

LEGAL ALERT

Defence Manufacturing in India in Present Policy Framework

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The Indian defence market presents an attractive and significant opportunity for Indian and foreign companies across the supply chain for the investment in the defence sector. As per FICCI-Centrum report, the market opportunity for private companies will grow 7 times from US\$6bn in FY14 to US\$41bn by FY22.¹ The opening of the defence manufacturing sector for private participation has helped foreign original equipment manufacturers to enter into strategic partnerships with Indian companies and leverage the domestic markets allowing them to aim at global business.

The sector will witness strong growth over the next decade due to its current size, longevity, and competitive advantage for the investment in the Defence Manufacturing in India. Also, large and relatively low cost engineering, talent pool and comfort of western nations with India from a geopolitical perspective provides umpteen opportunities.

The tremendous growth has been possible due to the major liberalization in 2001 which allowed 100% participation of the private sector and enhancement of Foreign Direct Investment (FDI) limit from 26% to 49%. According to the revised FDI Policy, the foreign investment upto 49% is allowed through Foreign Investment Promotion Board (FIPB) i.e. Government Route and if the investment is beyond 49%, the approval of the Cabinet Committee on Security (CCS) on case to

case basis is required. Many limitations such as single largest Indian shareholder to hold at least 51% equity and complete restriction on Foreign Institutional Investor (FII) existing in the earlier policy have been removed to facilitate investment in the sector. FDI in defence means a long-term presence in India and good returns on investment if repeat orders or contracts for newer models are assured.

Defence Procurement Procedure

Additionally, Defence Procurement Procedure (DPP) since 2002 has through periodic revisions been aiming at a higher self-reliance in critical technologies. DPP 2013 had focused on envisaging higher preference to **Buy** (India), **Buy and Make** (India), and **Make** options over the earlier thrust towards **Buy** (Global) or **import option**. On January 11, 2016, Ministry of Defence has unveiled the DPP 2016 in order to remove the bottlenecks in procurement procedure and to simplify various aspects of defence procurement such as:

- Enhancing strategic partnership with private firms;
- Transfer of Technology (ToT);
- Financial and legal examination of Standard Contract Document (SCD) to minimize uncertainty and scope for disputes etc.

¹ <http://www.makeinindia.com/article/-/v/direct-foreign-investment-towards-india-s-growth>

Defence Offset Policy

The Defence Offset Policy is another major overhaul and liberal policy as part of “Make in India” initiative that provided for the first time multipliers to supply technology and work with Micro Small and Medium Enterprises. It provides an opportunity for developing capability in Indian Industry. Under DPP 2016, the offset level has been raised to Rs, 2000 Crore from Rs. 300 Crore currently. The latest changes so far brought in the offset policy along with the amendments in DPP 2013 are to promote the following:

- I. **Make in India:** It is a directed offset plan in which the foreign vendor will be mandated to spend its 30 per cent investment share in a particular “Make in India” plan - to set up a defined manufacturing facility in India, be it a aircraft production line or a ballistic testing facility.
In an effort to boost the domestic defence industry, the Centre has introduced a category for acquisition — Indigenously Designed Developed and Manufactured (IDDM). While indigenously designed, developed and manufactured equipment must have at least 40 per cent local components, if the design is not Indian, 60 per cent of the components must be locally sourced.
- II. **Transfer of Technology (ToT):** A committee of the armed forces and defence ministry would be set up to decide what technology is needed. In this case, DRDO would be the custodian of the technology but the private sector will be preferred as production agency which would be fully involved from the beginning.
- III. **Skill Development:** Creation of R&D facilities, innovation centers, training institutions and labs to raise a new generation of skilled workers for the defence and aerospace sector.

The current requirements of defence in India are met by large imports through license agreements from Russia and Western Countries. Hence, in order to become self-reliant, the present Government has cleared many industrial licences for the Private Sector which has greatly enhanced transparency and facilitated greater domestic and foreign investments. The Government has also increased the validity of industrial license in view of the long gestation period of defence contracts to mature. The initial validity of industrial license for defence sector was seven years, further extendable upto 10 years but the validity is being revised to 15 years, further extendable up to 18 years for existing as well as future licenses.

Export Import Policy

One of the important objectives of “Make in India” Campaign is to develop export capabilities in the Defence Sector which is necessary to become globally competitive. Hence, under the export import policy following strategies have been notified for encouraging the export of defence products:

- Setting up an export promotion body;
- Constituting a defence export steering committee;
- Providing government support to defence exports;
- Export financing

Therefore, the stress on the policy frameworks mentioned above makes perfect sense. These policies as a part of “Make in India” program would boost innovation, investment and give rise to a spirit of enterprise to the foreign as well as Indian companies.

Dispute Resolution Mechanism

Arbitration clause in defence contract generally provides for appointment of a Sole Arbitrator or a panel of three arbitrators to act as Arbitral

Tribunal. In cases, where there is a sole arbitrator, the Ministry of Defence has been invariably empowered to appoint such a sole arbitrator. Such provision raises apprehension about the independence and impartiality of the arbitrator so appointed. But, in two cases of *Denel SOC Ltd. v UOI*, Supreme Court appointed an independent arbitrator in spite of there being a named arbitrator in the contract and awarded the Appellants with the damages, solving the issue of independence and impartiality.

Now, in line with the intent to evolve a pro arbitration and speedy dispute redressal mechanism, Parliament has passed the “Arbitration and Conciliation (Amendment) Act, 2015”. This act prohibits appointment of government nominated arbitrators. Also the said amendment to the Arbitration Act puts a stringent test on the independence and impartiality of the arbitrator.

To ensure that the scheme of Make in India is a success story, the Government has been continuously taking steps to ensure an efficient and effective dispute resolution mechanism for a stable legal and business environment.

Conclusion

Indian government is supporting the creation of a vibrant domestic defence manufacturing base. India has never offered so many tangible opportunities to pursue co-development and co-production projects in the sector.

Policy initiatives coupled with pro-industry dispute resolution mechanism present opportunities for indian and foreign companies to collaborate & design, develop and showcase their engineering strengths. This will also further India’s objective to be self reliant in this sector.

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