

Background

There is no single comprehensive legislation governing public procurement in India. The legal framework surrounding public procurement is instead governed by a series of sector specific legislations as well as rules, orders and manuals, issued both by the Ministry of Finance as well as relevant Nodal Ministries within whose ambit such procurement takes place.

In particular, the General Financial Rules, 2017 (**GFR**) empower the Central Government to provide for mandatory procurement of any goods or services from any category of bidders, or to provide for preference to bidders on the grounds of promotion of locally manufactured goods or locally provided services.

Pursuant to the GFR, the Government of India, through the Department for Promotion of Industry and Internal Trade (**DPIIT**) issued the Public Procurement (Preference to Make in India), Order 2017 on June 15, 2017 (**2017 Order**). The [2017 Order](#) mandated preference to local suppliers (i.e. suppliers fulfilling certain minimum local content requirements) in “all procurement” activities by the Government. The Order was subsequently amended in [2018](#) and [2019](#), laying down more stringent local requirements. Under these Orders, while local content requirements were ordinarily required to be 50 percent, Nodal Ministries were also empowered to prescribe different minimum local content requirements, as well as prescribe the methodology of their calculation in light of domestic manufacturing capacities and local competition. An example of this is the recent order passed by the Ministry of Chemicals, available [here](#).

Revised Order of June 4, 2020: Key Features

Against this background, the DPIT recently issued a [revised](#) Public Procurement Order on June 4, 2020 (**Revised Order**). While retaining several aspects of the preceding orders, the Revised Order has introduced certain key changes:

Applicability

The Revised Order applies to all “procuring entities” i.e. a Ministry or department or attached or subordinate office or, or autonomous body controlled by the Government of India and includes “government companies” as defined under the Companies Act, 2013.¹

Types of Procurement Governed

The Revised Order applies to the procurement of all goods, services or works. Separately, a list of approved product categories and Nodal Ministries is available [here](#).

Classification of Suppliers

The local suppliers under the Revised Order have now been classified into 3 categories as follows:

- Class-I local supplier – A supplier or service provider, whose goods, services or works offered for procurement, has local content equal to or more than 50%, as defined under the Revised Order.
- Class-II local supplier – A supplier or service provider, whose goods, services or works offered for procurement, has local content more than 20% but less than 50%, as defined under the Revised Order.
- Non-local supplier – A supplier or service provider, whose goods, services or works offered for procurement has local content less than or equal to 20%, as defined under the Revised Order.

Preference to Class I local suppliers:

Different classes of suppliers shall be eligible to bid for supply of goods or services depending on whether there is sufficient local capacity and local competition. Preference is first given to Class-I local suppliers, and only when the procuring agency seeks to issue a Global tender enquiry, with approval from the Department of Expenditure, are Non-local suppliers eligible to make a bid. Even where Non-local suppliers are eligible to bid, they are not awarded the entire portion of the contract as class I suppliers are invited to match their bid for 50 percent of the order quantity.

The WTO and Public Procurement

¹ “Government company” means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.”

India has not acceded to the World Trade Organization's (WTO) Agreement on Government Procurement (GPA) which sets out disciplines governing government procurement. However, India must still conform to the principles laid down in the covered agreements to which it is a party.

Government Procurement & National Treatment: Commercial Use

Article III of the General Agreement on Tariffs and Trade, 1994 (GATT) lays down the principles of national treatment and non-discrimination, i.e. it prohibits discrimination between imported and domestically produced like goods. Article III:8(a) of the GATT excludes government procurement from the scope of principle. However, this is conditioned on the fact that products be purchased for "governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale."

The WTO Appellate Body has interpreted the term "governmental purposes" in Article III:8(a) as referring to "purchases of products directed at the government or purchased for the needs of the government in the discharge of its functions".² It has further clarified that "products purchased for governmental purposes" in Article III:8(a) "refers to what is consumed by the government or what is provided by government to recipients in the discharge of its public functions", with the scope of such "public functions" determined on a case by case basis.³

An examination of the series of Public Procurement Orders reveals that the same do not contain any limiting provisions that exclude commercial usage by the Government. Given that procuring entities include government companies/public sector undertakings, the potential use of some of these products for commercial purposes cannot be ruled out from the text of the orders alone. For instance, the Department of Chemicals and Petrochemicals has included a variety of chemicals in its list of identified products subject to mandatory procurement, most of which are used as raw materials to produce downstream products. The subsequent usage of such chemicals once procured does not appear to be clear.

It is pertinent to note that in contrast to the Public Procurement Orders a sectoral policy issued by the Department of Information Technology in February, 2012, did in fact specifically include the words "not with a view to commercial resale or with a view to use in the production of goods for commercial sale", with respect to products procured thereunder. Therefore, the absence of such terminology in the Public Procurement Orders may raise potential concerns from the perspective of national treatment under the WTO.

Furthermore, the inclusion of "government companies" within the scope of the Revised Order raises additional questions. The derogation listed in Article III:8(a) applies to "the procurement by governmental agencies". The scope of the term governmental agency within WTO parlance is fairly restricted. The Appellate Body has found that the term "governmental agency" under of Article III:8(a) refers to "an entity acting for or on behalf of government and performing governmental functions within the competences conferred on it."⁴ (emphasis added). Moreover, the Appellate body has also noted that "the mere ownership or control over an entity by a government, without more, is not sufficient to establish that the entity is a public body".⁵

Therefore, "government companies" or Public Sector Undertakings in which the Government has a majority ownership stake that participate in the private realm and undertake commercial activities may not fall within the realm of a "governmental agency" as understood in Article III:8(a) unless their functions can be said to be of a "governmental" character.

Government Procurement & National Treatment: Inputs

It is pertinent to note that the Public Procurement Orders define local content by reference to the total value of the item procured minus the total value of imported content in the item expressed as a percentage. For example, the Ministry of Chemicals has listed the following formula for determining the same:

$$\text{Local content (\%)} = \frac{\text{Total Cost of Production} - \text{Total Imported Component Cost}}{\text{Total Cost}} \times 100$$

Wherein total cost of production includes (i) Direct Material Cost (ii) Direct Labour Cost; and (iii) Factory Overhead.

Therefore, in order to ensure that a final product subject to mandatory procurement meets a high local content percentage, the usage of a higher percentage of local inputs would be necessary. This may create an incentive for producers to source inputs locally, thereby creating disparity between the competitive conditions for foreign inputs and

² Appellate Body Reports, *Canada – Renewable Energy / Feed-In Tariff Program*, para. 5.67.

³ *Id.* at para. 5.68.

⁴ *Id.* at para. 5.61.

⁵ Appellate Body Report, *US – Carbon Steel (India)*, para. 4.10.

like local inputs. This is relevant from the perspective of national treatment under Article III: 4 of the GATT which requires that foreign producers receive treatment “no less favorable” than domestic producers of the “like products” in respect of “all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”⁶

Therefore, whether these inputs used in the production of final products subject to mandatory government procurement are also covered under the derogation for government procurement from national treatment requirements is a pertinent question.

In this regard, it is relevant to note that WTO law on the same is not entirely clear and the Appellate Body has in the past in *Canada – Renewable Energy/Feed-In Tariff Program* declined to rule on whether the cover of Article III:8(a) may also extend to discrimination relating to inputs and processes of production used in respect of products purchased by way of procurement.⁷ However, the Appellate Body in that case used the existence of a “close relationship” between the products affected by the domestic content requirements and the product procured as a ground to apply Article III:8 (a) to generation equipment used in publicly procured electricity.

However, notably the Panel and Appellate Body in the *India – Solar Cells* narrowed the scope of the question by concluding that local content requirements imposed on solar cells and modules used to produce electricity procured by the government were not covered by the derogation under Art. III:8(a) because the product being procured (electricity) was not in a “competitive relationship” with the product discriminated against (solar cells and modules).⁸ It further went on to rule that the question of inputs was *informative* and only arises when a competitive relationship already exists.⁹

If this principle were to be applied to inputs used in the manufacture of downstream products subject to mandatory procurement under the Public Procurement Orders, the same may pose questions of WTO-consistency with respect to the treatment of such inputs wherein the inputs may not have any competitive or close relationship with the final product and the government does not procure those inputs.

Conclusion

As elaborated above, in light of ambiguities in the Public Procurement Orders as well as their broad scope of application, it cannot be determined with certainty the purposes for which these products will be used as well as the status of inputs used in making these products. This may raise potential questions from the perspective of compliance with WTO disciplines on national treatment. The policy makers will be well advised in clarifying the scope and coverage of these orders which in turn would help India in mitigating risks of potential challenges from its trading partners.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com.

Disclaimer: The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein. This update is not intended to address the circumstances of any particular individual or corporate body. There can be no assurance that the judicial/quasi-judicial authorities may not take a position contrary to the views mentioned herein.

⁶ Article III:4, GATT 1994.

⁷ Appellate Body Reports, *Canada – Renewable Energy/Canada – Feed-in Tariff Program*, para. 5.63.

⁸ Appellate Body Report, *India – Certain Measures Relating to Solar Cells and Solar Modules*, para. 5.24

⁹ *Id.*