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INDIAN DEFENCE INDUSTRY AND DEFENCE OFFSET

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of Doing Business with India'

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Celebrating a Century

Bangalore

Kolkata

Mumbai

New Delhi



INDIA - INVESTORS' PARADISE

Key Attractions:

- Forecasted growth rate of real gross domestic product – 6.5% for 2013-2014.
- Foreign Direct Investment (“**FDI**”) inflows during the financial year 2011-2012 – \$46,847 Million
- Growth rate of FDI inflows – 31 % in 2011-2012.
- 3rd Rank - Most prospective host economies for 2012 – 2014.
- 7th Rank - Most promising investor home economies for 2012 – 2014.
- Key Advantage - Growing into a massive and cost effective manufacturing hub with a large domestic market.

Sources:

UN World Economic situation and prospects 2013
UNCTAD World Investment Report 2012
Department of Industrial Policy and Promotion, Government of India





INDIAN DEFENCE INDUSTRY

Key Information on the Indian Defence Industry:

- India is the world's largest arms importer – approximately 75% of India's weapons purchases come from imports.
- Indian defence budget for 2012–2013 is US \$ 36 Billion approximately.
- Growth of defence budget - 17.63%

Key Growth Drivers of the Indian Defence Industry:

- Modernization initiatives taken up by the government
- Threat from neighboring countries
- Arms race with Pakistan and China
- Strong economic growth
- Ambition to emerge as a super power





DEFENCE INVESTMENTS AND DEALS

Recent Defence Investments into India :

- The Indian defence sector has investments primarily from Russia, Israel, UK and US.
- 13th Indo-Russian summit - 24 December 2012 - \$5 Billion investment by Russia.
- US aerospace major Boeing - \$300 Million plan for investment in the Indian defence industry as 'offsets' for the four additional P8I long-range maritime patrol aircraft that India intends to buy for its navy.

Recent and Potential Defence Deals:

- \$10.4 Billion deal - Indian Air Force Medium Multi-Role Combat Aircraft - 126 Dassault Rafales.
- Potential Deals: \$3,000 Million deal for 197 light observations/utility helicopters, \$3,500 Million deal for 7 Scorpene Submarines, \$7,600 Million deal for 12 stealth frigates; and \$1,000 Million deal for 16 multi-role helicopters.





FDI IN THE INDIAN DEFENCE SECTOR

- FDI in India - sectoral caps - automatic route and approval route.
- FDI up to 26% - permissible under the automatic route. FDI beyond 26% - requires Foreign Investment Promotion Board (FIPB) approval.
- Foreign investment - subject to pricing guidelines
 - Listed company - sale/transfer price shall not be less than the price at which a preferential allotment of shares can be made under the Securities Exchange Board of India ("**SEBI**") Guidelines.
 - Unlisted Companies - sale/transfer price not less than the fair value to be determined by a SEBI registered Category - I - Merchant Banker or a Chartered Accountant as per the discounted free cash flow method.
- Issue of shares - Form FC-GPR
- Transfer/sale of shares - Form FC-TRS





OFFSET POLICY AND PROCUREMENT PROCEDURE

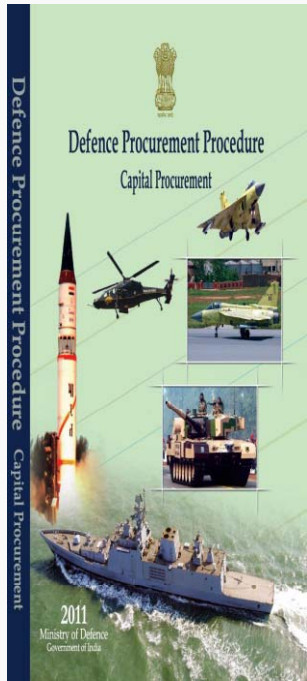
Defence Offset Policy ("DOP") – Key Object:

To leverage capital acquisitions to develop Indian defence industry by -

- Fostering development of internationally competitive enterprises;
- Augmenting capacity for research, design and development related to defence products; and
- Encouraging development of synergistic sectors like civil aerospace, and internal security.

Defence Procurement Procedure, 2011 ("DPP"):

- Prescribes procedures for defence procurements.
- Appendix D of DPP – Defence Offset Guidelines ("**DOG**").





CAPITAL ACQUISITIONS - PROCESS

- Services Qualitative Requirements.
- Acceptance of Necessity.
- Solicitation of Offers.
- Evaluation of Technical Offers by Technical Negotiation Committee.
- Field Evaluation and Staff Evaluation.
- Oversight by Technical Oversight Committee for acquisitions over 300 Cr.
- Commercial Negotiations by Contract Negotiation Committee.
- Approval of Competent Financial Authority.
- Award of Contract/Supply Order.
- Contract Administration and Post - Contract Management.





CAPITAL ACQUISITIONS - INDIGENEOUS/LOCAL CONTENT

Acquisitions covered under the 'Buy' Decision:

- Buy Decision - outright purchase of equipment.
- Buy Indian - Minimum 30% indigenous content if systems are being integrated by an Indian Vendor.

Acquisitions covered under the 'Buy & Make' Decision:

- Buy and Make Decision - purchase from a foreign vendor followed by licensed production / indigenous manufacture in India.

Acquisitions covered under the 'Buy & Make Indian' Decision:

- Buy and Make Decision - purchase from a Indian vendor followed by licensed production / indigenous manufacture in India.
- Buy and Make Decision - Minimum 50% indigenous content on cost basis.





OFFSET OBLIGATIONS

Applicability:

Defence offset obligations are applicable to all capital acquisitions where the indicative cost is INR 300 Crores (\$55.81 Million approximately) or more and the schemes are categorized as:

- **'Buy (Global)'** involving outright purchase from foreign / Indian vendors; and
- **'Buy and Make with Transfer of Technology ("ToT")'** i.e. purchase from a foreign vendor followed by licensed production in India.

Obligations:

The value of the offset obligations prescribed under the **DOG** is -

- 30% of the estimated cost of the acquisition in 'Buy (Global)' category acquisitions and
- 30% of the foreign exchange component in 'Buy and Make with ToT' category acquisitions.





OFFSET OBLIGATIONS (CONTINUED)

Avenues for Discharge



Offset obligations may be discharged by any one or a combination of the following methods:

- **Direct purchase** of, or executing export orders for, eligible products manufactured by, or services provided by Indian Offset Partners and Indian Enterprises, i.e. Defence Public Sector Undertakings, Ordnance Factory Board etc.
- **FDI in joint ventures** with Indian enterprises (equity investment) for the manufacture and/or maintenance of eligible products and provision of eligible services.





OFFSET OBLIGATIONS (CONTINUED)

Avenues for Discharge (Continued)

- **Investment in 'kind' in terms of ToT** to Indian enterprises for the manufacture and/or maintenance of eligible products and provision of eligible services:
 - Through joint ventures or through the non-equity route for co-production,
 - ToT should be provided without licence fee or restriction on domestic production, sale or export.
 - Investment in 'kind' in Indian enterprises by providing equipment through the non-equity route for the manufacture and/or maintenance of eligible products and provision of eligible services (excluding ToT, civil infrastructure and second hand equipment).
 - Provision of equipment or ToT to government institutions and establishments engaged in the manufacture and/or maintenance of eligible products and provision of eligible services, including Defence Research and Development Organization (as distinct from Indian Enterprises).
 - Technology Acquisition by the Defence Research and Development Organization in areas of high technology.





PRODUCTS AND SERVICES ELIGIBLE FOR DISCHARGE

The DOG in Annexure VI provides a 4 categories of products and services that are eligible for the purpose of discharging offset obligations:

- **Defence Products** (including small arms, mortars, cannons, guns, howitzers, anti tank weapons, bombs, torpedoes, rockets, missiles, handling, control, operation, jamming and detection equipment, energetic materials, explosives, propellants and pyrotechnics, tracked and wheeled armoured vehicles, vehicles with ballistic protection, armoured or protective equipment, vessels of war, special naval systems etc.);
- **Products for inland and coastal security** (includes all types of close quarter weapons, specialised protective equipment for security personnel, vehicles for internal security purposes, riot control equipment and vehicles, specialized equipment for surveillance and unmanned aerial vehicles, equipment and devices for night fighting capability, navigational and communications equipment etc.);





PRODUCTS AND SERVICES ELIGIBLE FOR DISCHARGE

- **Civil aerospace products** (includes all types of fixed wing and rotary wing aircraft or their airframes, aero engines, avionics, instruments and related components, composites, forgings and castings for the products training aids viz. Simulators, associated equipment, software and computer based training modules, guidance and navigation equipment, test facilities, related software etc.); and
- **Services related to the above eligible products** (includes maintenance, repair and overhaul, up gradation/life extension, engineering, design and testing, software development, quality assurance, training etc.).

Period of Discharge of Offset Obligations:

- Offset obligations - to be discharged within a time frame that can extend beyond the period of the main procurement contract by a maximum period of 2 (two) years.
- The period of the main contract includes the period of warranty of the equipment being procured under the main contract.





INDIAN OFFSET PARTNERS

- Indian enterprises engaged in manufacture of eligible products and/or provision of eligible services, are referred to as Indian Offset Partners (“**IOPs**”).
- The Original Equipment Manufacturer, vendor, Tier-I sub-vendor (**OEM**) are free to select the IOP for implementing the offset obligation provided the IOP has not been barred from doing business by the Ministry of Defence.
- The agreement between the OEM and the IOP is required to be governed by the laws of India.
- The DOG provides for a model offset contract between the OEM and the IOP in Annexure IV.
- The Acquisition Wing in the Department of Defence is responsible for technical evaluation, commercial evaluation and approval of offset proposals.
- Pursuant to technical and commercial evaluations, offset proposals require the approval of the Competent Financial Authority followed by the signature of the Acquisition Manager, Acquisition Wing, Ministry of Defence pursuant to the approval by the Ministry of Defence.





Defence Offsets Management Wing (DOMW)

- The DOMW under the Department of Defence Production is responsible for formulation of the DOG and all matters relating to post contract management.
- The DOMW works in close collaboration with the Acquisition Wing for smooth implementation of the DOG.
- The functions of DOMW will include monitoring the discharge of offset obligations, participation in technical and commercial evaluation of offset proposals as members of Technical Offset Evaluation Committee and the Contract Negotiation Committee, administration of penalties under offset contracts in consultation with Acquisition Wing, assisting vendors in interfacing with Indian industry etc.
- The DOMW assists OEM in interfacing with IOPs and relevant government authorities.
- Progress reports and claims relating to discharge of offsets are required to be submitted to the DOMW.





LICENCE REQUIREMENTS

Industrial Licence:

- Investment in the defence sector subject to compliance with licensing requirements stipulated by the Department of Industrial Policy and Promotion (DIPP).
- Manufacturers of arms and ammunition are required to obtain an industrial licence under the Industries (Development & Regulation) Act, 1951 .
- Applications in Form FC/IL accompanied by a crossed demand draft of INR 2,500 is required to be submitted to the Secretariat for Industrial Assistance, DIPP.

Industrial Entrepreneur Memoranda:

- Large scale industrial undertakings exempted from obtaining an industrial license are required to file an Industrial Entrepreneur Memoranda (IEM) in the prescribed format with the Secretariat for Industrial Assistance. The filing of IEM does not involve any registration or scrutiny of the memorandum and is intended purely for statistical purposes only.

FORM FC/IL
SIA
COMPOSITE FORM FOR FOREIGN COLLABORATION
AND INDUSTRIAL LICENCE

Please fill up the attached supplementary sheets
Part A: For only FC/Part B: For only IL/ Both Part A and Part B for FC+IL

GENERAL INFORMATION

1. Type of Application (Please, tick the Appropriate Boxes)

a. Foreign Collaboration (FC)
For Foreign Investment For Foreign Technology Agreements

b. Industrial Licence (IL)

2. (For Office Use Only)

Application No.

Application Date

3. Payment Details (For FC Application No Fee is Payable For Industrial Licences Rs.2500. 50 Payable)

Draft No.

Amount (Rs)

Draft Date

Drawn on Payable at
(Name of the Bank)

*Demand Draft should be made in favour of Pay. & accounts Officer, Deptt. of Industrial Development, to be payable at State Bank of India, Naraina Branch, New Delhi





IMPORT AND EXPORT CONTROL REGULATIONS

- The Indian Trade Classification based on Harmonized System Codes (“**ITC (HS)**”) lays down restrictions relating to imports (Schedule 1 - **Import Schedule**) and exports (Schedule 2 - **Export Schedule**) of certain items which require licences from the appropriate authorities under the government of India.
- **Weapons of Mass Destruction and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005** mandates exporters to obtain a licence for the export of any material, equipment or technology knowing that such material, equipment or technology is intended to be used in the design or manufacture of a biological weapon, chemical weapon, nuclear weapon or other nuclear explosive device, or in their missile delivery systems.
- To obtain an export license, an application in the prescribed form along with the prescribed documents must be submitted to the Directorate General of Foreign Trade (DGFT) Headquarters, Udyog Bhawan, New Delhi.
- The Export Licensing Committee (ELC) under the chairmanship of the Export Commissioner (EC) considers such applications on merits for issue of export licenses.





IMPORT AND EXPORT CONTROL REGULATIONS (CONTINUED)



- Further, the Export Schedule also lays down certain provisions governing dual use products. Appendix 3 of the Export Schedule contains India's national dual-use export control list, the Special Chemicals, Organisms, Materials, Equipment, and Technologies ("**SCOMET**") list.
- Exporters are also required to mandatorily obtain an export licence if they propose to export any item provided in the SCOMET list.
- To obtain a licence for export of SCOMET items, an exporter must apply in the prescribed Aayat Niryat Form (ANF 2E and ANF 1) along with the prescribed documents to the DGFT.
- It is important to note that the import and export control regulations, unlike the offset obligations, not only triggers in cases of sale or purchase of defence equipment to and from India but also triggers in cases where goods are assembled/manufactured or defence related services are rendered in India and the finished products are to be exported back from India to the foreign vendor.





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