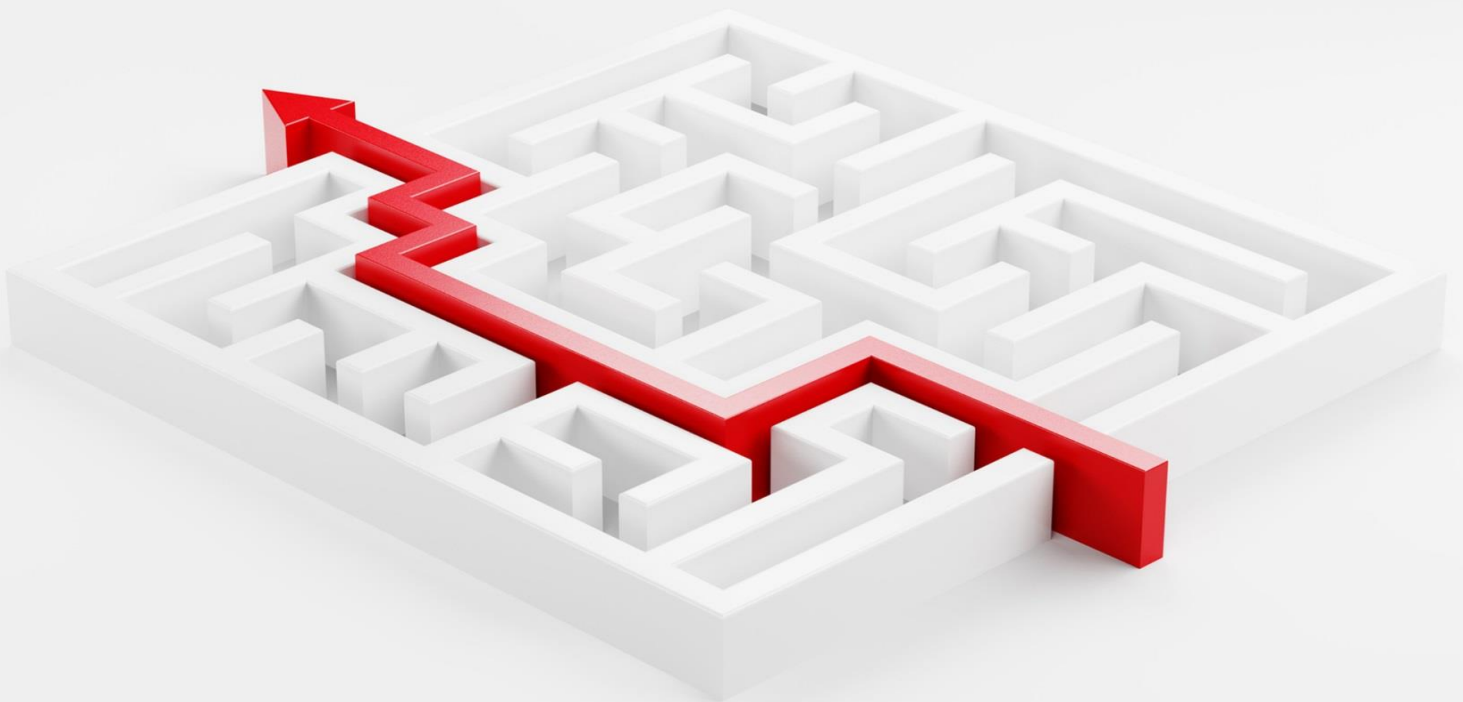




ECONOMIC
LAWS
PRACTICE
ADVOCATES & SOLICITORS



**THE INDIAN DEFENCE & AEROSPACE
SECTOR
CHALLENGES IN THE OPPORTUNITY**

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Preface

The Government of India (**GoI**) has been steadily creating an enabling ecosystem of policies and regulations to give the much-needed fillip to the Indian Defence Industrial Base (**DIB**). Over the last few years this has led to significant interest in this sector from domestic and foreign companies alike – which is primarily driven by defence equipment demand in India.

One of the interesting facets of this monopsony sector is the multitude of stakeholders that are involved even while there is only one primary buyer (the Government). To give a brief overview of the underlying dynamics, the ‘buyer side’ comprises of armed forces as demand drivers, while R&D is handled by Defence Research & Development Organization (**DRDO**), decision making lies with the Ministry of Defence (**MoD**) and the contractual responsibility is with the bureaucracy. The ‘sellers’ are similarly represented by Public Sector Undertakings (also owned by Government, which introduces an inherent conflict of interest), domestic private industry (large corporates, Micro/Small/Medium Enterprises (**MSMEs**) and now start-ups) and foreign OEMs/System Integrators, often represented by their own Governments.

Mirroring the complex industry structure, the procurement process too is mired with intricacies, which often leads to the sellers (and investors, in effect) facing significant uncertainty stemming from bureaucratic red-tape, budgetary issues and other similar concerns. Despite the uncertainties in the order booking timelines, the industries need to infuse large capital to build capability and capacity, well in advance. In addition to this, the hi-technology industry calls for sustained funding requirements to manage technology upgrades and deal with obsolescence regularly.

Apart from such commercial issues, one needs to be equally cognizant of legal challenges such as information security, intellectual property protection, regulatory and transactional due diligence, etc.

However, despite all the challenges, defence & aerospace remains a critical sector for India, often referred to as the ‘sunrise’ sector, given that India is aiming to shift from being the largest importing nation to being a self-reliant and exporting nation.

In the following sections, we examine the unique set of opportunities and the challenges that characterise defence & aerospace sector in India and discuss potential solutions to ease the way for heightened private sector participation. We hope this makes for interesting reading and you find the information useful.

Regards,

ELP Defence & Aerospace Team

| THE OPPORTUNITY: A SUNRISE SECTOR

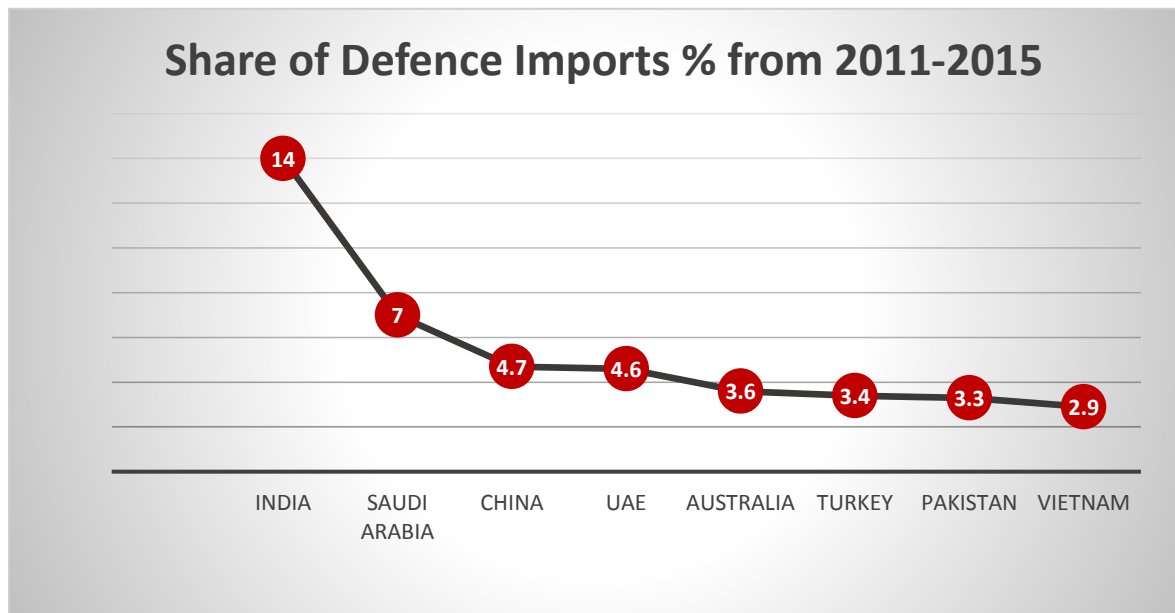


An Overview

Post-independence in 1947, India embarked on an inward-looking developmental path implemented through a strict focus on export substitution coupled with a preference to Public Sector Undertakings (**PSUs**). Consequently, India's markets and industries were insulated from advanced technologies and cutting-edge developments that were being introduced around the world. The pre-liberalisation period witnessed an India which was dependent on archaic technology and dominated by the PSU sector, license / permit raj and a weak domestic private sector.

Understandably, the country's defence sector was adversely impacted by lack of access to latest technical developments and other systemic factors. Consequently, India, which has always had tenuous relations with certain neighbours, was compelled to start acquiring state-of-the-art defence equipment. With India's domestic sector not being able to match the technology required for production of military equipment, the growing demand was met through imports. By 1990s, the Indian Armed Forces were highly dependent on imports making India one of the largest importers of defence equipment – a trend that continues till today.

Since the past four years, India's share of global imports of defence related goods was the highest in the world at around 14% – almost double of Saudi Arabia, which is ranked second. As per statistics of 2016, India is the 5th largest military spending nation in the world. India's defence budget has more than quadrupled from INR 58,587 Crores in 2000 to INR 2,95,000 Crores in 2018. A SIPRI study indicated that India is the biggest post war arms importer in the world.



In point of fact, India spends around 1.5-2% of its GDP on defence related expenditure. However, there has been a declining trend in % terms, even as the country's overall GDP has continued to grow. If we as a country are to realise our vision of creating a domestic military-industrial complex, this spend needs to be increased significantly. According to industry experts, the spend should be over 2.5% of GDP. Once India has achieved its objective, this can be moderated to around 2% but for now, the need of the hour is a huge influx of funds to aid the defence industry in capability and capacity building.

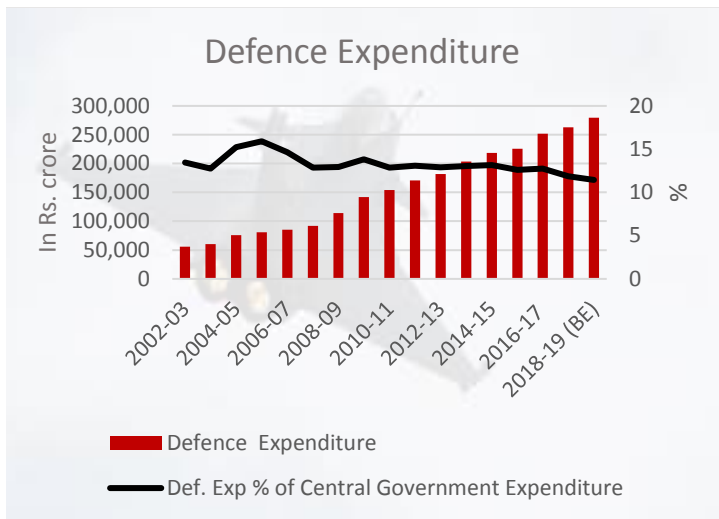


Figure 2: Defence Expenditure as a % of Central Government Expenditure ; Source : SIPRI

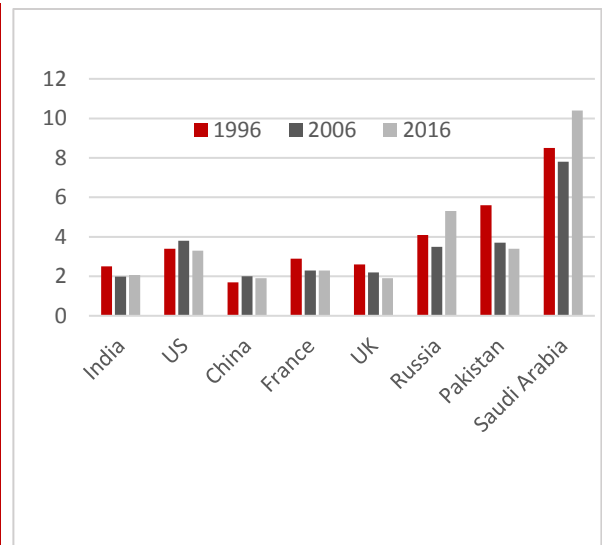


Figure 3: Defence Expenditure as a % of GDP Source: SIPRI

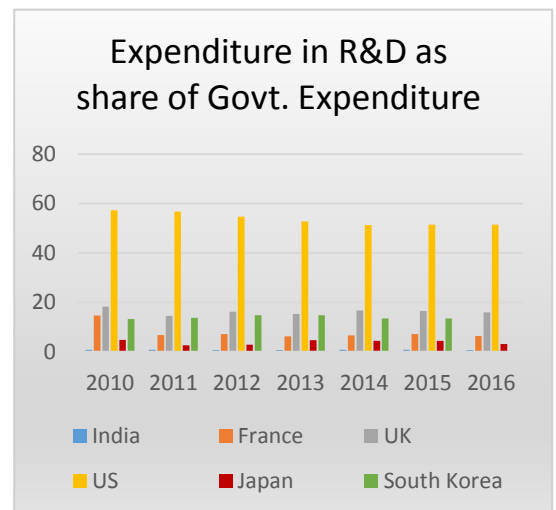
An interesting example of this can be found in Israel – a country much smaller than India but one which also has a hostile neighbourhood. India and Israel share another common aspect – both countries secured their independence around the same timeframe of late 1940s. However, today India continues to be the largest importer of arms while Israel exports almost 80% of its arms production. This is primarily because post the Sinai War of 1956 till the end of 20th century, Israel pumped an average of ~16% of its GDP into defence sector, which has now stabilized to nearly 5.5% over the last decade. This has not only led to Israel becoming the sixth largest arms exporter, it has immensely benefitted the economy, wherein arms sales contribute to about 8% of its GDP¹ and supports nearly 100,000 households.

Another example of a successful turn-around of defence industry is China, which was the world’s largest importer of defence equipment at one time; however, by developing its defence sector through constant investment and innovation, it has now become world’s 3rd largest exporter of defence equipment.

On the contrary, despite spending so much on imports, India is still not sufficiently prepared for any form of prolonged war and its stockpile of weapons is considerably less than the minimum amount it is required to maintain. At present, the Indian military is required to hold enough ammunition to fight a short intense war of 20 days². Presently, the actual War Wastage Reserve at the military’s disposal is only sufficient for 10 days, which means that India can only meet the requirements of war for a period of 10 days.

Also important to note is the fact that whilst India is now aiming for a substantial indigenous defence industrial base, only 0.6% of the Government’s total expenditure has been on R&D for this sector. While indicative figures are provided below, this amount clearly is considerably lower than most other countries. Appropriate

Figure 4: Expenditure in R&D by other countries as a share of their total Government Expenditure; Source : Eurostat



¹ <https://www.aljazeera.com/news/2017/10/israel-maintains-robust-arms-trade-rogue-regimes-171022100816302.html>

² Earlier, Indian military was required to store supplies, spares and ammunition - called War Wastage Reserve (WWR) - to fight a 40 day intense war. In 1999 the WWR was scaled down to only 20 days. Comptroller & Auditor General Report - https://cag.gov.in/sites/default/files/press_release/press_release_8_may_2015_19of2015.pdf

budget allocations are indeed the need of the hour. With the intent of promoting indigenous production of defence equipment and investment in new technologies, the government has announced various initiatives to give an impetus to this industry. A few of the key initiatives are listed below:

Key Initiatives

Formulation of Defence Planning Committee

'Super Committee' – represented by highest level decision makers in PMO / MoD

Order of Precedence

Accords higher priorities to Indian Vendors – gives a boost to Indian Industry

Boost to Make in India

Highest preference to Buy (IDDM) category – 40 % Indigenous Content (IC) for an Indian product and 60% IC for a foreign designed product

Enhanced Performance Parameters

Focuses on not just Price but Technical superiority of equipment

Make I and Make II

Indian development with foreign tie ups if required

Strategic Partnership

Formal mechanism to bring Foreign OEMs with technology with Indian Private Industry

Exports

Focused initiatives on Export Promotion – Defence Attaches being called to give specific focus

DTTI

Two projects underway and few others under consideration

Draft Production

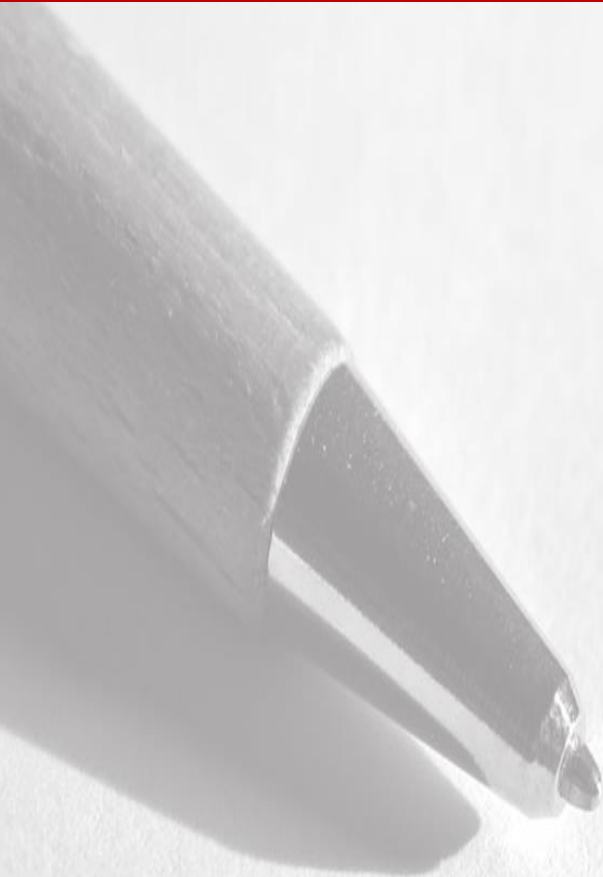
Draft Production Policy envisages focus on MSME's like never before and also contemplates opening of FDI in the sector to the extent of 74%

Draft Offset Policy

Draft Offset Policy contemplates opening up more OEM friendly offset discharge avenues which will also trigger a faster fund flow into the country. This could be utilised to develop capacity and capability

Any concerted effort by the Government will need both short and long term planning. While the sector offers significant opportunity to private industry, there are a myriad of challenges and bottlenecks which need to be optimally addressed.

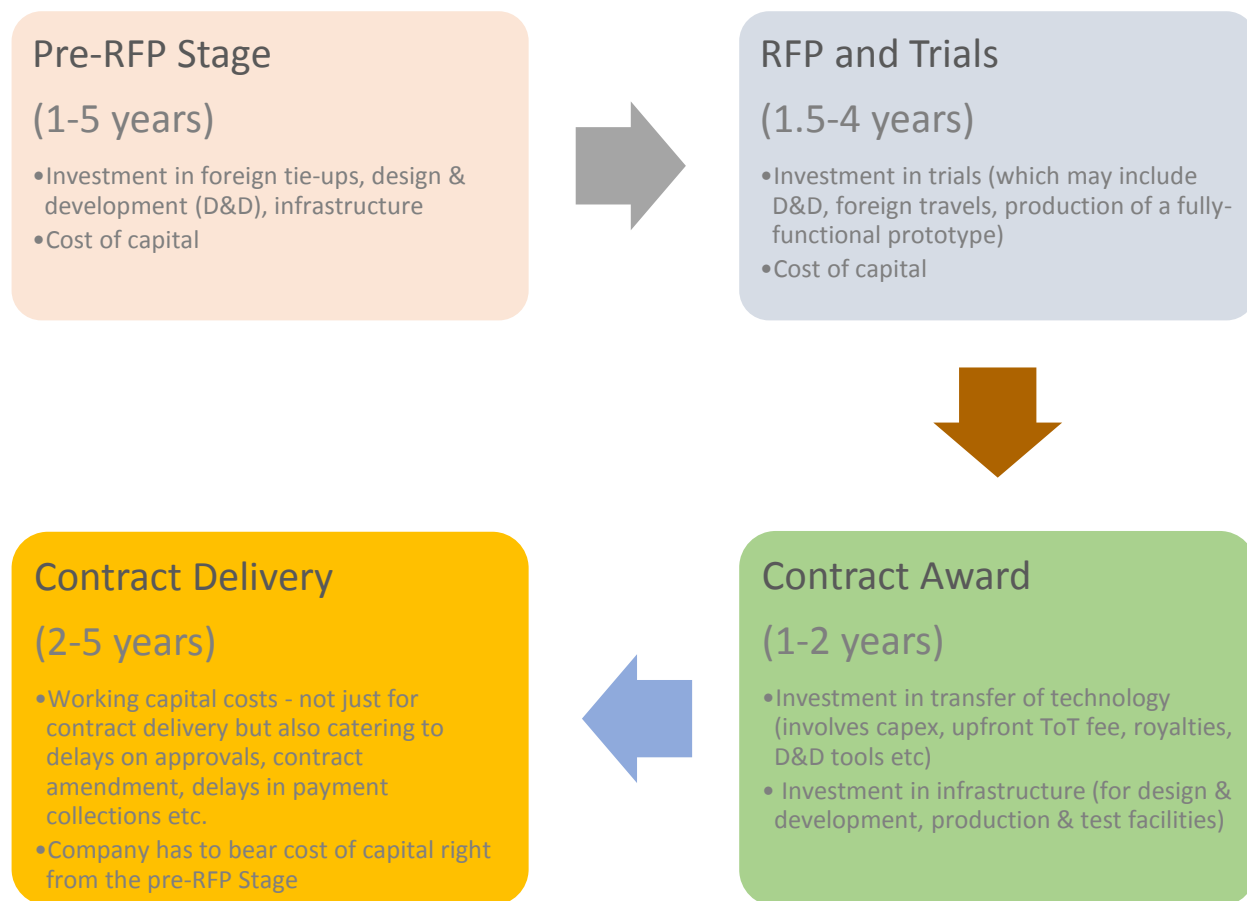
CONTRACT MANAGEMENT:
THE COMMERCIAL LANDSCAPE



I Agree

Practical problems in contract management

The problem of inherent delays in award and execution of defence contracts has been something the industry has constantly been grappling with. The implications of these delays and their impact on the overall development of a self-sustaining industrial military base are far reaching. An illustration of the practical problems which a company in the defence sector faces with regards to contract management is given below.



The pre-dominant inference from the above graphic is that the onus of bearing the cost of capital is on the industry right from the beginning of the program – the cycle time from inception of a program to actual delivery could be anywhere from 5 years to 15 years.

If an average Weighted Average Cost of Capital (WACC) of 15% is assumed, every rupee spent by a company from the inception to delivery of order needs a return of at least INR 7 in fifteen years or INR 3.5 in ten years. However, most defence deals are a result of either competitive bidding or a Government to Government contract, which are highly subject to public probity, leaving very little room to charge the cost of capital to the contract in its entirety. Thus, investors in the sector need to look at different ways of funding the high-capital business, such as:

- Optimised tax structuring to avail maximum incentives available
- Minimise cost of capital investment in R&D and infrastructure by availing Government schemes and subsidies
- Bringing in FDI investment / Technology Tie-ups
- Contractual negotiations that enable cash flows adaptable to the program cycles
- Different cost mechanisms (one-off, life-cycle costs, etc.)

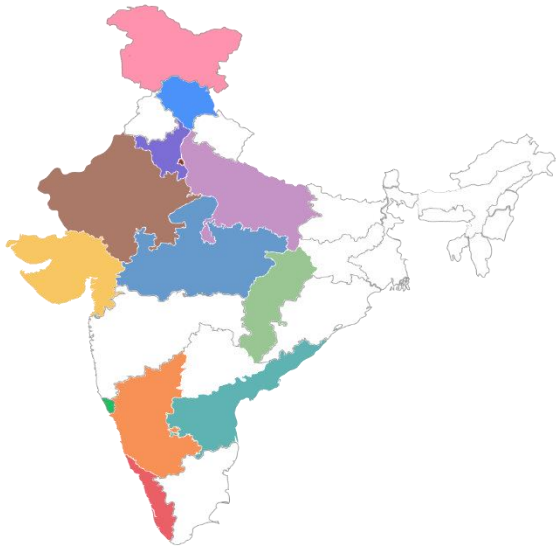
| STATE INCENTIVE SCHEMES: A BOON OR A BANE?



State wise incentives: A snapshot

As discussed above, defence & aerospace is a capital-intensive sector that needs huge amount of capital to be sustainable.

It is important to note that these incentives are linked to the investment made, with no linkage to the orders in-flow from Government of India (even in offsets, the GoI needs to first place the order on Foreign OEM/s for the offset order to be placed on Indian Companies). Thus, in many instances of investments in the country, while the infrastructure is created to support the prospective order booking, the delays in placement of the actual orders don't match up to the cost of carrying the investment. This makes it a very unviable commercial situation for any corporate making an investment in this sector.



This holds true not just for Indian companies but also for foreign players – a fact which is reflected in the miniscule FDI India has received, despite being the most-promising defence market in the world. Mindful of this, the GoI has been gradually reducing subsidies even while continuously increasing incentives for investors in this sector. While India does have a few central schemes to promote investment in R&D and capex (for example, M-SIPS), the primary incentives often come from the state governments to attract the investments in the sector. A collation of state wise benefits is provided below:

Andhra Pradesh		
Policy Incentives	Ease of Doing Business	State Features
<ul style="list-style-type: none"> 100% exemption from entry tax on 'plant & machinery and capital goods' for an initial period of 3 years. 100% subsidy would be provided on basic infrastructure 100% reimbursement on all input material for aircrafts brought in specifically for MRO in Andhra Pradesh Subsidy of up to 50% of the cost of land, building, and plant & machinery for an Aerospace & Defence park 	<ul style="list-style-type: none"> Skilled labour workforce available Single desk clearance 	<ul style="list-style-type: none"> 24/7 reliable power supply Excellent port logistics

Chhattisgarh		
Policy Incentives	Ease of Doing Business	State Features
<ul style="list-style-type: none"> Up to 100% exemption on stamp duty Up to 60% Interest subsidy Up to 100% entry tax exemption for 6-7 years Up to 100% electricity duty exemption for 7-10 years Up to 50% exemption in land premium on land allotment in industrial areas / industrial parks Up to 45% fixed capital investment subsidy 	<ul style="list-style-type: none"> Skilled labour workforce available Single desk clearance 	<ul style="list-style-type: none"> 24/7 reliable power supply Excellent port logistics

Delhi**Policy Incentives**

- Reforms related to “ease of doing business” undertaken in the various departments and agencies of Govt. of NCT of Delhi

Ease of Doing Business

- Online single window system
- Favourable industrial climate
- Existing vendor Base of MSMEs, many of which are already suppliers to ISRO and defence manufacturers

State Features

- Proposed industrial land of roughly 6372 hectares
- Energy rich - Power surplus state
- Metal rich- Total iron & steel production is 30% of India’s production, only tin producer in India
- Central & well connected

Goa**Policy Incentives**

- The state of Goa has enacted Goa Investment Promotion Act, 2014 to provide for the promotion and facilitation of investment in the state of Goa

Ease of Doing Business

- Single window mechanism
- Online portal for applications, permissions, monitoring, scrutinizing and payments has been developed by Goa State Pollution Control Board and Commissioner of Commercial Taxes

Gujarat**Policy Incentives**

- 100% exemption on electricity duty for the first 5 years for Aerospace & Defence enterprise
- Reimbursement of VAT and CST to the extent of 90% of the eligible fixed capital investment
- Cash subsidy of 25% on eligible fixed capital investment
- Graded interest subsidy on External Commercial Borrowing (ECB) & domestic borrowings

Ease of Doing Business

- Assistance provided by State Government for R&D centres and skill development
- Equity support provided by State Government

State Features

- Land availability & preference in allotment to Large/Mega Aerospace & Defence enterprises
- Government land would be provided at 50% of Jantri rate wherever such land is available.

Haryana**Policy Incentives**

- Haryana Government has offered land sites in Haryana which would be ideal for the defence production industry in public and private Sector

Uttar Pradesh**Policy Incentives**

- Capital interest subsidy of 5% for 5 years
- 100% electricity duty exemption
- Up to 100% stamp duty exemption
- 100% reimbursement of net SGST on all input material for 10 years
- 70% of net SGST reimbursement to eligible D&A units for up to 20 years
- 10% subsidy on capital investment for setting up R&D facility

Ease of Doing Business

- 24/7 reliable power supply
- Flexible employment conditions
- Simplified regulatory procedure

State Features

- Large number of public and private sector units manufacturing a range of products in the D&A sector (MSMEs, DPSUs, and Ordinance Factories etc.)

Himachal Pradesh

Policy Incentives

- Facility for online application for registration & e-payment of excise and taxes has been made
- Filling of all returns has been made online

Ease of Doing Business

- Single window clearance
- Land records digitized
- E-Stamp facilities introduced
- All relevant provisions of Factory Act made online

Jammu & Kashmir

Policy Incentives

- 30% investment subsidy & 20% employment generation subsidy of VAT & CST for 7 years
- 50% exemption on land tax for 7 years
- 50% exemption on electricity duty for 7 years
- 50% exemption on stamp duty and conversion charges
- Additional subsidies and exemptions on greater investments

Madhya Pradesh

Policy Incentives

- Special concessions for allotment of Government land to defence manufacturing units
- Special incentives for establishment of such units
- Entry tax exemption for 2 years
- Electricity duty exemption for 2 years
- Transfer subsidy of 50% on transportation of imported equipment
- Technical assistance/ support provided by Government.

Ease of Doing Business

The Govt. has recently approved a number of Defence related projects in the State including:

- Defence Manufacturing Park by M/s Reliance Infrastructure Ltd
- Aerospace Park by M/s Reliance Defence
- Small arms manufacturing units of M/s PunjLlyod Industries

State Features

- Government has identified about 4000 acres of land near Jabalpur which are ideally suited for defence production units because of its strategic and secured location.

Karnataka

Policy Incentives

- State Government is in the process of clubbing the industrial areas consisting of Aerospace Park, Aerospace SEZ, IT Park and Hardware Park spread across 3,200 acres
- The State shall provide 50% of the cost of the land, building, plant and machinery for testing centre, technology innovation/certification / centre and common facility centre in Bangalore Aerospace Park & SEZ
- MSMEs in the aerospace sector shall have preference in allotment of land in designated Aerospace Parks. At least 30% to 40% of the land in Aerospace Park will be reserved for MSMEs.
- Exemption of stamp duty & registration charges along with reimbursement of conversion charges in certain cases

Ease of Doing Business

- Lower burden of compliance on investor
- Large number of highly qualified low-cost engineers and scientists

State Features

- Congenial industrial ambience
- Excellent labour relations
- Skilled manpower
- Simple regulatory processes

Rajasthan			Kerala	
Policy Incentives	Ease of Doing Business	State Features	Policy Incentives	Ease of Doing Business
<ul style="list-style-type: none"> Land required for the defence manufacturing industry is expeditiously arranged by Rajasthan State Industrial Development & Investment Corporation Ltd. 	<ul style="list-style-type: none"> Single window clearance Excellent logistic & transportation infrastructure 	<ul style="list-style-type: none"> Abundant power availability Skilled manpower at reasonable cost 	<ul style="list-style-type: none"> KINFRA Defence Park is proposed to be established which would provide infrastructure facility exclusively for defence manufacturers with assistance from Government of India 	<p>The Park would provide:</p> <ul style="list-style-type: none"> Single window clearance facility Complete eco-friendly infrastructure Shared common infrastructure facilities like common facility centres (CFC's), testing and quality assurance labs, tool room, paint booth etc. <p>Land in parcels and built up spaces for establishment of units on lease basis</p>

Defence Industrial Corridors

Besides these state-specific incentives, the GoI has also announced the creation of two 'Defence Industrial Corridors' in the country – one in Uttar Pradesh and the other in Tamil Nadu.

While the TN corridor details are yet to be announced, the UP corridor details have been recently published in February 2018, when the Prime Minister announced the establishment of an INR 20,000 crore defence corridor at Bundelkhand - a region divided between Uttar Pradesh and Madhya Pradesh -- that will generate 2,50,000 jobs and will link Agra, Aligarh, Lucknow, Kanpur, Jhansi and Chitrakoot. As per the Uttar Pradesh Defence & Aerospace Manufacturing Policy of 2018, this defence corridor will be entitled to the following benefits, in addition to those given above³:



Loans

For private Aerospace & Defence Parks developed on more than 150 acres of land in the Bundelkhand & Purvanchal Region:

- On a loan taken to buy land, interest reimbursement @50% of annual interest, for 7 years up to INR 50 lakh p.a per park
- On a loan taken to build infrastructure, interest reimbursement @60% of annual interest, for 7 years up to INR 10 crores p.a with an overall ceiling of INR 50 crores per park
- On a loan taken to build common facilities, interest reimbursement @60% of annual interest, for 7 years up to INR 5 crores p.a with an overall ceiling of INR 30 crores per park, 100% exemption on stamp duty to the developer



Reimbursement

Reimbursement up to 25% of the cost of land to units investing over INR 300 crore or creating at least 1,000 direct job opportunities in notified area of the defence corridor.

³ Uttar Pradesh Defence & Aerospace Manufacturing Policy 2018, available at https://niveshmitra.up.nic.in/Documents/DraftPolicies/UttarPradeshDAMfgPolicy_v3_2018.pdf



Anchor Units

This 25% reimbursement will also be applicable to 'anchor units' — which will be global or Indian original equipment manufacturer companies which design and manufacture defence and aerospace platforms with investments of over INR 200 crore and bring along at least 10 vendor units.⁴

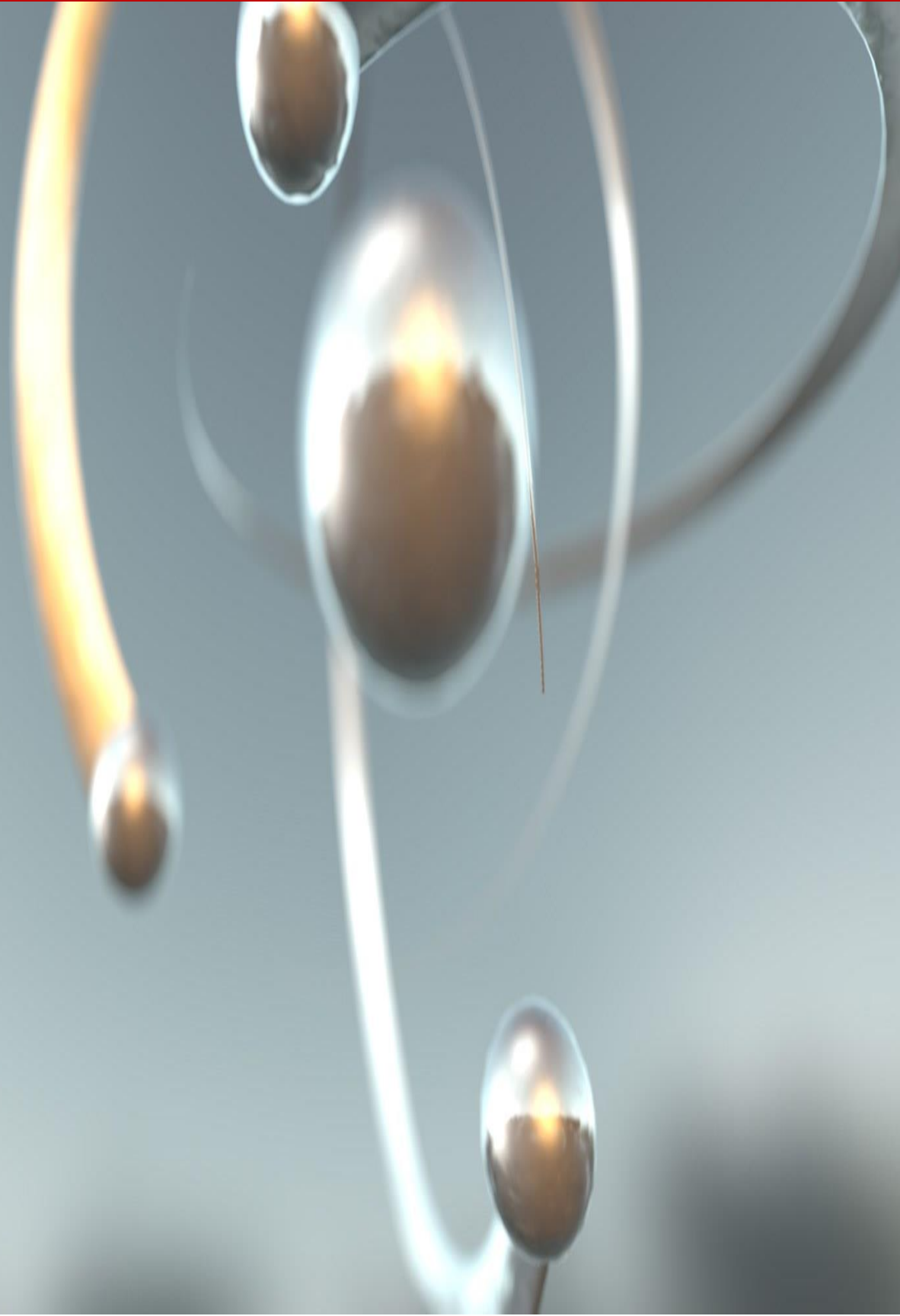


Incentives & Capital Investment

All incentives given on a case to case basis in the form of reimbursement, subsidies, exemptions etc., will be subject to a maximum of 300% of fixed capital investment made in Poorvanchal and Bundelkhand area.

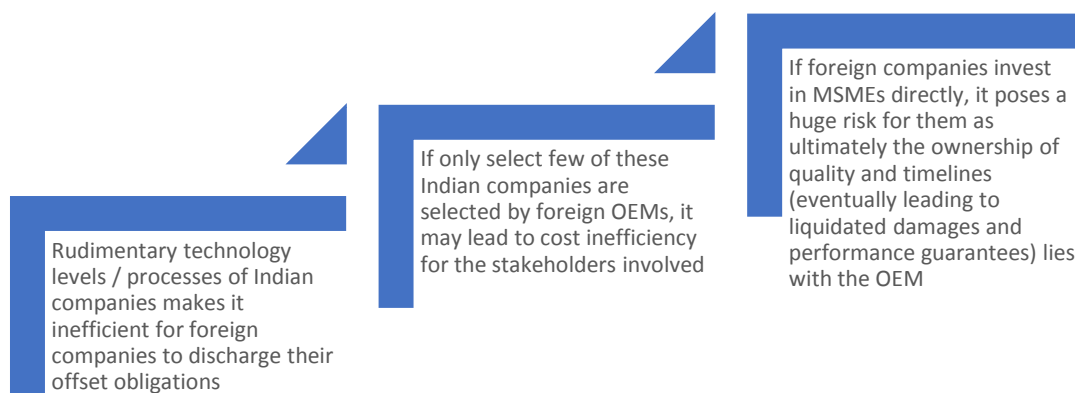
⁴ Discounts on offer to set up units in UP Defence Corridor, available at <https://economictimes.indiatimes.com/news/defence/big-discounts-on-offer-to-set-up-units-in-ups-defence-corridor/articleshow/64153551.cms>

| DRAFT OFFSETS POLICY: A PARADIGM SHIFT



Present Challenges in discharge of Offset Obligations

Discharge of offset obligations has been beset with numerous issues since offsets were first introduced a decade back. The reasons are multiple and are highlighted below:



As per a Government-sourced data-point on offsets as on 6th May 2016, total offset obligations for the contracts already placed stands at USD 6.13 billion and were to be discharged by 2022. Of this, offset contracts with Indian vendors have been signed to the extent of USD 2.23 billion and the actual reported discharge claims are USD 1.78 billion. This still leaves a gap of discharging USD 3.9 billion worth of offsets, and this is only as on 2016. Offset obligations beyond 2016 will continue to remain outstanding.

Proposed changes to the defence offset guidelines

In a parallel development, the MoD has also proposed changes to the 'Defence Offset Guidelines' which currently form part of the Defence Procurement Procedure, 2016. The proposed modifications are progressive and aim to include more stakeholders in the sector by opening additional avenues for discharge of offset obligations along with high multipliers (effectively reducing the obligation for the foreign OEMs).

Foreign vendors in the defence sector are required to comply with an offset obligation, which is quantified on the basis of the value of the procurement contract executed by the vendor.

Presently, any defence procurement contract valued at or above INR 2000 crore would trigger an offset obligation amounting to 30% of the contract value or the foreign exchange component thereof, depending on the nature of the contract.

As per the extant Defence Offset Guidelines, offset obligations can be satisfied by vendors through specified avenues. One of the permitted avenues for fulfilling offset obligations is FDI (equity investment) by the vendor in joint ventures with Indian enterprises, for the manufacture and/or maintenance of eligible products and provision of eligible services. The FDI would also be subject to guidelines/licensing requirements stipulated by the Department of Industrial Policy and Promotion.

In the 'Draft Modifications to Defence Offset Guidelines'⁵ released by the MoD for public comments, further avenues for discharge of offset obligations have been proposed. Each of these investment avenues has specific multipliers assigned

⁵ Draft modification to Offset guidelines available at <https://ddpmod.gov.in/sites/default/files/OFFSET%20GUIDELINES.pdf>

for discharge of offset obligation. These avenues, if notified, are likely to benefit the foreign vendors by providing them quicker ways to discharge offsets with less operational burden, as well as the defence industry in India by providing them access to funds and technology for capacity and capability creation.

In the proposed Policy, two of the avenues of offsets discharge are through investments in equity or a SEBI-regulated Fund that specifically invests in MSMEs and Start-ups in the Defence, Aerospace and Internal Security sectors. Such an investment will get the investing Foreign

OEM a multiplier of 3 and will not result in any additional obligation on part of the Foreign OEM. This makes it an attractive proposition since the Foreign OEM's will be devolved of all operational challenges they currently face in the execution of Offset Contracts. Through such funds, the defence industrial base in India, especially MSMEs would have access to funds for research, design and development as also for creating infrastructure, specialized test facilities and production lines.

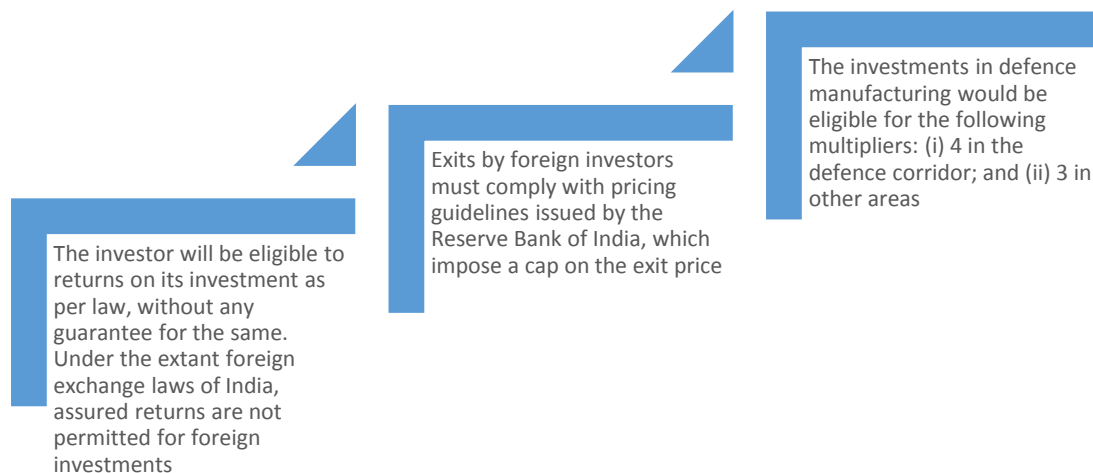
The three proposed new avenues for discharge of offsets

- Investment in specified projects for development of internationally competitive defence, aerospace and internal security related enterprises in the country
- Investment in defence manufacturing through equity investment
- Investment in specified SEBI regulated funds for defence, aerospace and internal security

Challenges of the Proposal

One of the suggested avenues is equity investment in an Indian company for setting up a manufacturing unit in defence, aerospace and internal security. In this regard, the use of the words “setting up” may imply that only investments in greenfield projects would be considered for discharge of offset obligations. A clarification may have to be sought with respect to investment in brownfield projects, if the language of the amended Defence Offset Guidelines does not clarify the aforementioned.

Certain other important considerations are as follows:



If implemented, the revised Defence Offset Guidelines are likely to encourage foreign vendors to undertake equity investments in local manufacturing projects. If the FDI cap in the defence sector is increased to 74% under the automatic route, it would provide further comfort to these vendors-cum-investors as they would be able to own a controlling stake in the Indian target company. Presumably, investors will also be more comfortable in transferring defence technology to Indian subsidiaries where they have a majority stake, and therefore more control over dissemination of intellectual property and know-how.

However, the sectoral conditionalities for the defence sector are crucial, as they could potentially negate any positives of liberalisation of the sectoral cap. In this regard, it is not clear if the Government intends to liberalise the sectoral conditionalities currently applicable for foreign investment in the defence sector, although the Draft Defence Production Policy, 2018 does hint at further liberalisation. If Government plans to go ahead, it will have to consider stricter compliances by the Foreign OEM (and some may require negotiations at a G2G level) to ensure that technology brought into India through FDI shall remain in India and that our national security is not compromised in any manner.

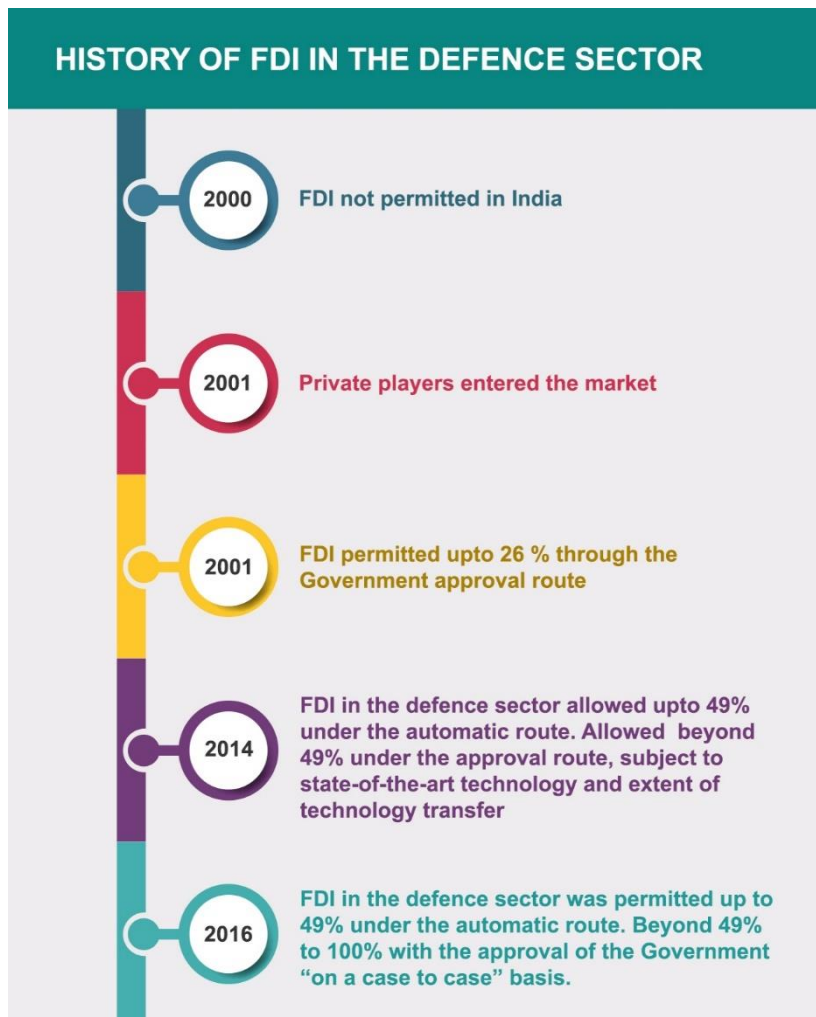


LIBERALISATION OF FDI REGIME



History of Liberalisation

From 2000 to 2018, India received foreign investment in the defence sector of approximately USD 5.13 million⁶, which is a negligible amount (less than 0.1%) when compared to the aggregate foreign investment inflows to India. The recent history and pertinent developments pertaining to FDI in India's defence sector can briefly be summarized as follows:



Proposed Liberalisation of the FDI Regime

It is apparent that efforts at liberalising foreign investment in the defence sector have not been successful in attracting substantial investment or technology transfer, nor have they managed to give the desired momentum to the domestic defence manufacturing or services sector.

In the Draft Defence Production Policy, 2018⁷, the Government has proposed a further liberalisation of FDI in the defence sector. This includes permitting FDI up to 74% under the automatic route, in niche technology areas. Details of other liberalisation measures have not yet been specified in the Draft Defence Production Policy, 2018.

If the proposal is given effect, it would be a significant step forward. For the first time, foreign investors would be able to hold a controlling stake (over 51%) under the automatic route in an Indian entity in the defence sector. The ability to control decisions at a shareholder level will provide a significant level of comfort to prospective investors. Most contracts which involve foreign

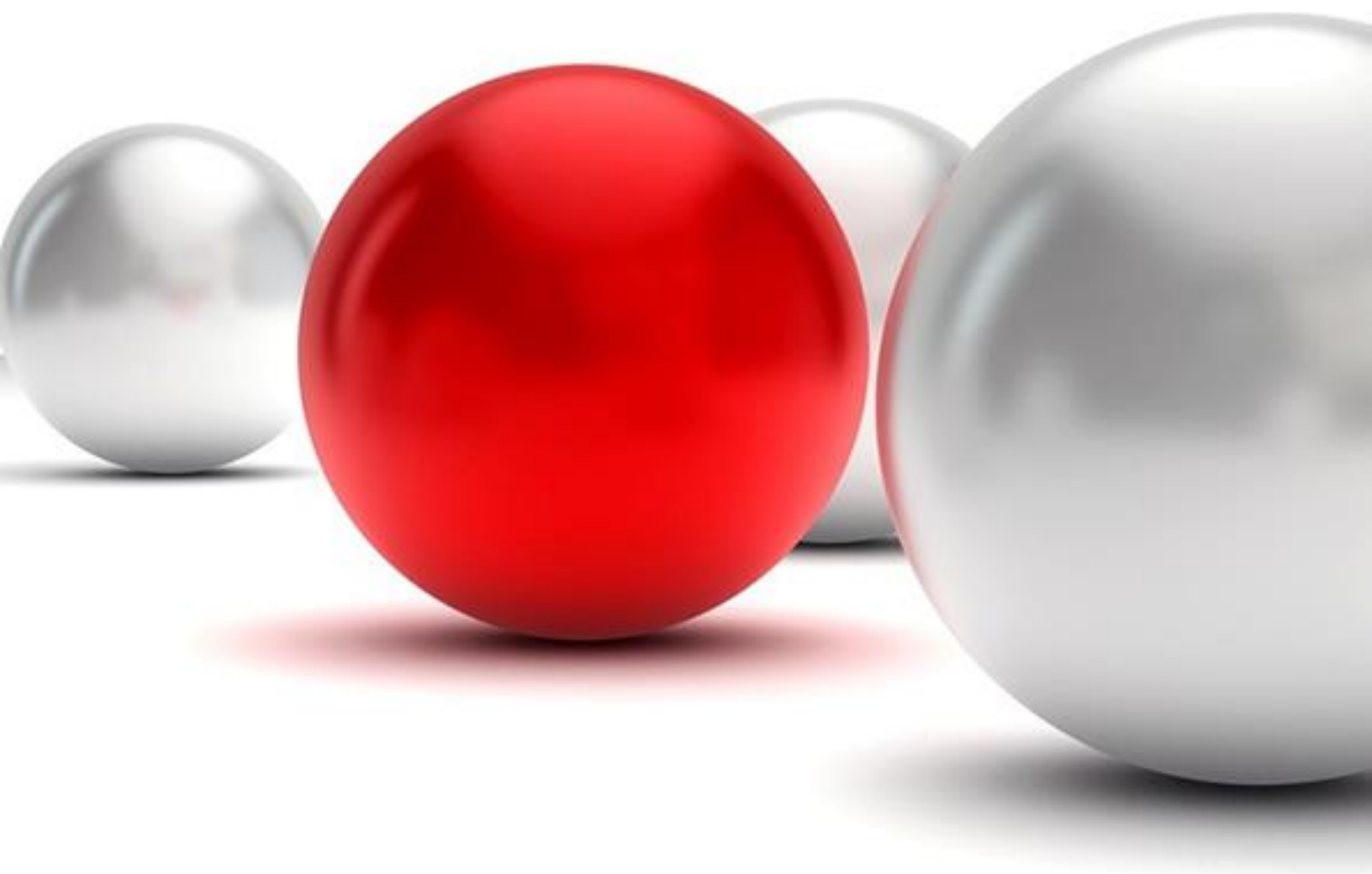
technology require the foreigner to be responsible for the quality of the deliveries, due to which they insist on ownership in such JVs.

However, given the significance of the sector, this may not be a decision that the government can make easily. Stringent measures to protect national interest will first have to be put in place before any such move is made. Government today is facing immense backlash on the proposal to increase FDI sectoral cap from many factions of the Industry.

⁶ <https://economictimes.indiatimes.com/news/defence/total-fdi-in-the-defence-sector-from-2000-18-is-rs-35-crore/articleshow/65038196.cms>

⁷ Draft Defence Production Policy, 2018 available at <https://ddpmod.gov.in/sites/default/files/Draft%20Defence%20Production%20Policy%202018%20-%20for%20website.pdf>

INDIA'S DEFENCE & AEROSPACE PARTNERS: RECENT UPDATES



Country Partnerships: Recent Updates

Since the present Government (NDA) took over in 2014, India has seen a lot of traction on building multiple geo-political relationships. Defence & Aerospace being a large market in India, has worked out to be a good leverage to enhance trade relationships with many advanced economies which also has the technologies India needs. Some of the recent updates from various country partnerships India has signed up with, are given below:



UNITED STATES OF AMERICA

- Defence companies in the US have been very upbeat about the opportunity in India's defence & aerospace sector and in many cases, have already announced their partnership with Indian private industry to re-affirm their commitment to the 'Make-in-India' initiative and the 'Strategic Partnership' policy announced in 2016.
- The latest step forward that India and USA have taken to forge a strong partnership is by signing a military-information sharing pact known as Communications Compatibility and Security Agreement ("Comcasa"). Comcasa will give India access to advanced new defence systems like armed drones and will enable the armed forces to exploit existing US-origin platforms much more efficiently for keeping an eye on any threats in our neighbouring regions.
- India and the US also agreed to open a hotline between their foreign heads and hold joint exercises involving the air force, navy and the army off the eastern Indian coast in 2019.
- However, one key issue that is often overlooked is the legal limitation of information exchange between the private companies of the two countries. US and India have the General Security of Military Information Agreement (GSOMIA) which was signed in 2002 and allows sharing of classified information from the U.S. government and American companies with the Indian government and Defence Public Sector Undertakings (DPSUs). However, this Agreement does not extend to Private Sector and would require an Annex to be executed between the two Governments before the classified information can be exchanged between US companies and Indian Private Industry.
- Since the Government of India has notified the Security Manual for Licensed Defence Industries (Private Industry), the Government could well align Chapter 5 (Handling of Documents and Equipment) of the Security Manual to the GSOMIA. This would ensure that the Indian private industry also complies with the requirements of the GSOMIA and therefore signing the Annex to enable exchange of classified information between the two countries. If this issue is not resolved at the earliest, it could potentially be a major bottleneck and stall the entire process of the Strategic Partnership program (in the immediate instance, the fighter jet program).



FRANCE

- India and France inked a strategic pact providing for the use of each other's military facilities including opening naval bases to warships, an agreement that comes amid China's growing military expansionism in the Indo-Pacific region. As per the agreement, the space agencies of the two countries will have joint monitoring mechanisms for

developments in the maritime sphere, while their navies will share intelligence and call their respective military bases for any requirements.

- The two countries also signed a pact on exchange and reciprocal protection of classified and protected information.
- In addition, India has already placed an order for 36 Rafale Fighter Jets which have an offset obligation of over Euro 3Bn. India is planning to buy over 100 more fighter jets under the Make in India initiative. While the decision on the OEM is a few years away, France is one of the leading candidates and thus, a key partner for India in the near term.



- In the last one year, State visits by the Indian PM to Israel and the Israeli PM to India has been a testimony to the growing bond between the two countries.
- Israel has emerged as India's third largest supplier of sophisticated defence equipment, notching up sales worth \$1 billion almost every year and is likely to rapidly go up the ladder in the coming years. The arms acquisition from Israel ranges from airborne warning and control systems and unmanned aerial vehicles to radars, anti-missile defence and several types of bombs and missiles. India's Defence Research and Development Organization (DRDO) is responsible for collaborating with Israeli companies in a host of strategic ventures, including the Agni missile system.
- The four significant pillars of India and Israel's defence ties include: First, the most significant is export of Israel's weapon system. In this regard, India has acquired a wide variety of weapons from anti-tank missiles to aerial reconnaissance drones and both states have signed defence contracts worth billions in USD. Second is the export of components and sub-systems, mainly electronics. Third is a joint venture regarding the weapons program and this joint venture in the defence sphere is viewed as a main thrust to the future defence ties between India and Israel. The fourth are the export of India's military services and hardware to Israel.

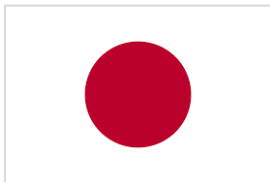


- The Defence and International Security Partnership ("DISP") between India and the United Kingdom endeavours to bring about not only cooperation in defence industry but also stronger military to military engagement, including training and advanced joint exercises.
- The nations have agreed to further strengthen their naval interactions, including enhanced Maritime Domain Awareness (MDA) to exchange information to track terrorists and pirate vessels as well as build capability partnerships focusing on best practices in Counter Terrorism, Counter Improvised Explosive Devices, air force training, aircraft carriers, maritime safety, shipbuilding and UN peacekeeping.



SOUTH KOREA

- India has moved from a mere 'Look East' Policy to 'Act East' Policy to counter threats from the immediate neighbors and secure India's position as a regional power. South Korea, Japan, Australia, Vietnam, Cambodia and Bangladesh have been key strategic partners for either technology tie-up or exports in this context.
- Towards this, India and South Korea signed an agreement to firm up bilateral cooperation in defence shipbuilding. Under the MoU, conceived under the umbrella of the special strategic partnership, the two sides will nominate one shipyard each for this purpose.
- The two countries will also work on the first-ever bilateral cooperative project focused on unmanned ground vehicles (UGVs) and robotics.
- Additionally, South Korea are highly interested in establishing a presence in the defence corridors in Tamil Nadu and Uttar Pradesh, a part of the 'Make in India' policy.



JAPAN

- India and Japan have recently inked key defence agreements - one concerning the Transfer of Defence Equipment and Technology and another related to Security Measures for Protection of Classified Military Information.
- India also announced that Japan will be a partner in Malabar Naval Exercises, taking it from a bilateral naval exercise with US to a trilateral level on a permanent basis.
- The decision by India and Japan to boost defence ties comes amid escalating tension in the region in the wake of the nuclear test by North Korea and China's growing assertiveness in the South China Sea.
- India also plans to buy the US-2 ShinMaywa aircraft from Japan for its navy. The two sides also agreed to ramp up counter-terror cooperation, besides the deepening engagement among navies, air forces and ground forces of the two countries.



AUSTRALIA

- Australia has identified India as a key security and defence partner to maintain stability and rules-based international order in the Indo-Pacific region amid growing strategic ambitions by an assertive China that impacts both Delhi and

Canberra. In its Defence White Paper for 2016 (most ambitious Defence document so far) Australia has identified India as its key defence partner for the Indian Ocean Region.

- The two sides signed key counter-terror agreements to fight common challenges. They also held talks on Canberra supplying uranium to Indian nuclear power plants. It's hoped that Canberra would start the supply beginning this year, 2018. The two sides signed five other pacts, including one on space cooperation.

While having multiple countries as key partners is tricky to handle geo-politically, India can surely leverage its position to get the maximum traction. Each of these relationships come with caveats either on information exchange, or export clearance or the extent of technology transfer feasible. However, if India chooses to go for Strategic Partnership in India (newly-notified policy), some of these relationships will end up competing and the country is stand to gain provided timelines are adhered to.

| STRATEGIC PARTNERSHIP POLICY: A NEW DAWN?



Strategic Partnerships

India announced its Strategic Partnership (SP) Policy in 2016.

Just as India's "Make" Procedure (which was introduced to encourage development of indigenous products), the SP Policy – touted to be the policy to further the self-reliance agenda – seems plagued by similar issues that kept the 'Make Procedure' from ever truly taking off. The Defence Acquisition Council (DAC) recently approved the details for each category of SP, the first RFI on P75(I) Submarines was expected to be procured under Strategic Partnership but is now seemingly being nominated to Mazagon Dock Shipbuilders Limited, a Defence PSU. This is despite an RFI being already issued to Foreign OEMs under the Strategic Partnership model. India has also issued an RFI for purchase of fighter aircrafts for the Indian Airforce, however, the vague requirements specified in the RFI are being criticised by the experts.

Thinking ahead, even if the SP Policy is spun into quick action, it would still imply anywhere between 4-7 years before any actual order would be placed on the Strategic Partner. Only post the order, will the investment begin whilst the upgrades (as envisaged through R&D and co-development within the country) and lifecycle support are still far off. If one were to go by the track record of such programs actually taking off, the MAKE programs are a good example. The 'MAKE' category was introduced in year 2006. Cut to twelve years later, the two MAKE programs which have down-selected vendors, still haven't seen the light of the day in terms of actual prototype development. These programs have been prolonged so far, that the Army is now contemplating on the need and the urgency of one of these critical programs and the same ('Battlefield Management System') may actually be even be rolled back. Even the other Make Program ('Tactical Communication System') is still stuck despite the down-selection announcement in year 2012.

Both the Strategic Partnership as well as the MAKE categories (Make I and Make II) no doubt started with the right spirit; however, it is the implementation that has always taken a beating from the various stakeholders involved. If lessons learned from the past errors are used to correctly implement the SP Policy without bias, this can actually transform India into the much-desired export-oriented defence economy, however, the focus should be on productivity and not proclivity. Clearly, also, the timelines for EOI / RFP formulation, product / vendor selection and approvals need to drastically reduce. While Make II has made progress since its introduction, and the Project Sanction Order (PSO) for one program has already been issued, it remains to be seen how quickly the actual purchase will happen.

Another important aspect Government would have to bear in mind would be to look at the Program not just from the lens of public probity (which is a given), but also from the view point of commercial viability. DPPs, from time to time, have addressed this issue at the Procedure level, but what India now needs is seamless and committed implementation of these procedures. The government would need to (a) commit to orders if prototyping / initial order is successfully delivered, (b) understand the issues involved in cost or cost-plus models for all legally 'for-profit' organisations, and last but not the least (c) expedite decision making on such matters without succumbing to red-tapism. This might have some impact on cost, but that would seem to be an acceptable price for achieving sustainable level of self-reliance within a reasonable time frame.

GOODS AND SERVICE TAX (GST): IMPACT OF THE NEW REGIME



Several measures have been introduced by Government of India to incentivise green field and brown field projects in India, avenues such as PPP (public private partnership) business models, single window clearances and several others. Schemes have been introduced that indirectly enable businesses to counter or minimise the adverse impact of high investment needs of the sector as well as the long gestation period in setting up manufacturing facilities.

Several schemes and incentives have been used by the Government, in addition to using tax incentives, to give impetus to the sector. GST, being co-terminus with overall government focus and attention to the defence manufacturing sector, adds to optimism and other favorable considerations for 'Making in India'. Hence, the traditional barriers when looking at India – 'policy' as well as 'tax' could, in fact, now become the game changers.

GST was implemented in July 2017 with the intent of the concept of 'One Nation, One Tax'. It is styled as a 'consumption-based destination tax' and is levied on value addition done by businesses, at each stage of the value chain of goods and services. With seamless recovery of most taxes paid on procurements, the benefits of the new tax regime range from lowered prices of goods and services as well as uniformity and certainty of taxes across Indian states.

Impact of GST

Simplified Tax Structure

Simple ad valorem computation and taxpayer friendly administration

Economic Union of India

No more state barriers

Uniform Tax Regime

The tax regime is uniform across the country and the policy making is administered centrally; empowers business decision making given more certainty and consistency

Enlarging markets

Tactical compliance mechanics is bringing all under the transparent tax net and thus, there is only one ever expanding market and no scope for parallel economy

Increase in Exports

The new regime makes exports more competitive and hence, when coupled with other schemes, GST on an overall basis promotes interest of exporters

Increased competitiveness

The prices have become more transparent and opportunities have increased for business

Benefits of GST for business considerations:

Singular tax regime – no multiplicity of taxes

Tax on tax, cascading, is by and large a thing of the past

Reduced cost of procurement; burden of tax lowered due to free flow of credits of tax paid on procurement

More certainty than ever with uniformity of taxes across the country – enables more qualitative focus on business approach

Lowered overall tax burden with transparency of taxes

Improved market economics, both demand and supply are improving

Makes economy more buoyant

GST, therefore, gives the desired impetus to 'Make in India', with 'low cost' and 'tax certain' business models becoming a reality. With India's defence manufacturing competencies focusing on growth and new investment, GST (basis above factors) is a timely boon in the whole equation. Also, with overall inter-state trade being abridged post the introduction of GST, several facets of business such as job-work or toll manufacturing, etc. have also become more efficient.

A taxation aspect that previously deterred the private sector from investing in the defence industry was the erstwhile transaction tax exemptions available to Defence Public Sector Undertakings and the Ordnance Factories. These were done away with in the run up to GST implementation ostensibly with a view to provide level playing field to the private sector.

With the GST regime still at a nascent stage, teething issues cannot be completely ruled out.

Illustrative issues within GST that can adversely impact industries

Anomaly in applicable rates (a) across the sector (specific item wise or business wise - For example, the distinction in rate burden on local and foreign MROs); and (b) for input and output items, which leads to an inverse tax structure or accumulation of credit

Aligning the GST code on job-work and new offsets policy to enable greater value generation for the businesses. Needless to add that, this aspect impacts only a certain fact pattern and hence, must be construed accordingly

Ambiguities surrounding the 'place of supply' in case of certain "Bill to-Ship to" transactions

Allowing credit of GST applicable, on such commercial transactions with non-residents but the goods being delivered indigenously, to the indigenous recipient, if registered

Requirement for non-residents to take temporary GST registration for business in India; etc.

Several amendments, which are likely to address the issues above, have already been made or proposed and the balance are in works. The entire approach of the government is reflective of its intent to assist the industry/ sector at large.

On a case by case basis, certain aspects above and others could also be resolved by way of efficient planning opportunities available under the law. This could be local or international job-work, combining various supply scopes for a rate arbitrage, rerouting the supplies in a manner where GST is not billed to international parties, etc.

On an overall note, a simplified tax regime, complemented with overall policy level support will certainly contribute towards attracting private sector support and investments in the defence sector.

DIRECT TAX IMPLICATIONS: AN IMPORTANT CONSIDERATION



Critical direct tax aspects

Direct taxes play a critical role in guiding investment decisions, more so in the context of long term, capital intensive, cross-border investment opportunities. A few of the critical direct tax aspects in the context of India's defence & aerospace sector are given here below.

Taxability of a foreign company under the domestic direct tax law

- Corporate tax in India is governed by the Income-tax Act, 1961 ('the Act') along with the Income-tax Rules, 1962 ('the Rules'). While, a resident company is taxed on its global income, a non-resident company ('foreign company') is taxed only on the income received or deemed to be received, accrued or deemed to accrue or arise in India.
- Income deemed to accrue or arise in India is determined on basis of various criteria which, amongst others, include a foreign company having a 'business connection' in India. The term 'business connection' which has been a subject matter of interpretation by various courts has recently witnessed an amendment to specifically cover a situation where the business activity of a foreign company is carried out by a person in India concluding contracts or even playing a principal role in conclusion of contracts. Thus, a foreign company could be taxable in India, if it satisfies the test of 'business connection' in India.
- The corporate tax rate for a resident company ranges between 25% to 30% vis-à-vis a foreign company which taxed at the rate of 40% on the income sourced from India.

A foreign company could be held to be a resident' for tax purposes in India

- A company is said to be a resident in India if it is an 'Indian company' or it has a 'Place of Effective Management' ('POEM') in India. POEM refers to the place where the company's key management and commercial decisions (necessary for the conduct of the entity as a whole) are made in substance.
- A non-resident company needs to be aware that if it fulfills the criteria of POEM in India, then such a non-resident company, even though not incorporated in India, would be treated as a 'resident' for tax purposes.

Privilege to foreign companies to take recourse to beneficial provisions of Double Tax Avoidance Agreement, if applicable

- A foreign company enjoys the privilege of getting taxed either under the Act or the Double Taxation Avoidance Arrangement ('DTAA') executed by India with the country of the non-resident company. This makes it imperative for non-residents to analyse whether the provisions of DTAA are beneficial as compared to the provisions of the Act

Contractual Receipts

- More often the foreign companies enter into contracts with an Indian counterpart with respect to transfer of technology, transfer of design, annual repair and maintenance contract, training, etc. for which the foreign company receives certain consideration.
- Such income received from India has tax implications for the foreign company in India. It is important to analyse the taxability of such receipts under the parameters laid down for characterisation of royalty, fees for technical services (FTS), commission, interest, etc. Such an analysis needs to be undertaken under the Act as well as under the relevant DTAA of the country of the foreign company.

Net of tax arrangements

- Generally, foreign companies enter into a net of tax arrangement with Indian counterparts.
- In such arrangements, the taxes are to the account of the Indian entity which means that the taxes are grossed up by the Indian entity at the time of payment.
- Even though the foreign company does not bear the brunt of Indian taxes, they are still obligated to undertake the Indian tax compliances such as obtaining tax registration, filing of annual return, etc. Thus, foreign companies should evaluate the Indian tax implications at their initial stages of operation or entering to contracts, as it could facilitate in mitigating a huge tax exposure at a later point in time.

| INDIA & EXPORT CONTROL REGIMES



India's engagement with the multilateral Export Control regimes: A Background

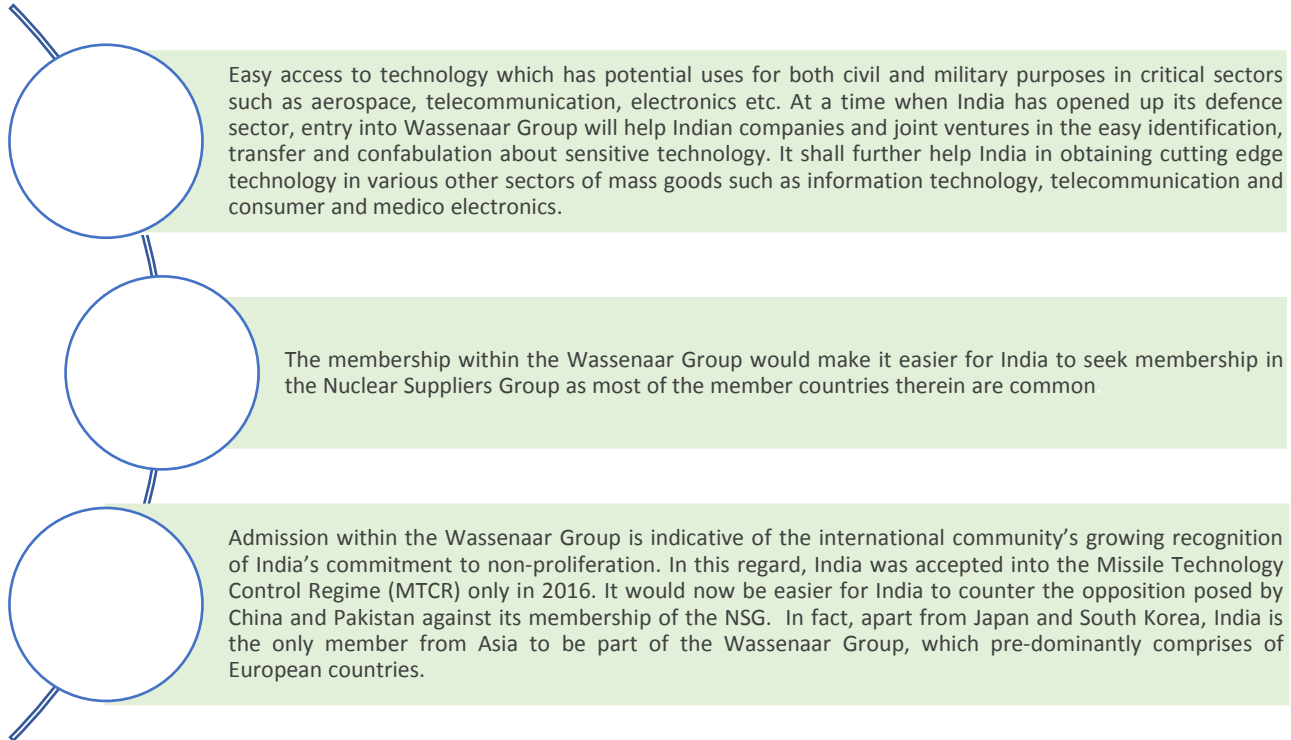
The admission of India as the 42nd member of the Wassenaar Group in December 2017 marks a significant milestone for India. Since the Indo-US civil nuclear deal in 2005, India has been trying to make its way into several major export control regimes namely Nuclear Suppliers Group, Wassenaar Group, Missile Technology Control Regime and Australia Group. With persistent efforts and constant upgradation of its export control laws, India managed a break through with the membership of the Missile Technology Control Regime (MTCR) in June 2016, subsequently followed by membership into the Wassenaar group in December 2017 and the Australia Group in January 2018. The membership in these 3 major export control regimes is clearly an ode to India's emergence as a responsible economic superpower.

Effect of India's admission into the Wassenaar Arrangement

The Wassenaar Group had been established to contribute to regional and international security and stability by prescribing the participant countries to adhere to export control restrictions on transfer of conventional arms and dual-use goods and technologies, thereby preventing any misuse through unwarranted acquisition, amongst other things, by non-state actors and terrorist groups.

The participant countries, *inter alia*, are required to share, on a bi-yearly basis, their arms transfer and permissions or denial of dual use of goods and technologies to countries that are not a party to the Wassenaar Group. This is to ensure greater transparency and a common understanding of the risk of transfer amongst participant states. Consequently, there are greater restrictions imposed on the transfer of technology or goods from a participant states to states which are non-members.

The admission in the Wassenaar Group is expected to provide multiple benefits to India



Indian domestic laws as applicable to export control

With membership to the majority of multilateral export regimes, there have been regular changes made to the domestic export control regulations from time to time in keeping with the best practices adopted by India's trading partners. By way of background, for all matters concerning foreign trade including exports and imports thereof, applicable policies derive their legality from the Foreign Trade (Development & Regulations) Act, 1992 ('FTDR Act'). Under the powers granted under FTDR Act, the Foreign Trade Policy ('FTP') and Indian Tariff Classification (Harmonized System) of Export and Import items ['ITC (HS)'] has been issued.

An item-wise export policy is contained in Schedule 2 to the ITC (HS), which sets out an Export Licensing Schedule. The Export Licensing Schedule sets out the export policy regime applicable on the items, based on which items are Prohibited / Restricted / Free for exports. The Schedule is divided into two parts viz. Table A and Table B.

Table A *inter-alia* includes the Special Chemicals, Organism, Material, Equipment and Technologies (**SCOMET**) list, a single unified control list of all dual-use items (set out under Appendix 3 to Schedule 2). It may also be noted that the SCOMET list is notified by the Central Government under the empowerment of the FTDR Act. Further, the FTDR Act itself contains specific provisions/chapter which seeks to provide for "controls on the export of specified goods, services and technology". Hence, determination of whether a particular item is regulated by export control provisions has to be primarily seen within the provisions of the FTDR Act and the SCOMET list.

In addition to the regulations under the FTDR, 1992 and ITC (HS), the export of certain goods is also prohibited/ restricted under the other enactments such as Atomic Energy Act, 1962, Chemical Weapons Convention Act, 2000, Environment Protection Act, 1986, Indian Arms Act, 1959 and Weapons of Mass Destruction and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005 ('WMD Act').

In fact, over the last one year, the GoI has been proactively undertaking a review of its existing laws as well as raising awareness through public dialogue on export control laws and the necessity of its compliance. In furtherance thereof, in May 2017, the Government completely overhauled the decade-old SCOMET list and notified a new list which confirmed to / aligned with the international export control lists. Relevant to note is that a new Category 8 dealing with "Special Materials and Related Equipment, Material Processing, Electronics, Computers, Telecommunications, Information Security, Sensors and Lasers, Navigation and Avionics, Marine, Aerospace and Propulsion" was introduced and a Munition List was populated under Category 6 of the SCOMET list to align India's export control laws with that of Wassenaar Group.

USA recognises India as a trusted STA-1 trade partner for sensitive products

In a significant boost to the country's defence sector aspirations, India recently entered the Wassenaar Group and also received STA-1 status from USA (by way of relaxing a key condition set by the Obama Administration that India would be eligible only after it had secured the membership of all four technology control regimes — the Nuclear Suppliers Group, the Missile Technology Control Regime, the Wassenaar Arrangement and the Australia Group). Subject to certain changes to US export regulations, these developments will enable India to acquire single comprehensive project licenses from various relevant licensing authorities for any dual-use or sensitive product imports, instead of stage-wise authorisation for different project stages.

The STA-1 status reaffirms that there is mutual trust between India and the USA regarding trade in sensitive products. This categorisation benefits both private and public entities and sets a presumption of in-principle approval for any projects underwritten by governments of both sides. From the industry's perspective, these developments will help reduce the red tape significantly. As an illustration, any license sought by India in this category will move through the applicable process and any authority/agency will now have to actively intervene to stop the approval process, as against

the earlier requirement of seeking specific approvals at every point. This also provides an opportunity for India to focus on dual-use technologies, including sensitive products meant for defence - a promising growth area.

The MTCR and Wassenaar memberships, as well as the implied seal of approval from the USA in the form of the STA status, would mean that India's desire to join the NSG could soon be realised. This development will not only boost ties between both the countries but will also provide an opportunity for India to take advantage of producing technologies for dual use including sensitive products meant for defence - a promising sector of growth for times to come



LITIGATION & DISPUTE RESOLUTION

Noteworthy contentions and disputes in this sector

The defence and aerospace industry has a very complex, multi-dimensional framework of applicable laws and regulations, leading to heightened possibility of disputes between buyers and vendors arising out of breach of defence procurement contracts are similar to those arising out of breach of commercial contracts of any other nature.

Most disputes that receive public attention in defence industry involve allegations of proclivity in the process of allocation of the defence contract and consequent termination of the contract. In certain cases, parties are required to sign Integrity Pacts. Breach of such pacts, therefore, creates another body of disputes.

As per recent reports, while the law ministry shows the Ministry of Defence to be the fifth highest litigant, experts point out that with correct numbers it is actually the second highest litigant while practically speaking it might be the largest litigant⁸. However, large number of disputes are in the Armed Forces Tribunal and few are of commercial in nature, given that Ministry of Defence is a large market and market-maker in itself.

Given its direct nexus with national security, Courts take an extremely cautious view while deciding matters pertaining to defence and aerospace sector. With this in mind, only a few commercial disputes reach the courts and it's most desirable to settle any disputes through either amicable dispute resolution or alternative dispute resolution mechanisms.

A few noteworthy contentions and disputes as settled by the Indian Courts in recent times in the defence and aerospace sector are summarised as under:

Registration of firms for procurement by other Departments of the Ministry⁹

Facts	The present writ petition had been <i>inter alia</i> praying for issuance of necessary direction upon the respondents to allow the petitioner no. 1 to participate in the bid in respect of the tender for supply of NARS SPARES FOR JAGUAR AIRCRAFT (RFP) NO. AIRHQ/CPF-243/AHQ/JAGUAR/W1725041 PUR under Single Bid System on Limited Tender Enquiry ("LTE") basis dated 12.03.2018.
PC ¹⁰	<ul style="list-style-type: none"> • A firm registered with any Department of the Ministry of Defence, may be considered as a registered firm for procurement by other Departments of the Ministry. • The vendors already registered with the Army, Navy, Air Force for similar items will be treated as registered vendors and may be considered for issue of LTE. • Hence, LTE should be sent to as many registered/known suppliers as possible.
HC Ruling	This Court directed the respondents to allow the petitioner no. 1 to submit its bid subject to the result of the present writ petition.

Government's right to withdraw the bid with valid reasons¹¹

Facts	The Petitioner challenged the withdrawal of a Request of Proposal ("RFP") dated 30.04.2012, issued by the Union Ministry of Defence ("MoD"), for procurement of forty-five (45) Bird Detection and Monitoring Radar Systems ("BDMRS").
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⁸ <https://indianexpress.com/article/india/mod-data-on-pending-litigation-raises-doubts-on-correct-numbers/>

⁹ R-MC Power Recovery (India) Pvt. Ltd. & Anr. v. Union of India & Ors. [2018 SCC OnLine Cal 3400]

¹⁰ Petitioner's Contention

¹¹ Axicades Aerospace and Technologies Pvt. Ltd. v. Union of India & Ors. [2018 SCC OnLine Del 9320]

PC	It is a settled practise that a contract for public procurement should be awarded to the lowest evaluated bidder whose bid fulfils all the technical and commercial requirements. Any departure from this practise can only be substantiated with strong reasons, grounded in public interest.
HC Ruling	<ul style="list-style-type: none"> The decision to award a public contract by the Union Ministry of Defence is not based merely on factors such as fulfilment of technical qualifications and financial viability of the offer of a given bidder but much more. The vital public interest is a necessary condition, which invariably informs every decision of the executive authority or agency that is to award the contract. Thus, no vested right accrues on the lowest bidder and the government has the right to withdraw the bid with valid reasons

Non-permissibility of indefinite suspension of the contract¹²

Facts	The Union of India (UCT) through the Ministry of Defence had put “on hold” all contracts with the Petitioner companies. As a result of this, the work concerning contracts worth several crores of rupees was at a standstill and even the bills for past supplies which have been found to be in accordance with the contracts had not been cleared. This was causing each of them great hardship.
PC	The impugned orders putting on hold the contracts have been passed in violation of the principles of natural justice. None of the Petitioners has been issued as much as a show cause notice seeking an explanation in regard to any of the conclusion.
HC Ruling	Indefinite suspension of the contract without offering any reasons for such decisions will undoubtedly cause severe prejudice and the same cannot be put to hold for such an extended period of time.

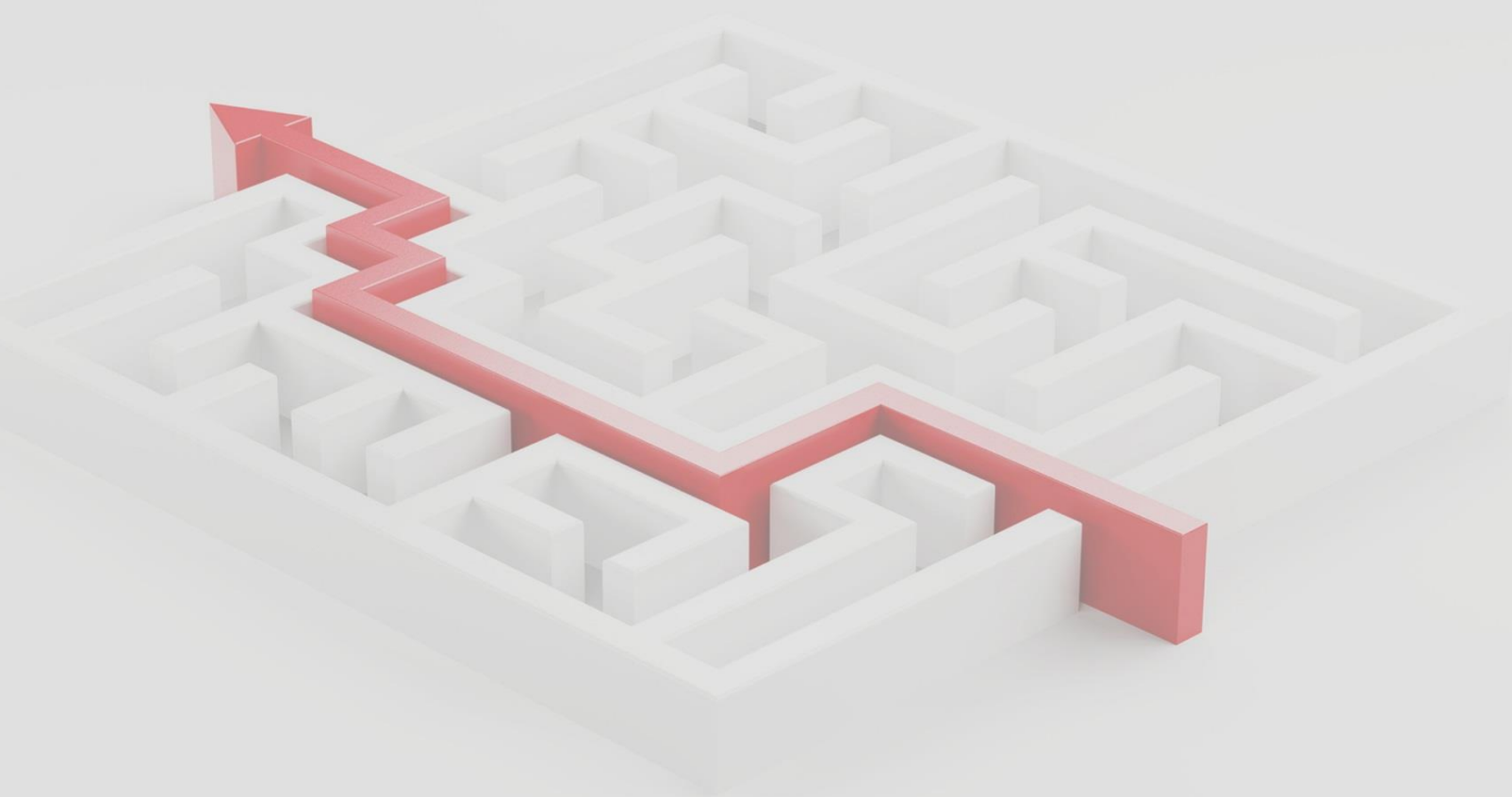
Non-responsiveness of bid due to escalation clause on account of foreign exchange in a Firm and Fixed Price RFP¹³

Facts	<ul style="list-style-type: none"> The Petitioner’s bid was found to be non-responsive instead of being the lowest bidder. This is because, as per the tender conditions, though the price was to be firm and fixed for the entire duration of the contract and was not subject to escalation, yet the petitioner claimed foreign exchange rate variation. Subject to the same, the Petitioner withdrew the condition after opening of the bid documents.
PC	The Petitioner on account of its bid being non-responsive subsequently to opening as the commercial bids, withdrew its earlier offer and offered the quoted price without FERV content in order to to make a nonresponsive bid as responsive.
HC Ruling	<ul style="list-style-type: none"> Once, a bidder can submit a bid containing a foreign exchange component, the price payable in Indian rupees as on the date of opening of the bid can surely and only be calculated on the basis of the conversion rate on the date of opening of the bid. If the contract was awarded in the favour of the Petitioner, then it could have claimed escalation in price, assuming FERV condition was there, by selecting any one or more foreign currencies which would have appreciated qua the Indian rupee during the performance of the contract But since the Petitioner's bid was clearly non-responsive due the tender condition not being satisfied, it was not entitled to the contract and a non-responsive bid cannot subsequently be made responsive.

¹² R.K. Machine Tools Ltd. & Anr. Versus Union of India [(2010) 115 DRJ 422]

¹³ MANU/DE/3111/2010 (W.P. (C) No. 3231/2010)

| CONCLUSION



India has already crossed France to emerge as the sixth largest economy in the world and is soon expected to cross US's GDP to stand tall at No. 5 in the global pecking order.

Besides the national security aspects associated with the sector, defence & aerospace also gains prominence in most countries due to its impact on the overall economy management, in terms of FDI inflows, outflows, fiscal deficit, growth in GDP, job creation and therefore per capita income, etc. Although defence & aerospace as a sector has been identified as a major thrust area by the GoI, its role in overall growth of the economy is still evolving.

Having stated the above, we certainly need an urgent focus to equip our armed forces, who sacrifice their lives protecting our borders and it is our responsibility to ensure they are equipped against the forces we are likely to fight against.

We hope that the government's policy push toward creating an enabling framework of laws and regulations governing this sector is successful in assuaging some of the concerns aired by the industry. The ecosystem is still evolving, and we anticipate a significant lessening of head winds facing the industry.



ECONOMIC
LAWS
PRACTICE
ADVOCATES & SOLICITORS

Mumbai

109 A, 1st Floor, Dalamal Towers
Free Press Journal Road, Nariman Point
Mumbai 400 021
T: +91 22 6636 7000, F: +91 22 6636 7172
E: mumbai@elp-in.com

Ahmedabad

801, 8th Floor, Abhijeet III
Mithakali Six Road, Ellisbridge
Ahmedabad 380 006
T: +91 79 6605 4480/1, F: +91 79 6605 4482
E: Ahmedabad@elp-in.com

Bengaluru

6th Floor, Rockline Centre, 54, Richmond
Road, Bangalore 560 025
T: +91 80 4168 5530/1
E: bengaluru@elp-in.com

Chennai

No. 6, 4th Lane, Nungambakkam High Road
Chennai 600 034
T: +91 44 4210 4863
E: chennai@elp-in.com

Delhi

801 A, 8th Floor, Konnectus Tower
BhavbhutiMarg, Opp. Ajmeri Gate Railway
Station, Nr. Minto Bridge New Delhi 110 001
T: +91 11 4152 8400, F: +91 11 4152 8404
E: delhi@elp-in.com

Pune

202, 2nd Floor, Vascon Eco Tower
BanerPashan Road, Pune 411 045
T: +91 20 49127400
E: Pune@elp-in.com

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