties on all imports of military equipment. The move served to promote the Governments' Make-in-India initiative by encouraging contractors to manufacture indigenously. However, with the withdrawal of exemptions, the defence contractors engaged with MoD were being reimbursed the customs duty paid on imports, which ate into the MoD budget. With the ministry forced to spend a significant chunk of its budget on imports, the customs duty outflow reduced the availability of modernization budget, leading to the armed forces cutting back on plans to acquire new systems.

In a move to rectify this policy, the Defence Budget 2019 once again implemented the exemptions on customs duty on defence items, and now on 20 September 2019 Finance Minister Nirmala Sitharaman announced that GST and I-GST will also be exempted for imports, of those defence items which are not being manufactured in the country. As a result, the MoD is to be exempted from the customs duty and GST, beginning from 1 October 2019, up until 2024.

▪ **Scheme for promotion of MSME's in the defence sector**

In order to boost the self-reliance of the country in the defence sector, the Government of India has been keen to bring Micro, Small and Medium Enterprises (**MSMEs**) into the defence supply chain, to enable them to contribute towards the burgeoning defence exports market. The Government has introduced this scheme to provide the following benefits to MSMEs:

- i. MSME vendors will be imparted awareness and information about opportunities emanating out of the Defence Procurement Procedure, and more specifically out of the new Make II procedure.
- ii. MSMEs from non-defence sectors will be connected with OEMs, DPSUs and OFB to help them avail the opportunities under Make in India programmes in the defence sector.
- iii. MSMEs to be educated about the relaxations in the procurement process and will also be familiarized with the various funding mechanisms established specifically for facilitating capable entrepreneurs low on capital, or for capital intensive projects.
- iv. The establishment of common testing and allied facilities at select centres will be explored.

RECENT TRENDS

▪ **Four nuclear missile tests in November**

India has lined up four indigenously developed nuclear-capable missiles for tests this month. The missions assume significance in the wake of recent skirmishes along India's borders and the missiles are to be flight tested from different platforms. The weapon systems slated for tests are submarine-launched long-range ballistic missile K-4, supersonic cruise missile BrahMos, intermediate-range ballistic missile Agni-II and short-range ballistic missile Prithvi.

▪ **ISRO develops design for 'Deep Ocean Mission'**

The Indian Space Research Organisation (**ISRO**) has developed a design for a crew module, which will be used in making a manned submersible to send men to explore the depths of the ocean for precious metals and minerals. An MoU has already been signed between the ISRO and National Institute of Ocean Technology (**NIOT**) on the development of the module, with NIOT being tasked with aspects like electronics and navigation for the manned submersible. The development of the underwater craft is part of the INR 10,000 crore 'Deep Ocean Mission' to dive as deep as 6km to explore metals and minerals, as well as conduct studies on climate change, marine life and ocean exploration. This 'Deep Ocean Mission' serves as the next milestone for ISRO to achieve after its Chandrayaan missions.

▪ **Second '2+2' dialogue with USA**

Defence minister Rajnath Singh and Foreign minister S Jaishankar will be in Washington next month for the second '2+2' dialogue with their US counterparts. The agenda of their meeting will be primarily to speed up defence technology cooperation between India and the USA. The recent meeting of the Defence Technology Trade Initiative (**DTTI**) working groups concluded in New Delhi with a signed statement of intent to strengthen dialogue and cooperation on specific DTTI projects including lightweight small arms technologies and air-launched Unmanned Aerial Systems. The working group noted that "significant progress has been made on developing a DTTI Standard Operating Procedure (**SOP**) for the identification and development of cooperative projects under DTTI. The upcoming 2+2 will serve as an opportunity to finalise the SOP.

NEW DEALS/TENDERS

Sr. No.	Name of Platform	Amount	Description
1	Samyukta Electronic Warfare System	INR 919.42 crore (approx. USD 130 million)	Contract for Project Upgradation (Obsolescence Management) has been signed between the Indian Army and M/s Bharat Electronics Limited (BEL), Hyderabad on 3 July, 2019
2	Delhi class P-15 ships	INR 2787 crore (approx. USD 394.5 million)	Contract for upgradation of Kashmir Surface to Air Missile (SAM) Complex to Shtil-I SAM Complex, and Radar Fregat MAE to Fregat M2EM has been signed between the Indian Navy and M/s JSC ROE, Russia on 12 September, 2019
3	Two ship-set of Gas Turbine Aggregate for Additional Project 11356 follow-on ships	INR 506.3 crore (approx. USD 71.6 million)	Seven separate contracts for procurement have been signed between the Indian Navy and M/s Zorya Mashproekt RPC, Ukraine on 12 September, 2019

OUR REFLECTIONS

- Through numerous circulars and notifications, the Indian Government has begun addressing the concerns of the defence industry about the amount of paperwork and submissions that are required to acquire even simple licenses for transfer of items amongst different subsidiaries of the same parent company. This forms part of the Governments mandate to ensure ease of doing business in India. Notifying categories under OGEL is a very progressive step and we expect MoD to notify more and more SCOMET Category 6 items under OGEL.
- As of now, only a few MSMEs are exporting defence components and sub-systems. However, the Governments 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 MSMEs.
- The Government is also taking numerous steps to improve its bilateral relations with other countries, namely USA and Russia, to ensure that its dealings with one of these superpowers will not hinder its relations with the other.
- Lastly, by exempting the MoD from the customs duty and GST, the Government is attempting to fast-track defence purchases to aid modernization. Import of defence equipment is still essential for the growth of this sector, and hence levying of hefty duties on the same only serves to be counter-productive to the Governments ultimate goals. We would however hope that these exemptions do not in any way hinder the ultimate goal of achieving self-reliance in the sector and all steps to ensure this need to be taken by the MoD.



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