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# Defence Procurement Policy 2016: Picking cherries!

## Regulatory Update



In order to provide impetus to "Make in India" initiative and further streamline the procurement process, the Ministry of Defence ("MoD") released the revised Defence Procurement Procedure as on March 28, 2016 ("DPP 2016"). DPP is a set of guidelines approved by Defence Acquisition Council for procurement of defence equipment and technology and provides the framework and criteria for allotment of defence contracts to private players. DPP was first introduced in 1992 but came into effect in 2002 and, thereafter, it has been revised 7 times in the years 2005, 2006, 2008, 2009, 2011, 2013 and now in 2016. DPP 2016 is a major first step towards making the Indian defence system self-reliant and cutting down imports. Now let us see some of the crucial elements of DPP 2016. We would cover other aspects in our subsequent write-ups.

### 1. Capital Acquisition

DPP 2016 specifically mentions that while procuring defence equipment, the decreasing order of priority shall be as follows –

1. **Buy (Indian – IDDM):** An Indian vendor either designs and manufactures the product in India with at least 40% Indigenized components, including basic cost, spares and test equipment OR manufactures the product in India but is designed/developed abroad but with 60% Indigenized components, including basic cost, spares and test equipment.

The onus of proving that the equipment design is indigenous, rests with the vendor, and such vendor claims will be verified by a committee comprising scientists from DRDO and representatives from SHQs, based on documents issued by authorized agencies and presented by the vendors. The process of verifying the availability of indigenous design and development, should be completed prior to fielding of SoC for categorization; guidelines pertaining to the same will be issued by the DG (Acquisition), with inputs from DRDO.

2. **Buy (Indian):** An Indian vendor manufactures in India, but the product is designed/developed abroad with only 40% Indigenized components.
3. **Buy and Make (Indian):** The initial procurement of equipment is in a fully formed state, from an Indian vendor, which has a tie-up with foreign OEM and starts manufacturing in India with 50% indigenous content and starts the transfer technology from foreign OEM in phased manner.
4. **Buy and Make:** Initial procurement of equipment from foreign vendors, followed by domestic production and involving transfer of technology in a phased manner.
5. **Buy (Global):** Purchase of equipment from foreign or even Indian vendors. In case of foreign vendors, Government to Government route may be adopted, for equipment meeting strategic/ long term requirements.

In addition to the above listed categorization, there is the **Make** category, which aims at developing long-term indigenous defence capabilities. Acquisitions covered under the Make category refer to equipment/system/sub-system/sub-assembly, major components, or upgrades thereof, to be designed, developed and manufactured by an Indian vendor, as per procedure and norms detailed in Chapter III of DPP. Depending upon factors such as Indian industry's capability, access to technology, time frame required and available for development, the 'Make' category of procurement would be pursued in isolation, in sequence or in tandem with any of the five categories under 'Buy' or 'Buy and Make' classifications, with a separate heading under SCAP and AAP.

For the purposes of DPP 2016, for defence products requiring industrial licence, an "**Indian entity**", would include incorporation/ownership models as per Companies Act, partnership firms, proprietorship, and other types of ownership model as per relevant Indian laws, complying with, besides other regulations in force, the guidelines/licensing requirements stipulated by the DIPP as applicable; and for defence products not requiring industrial licence, an Indian entity, which could include incorporation/ownership models as per Companies Act, partnership firms, proprietorship, and other types of ownership model as per relevant Indian laws and complying with all regulations in force applicable to that industry.

The definition of Indian vendor allows JVs, in which the FDI can now go up to 100% (up to 49 per cent through automatic route and beyond that through the FIPB route), to be treated as Indian vendors. However, the JVs in which foreign equity is more than 49% would not be eligible to participate in the 'Make' programme, which is reserved for entities in which the majority stake is to be controlled by resident Indians.



## 2. Acquisition Process

The acquisition process for the five categories of procurement under the 'Buy' and 'Buy & Make', schemes will involve the following processes:

- a. Request for Information (RFI) as published in MOD website
- b. Services Qualitative Requirements (SQRs)
- c. Acceptance of Necessity
- d. Solicitation of offers
- e. Evaluation of Technical offers by Technical Evaluation Committee (TEC)
- f. Field Evaluation
- g. Staff Evaluation
- h. Oversight by Technical Oversight Committee (TOC)
- i. Commercial negotiations by Contract Negotiation Committee (CNC)
- j. Approval of the Competent Financial Authority (CFA)
- k. Award of contract/Supply Order
- l. Contract Administration and Post-Contract Management.

For equipment/systems/platforms already inducted into service, it may be necessary to go back to the OEM/vendors for placing repeat orders. In such cases it may be ensured that the SQRs of the equipment are as per the previous order. All such cases would not be construed as single vendor cases. In such cases, after seeking acceptance on necessity, a commercial RFP would be issued to the vendor, for quantity not exceeding 100% of the previous order. Specific approval of DPB (in acquisition cases up to Rs. 300 crores) or DAC (in acquisition cases excess of Rs. 300 crores) as the case may be, would be obtained for Repeat Order of quantity exceeding 100% of previous order. Such restriction in Repeat Order would not be applicable for cases categorized as 'Buy and Make'/'Make'/'Design & Development' cases. Repeat order cases may fall under any of the following categories:

- a. **Additional Quantities:** This may be necessitated to make up for deficiency in the existing scaling or to cater for the requirements due to new raisings/war wastage reserves/sector stores.
- b. **Replacement Equipment:** This may be necessitated due to equipment declared 'Beyond Economical Repairs' or damages or loss to the earlier equipment by way of accidents/natural calamities or such like reasons.
- c. **Major-assemblies/sub-assemblies/Special Maintenance Tools/Special Test Equipment/maintenance/integration of Buyer Furnished Equipment.**
- d. **Spares for All Levels of Maintenance:** It must, however, be ensured that when spares etc. are procured from OEMs of sub-assemblies, the assurances/warranties extended by the OEM for the main equipment retain their validity.

If certain state-of-the-art equipment is manufactured by only one vendor, then such cases should be discussed and decided by DAC, in consultation with DRDO once the technology scan is carried out, as **Single Vendor Cases**. However, the following would not be considered as Single Vendor cases –

- a. Cases which are being undertaken by DRDO/DPSUs/OFB/Indian private industry as design and development projects. However, approval of DAC for carrying out the design and development need to be sought prior to commencing the design and development process.
- b. If DPSUs/OFB/Indian private industry signs MOU with a foreign firm for co-production/ToT/ procurement of equipment to be offered to services with approval of DAC. Alternatively, if the DPSUs/OFB/Indian private industry signs MOU without the approval of the DAC then it would have to compete in a competitive manner for the said procurement.

Procurement on Strategic Considerations: In certain acquisition cases, imperatives of strategic partnerships or major diplomatic, political, economic, technological or military benefits deriving from a particular procurement may be the principal factor determining the choice of a specific platform or equipment on a single vendor basis. These considerations may also dictate the selection of particular equipment offered by a vendor not necessarily the lowest bidder. Decisions on all such acquisitions would be taken by the Cabinet Committee on Security on the recommendations of the DPB.

### 3. Inter Government Agreement

In case procurements are done from friendly foreign countries due to geo-strategic advantages to our country, they would not classically follow the Standard Procurement Procedure and the Standard Contract Document but would be based on mutually agreed provisions between the governments of both the countries. Such procurements will be done based on an Inter-Governmental Agreement after clearance from CFA. The following cases would fall under the purview of this provision:

- a. The equipment of proven technology and capabilities belonging to a friendly foreign country as identified by our Armed Forces while participating in joint international exercises.
- b. A very large value weapon system/platform in service in a friendly foreign country is up for transfer or sale. In such cases, a composite delegation would be deputed to ascertain its acceptability in its present condition and cost & its repairs/modifications would be negotiated based on Inter-Governmental Agreement.
- c. In certain cases, there may be a requirement to procure a specific state-of-the art equipment/platform; however, the government of the OEM's country might have imposed restriction on its sale and thus the equipment cannot be evaluated on 'No Cost No Commitment' basis. Such equipment may be obtained on lease for a specific period by signing an Inter-Governmental Agreement before a decision on its purchase is taken.
- d. In cases of large value acquisitions, especially cases requiring product support over a long period of time if not already covered under an umbrella agreement covering all cases with the Government of the country from which the equipment is proposed to be procured after the requisite inter-ministerial consultation. Such an Inter-Governmental Agreement is expected to safeguard the interests of the Government of India and should also provide for assistance of the foreign government in case the contract(s) runs into unforeseen problems.

### 4. Make Projects

DPP 2016 has divided the Make projects into two categories – (i) Make-I (Government Funded) and (ii) Make-II (Industry Funded).

- a. **Make-I (Government Funded):** Projects under Make-I sub-category will involve government funding of 90%, released in a phased manner, and based on the progress of the scheme, as per terms agreed between MoD and the vendor. Projects involving design and development of equipment, systems, major platforms or upgrades thereof; necessitating harnessing of critical technologies, and may involve large infrastructure investment for development, integration, test and manufacturing facilities. Usually, projects under Make-I sub-category will involve a development period of not less than three years.

- b. **Make-II (Industry Funded):** Projects under Make-II category will involve prototype development of equipment/system/ platform or their upgrades, or their sub-systems/ sub-assembly/assemblies/components with a focus on import substitution, for which no government funding will be provided for prototype development purposes. Projects involving design and development of equipment, minor platforms, systems, sub-systems, components, parts or upgrades thereof; use of readily available commercial, military or dual use mature technologies, which may involve marginal infrastructure investment for development, integration, test and manufacturing facilities. Import substitution will be a key focus of projects under this category.

## 5. Crucial aspects of DPP 2016

- a. **RFI Process:** DPP-2016 has tried to establish the request for information (RFI) process and provided much needed clarity in the vital steps of procurement, which will have far reaching implications on the source of procurement, indigenisation, the timeliness of procurement and competition. The most significant change is the formulation process of RFI by the concerned SHQ in consultation with other relevant stakeholders, including DRDO, DDP and HQ IDS as opposed to by the SHQs so that all contrary views are taken into consideration in RFI.
- b. **Award of Contract:** The new L1-T1 methodology for selecting the supplier of military goods under the 'Buy' and 'Buy and Make' schemes means that the final bidder would not necessarily be selected on the basis of lowest price quoted by the technically-compliant vendors but by a combination of price and superior technology offered by qualified vendors.
- c. **EPP:** The L1-T1 method would ensure that the equipment that is bought are with Enhanced Performance Parameters, a notch higher than the Essential Parameters. This will provide additional incentive to equipment suppliers with superior, expensive and uncompetitive products impetus to bid.
- d. **Single OEM, Multiple Bids & Multiple Bids by Single Indian Vendor:** DPP 2016 has incorporated two significant provisions – "single OEM, multiple bids" and "multiple bids by single Indian vendor". The first case is likely to arise in 'Buy and Make (Indian)' category in which a single foreign original equipment manufacturer (OEM) offers the same product through multiple bids in collaboration with a number of Indian companies. In such a situation, the new provision allows the authorities to continue with the procurement process, provided that the Defence Acquisition Council (DAC), the highest decision-making body of the defence ministry, decides that changes in the RFP condition will not invite participation of any more foreign vendors.
- e. **Provision of Procurement in Single Bid Situation:** DPP 2016 has allowed the procurement process to continue in certain situations where only one bid is received in response to an RFP. This would require approval of the DAC, which must certify that there is no scope for change of the RFP conditions.

- f. **Hike in Offset Threshold Limit:** DPP 2016 has raised the offset threshold limit to Rs. 2,000 crores (approximately USD 305 million) from Rs. 300 crores. This hike would mean that fewer arms import contracts would now be eligible for offsets and would be a setback to the local manufacturers of parts and components. There is no clarity whether the wholly-owned subsidiaries of foreign companies would qualify as Indian Offset Partners. The offset guidelines lack the necessary punch till the detailed offset guidelines notified.

## Conclusion

DPP 2016 is far from just a procurement manual and has laid down plan to achieve self-reliance in defence sector by linking the DPP 2016 with Make in India initiative. The major aspect that is missing from DPP 2016 is the concept of Strategic Partnership proposed by Dr. V. K. Atre Committee. The idea of Strategic Partnership was to create an additional capacity in private sector to share the burden of Defence PSUs and Ordnance Factories as the private players cannot compete with Defence PSUs and foreign OEMs. It also suggested to exclude defence manufacturing in Strategic Partnership Mode from the scope of Competition Act, 2002.

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