

DEFENCE PROCUREMENT POLICY **2016: A PERSPECTIVES**

Lecture - 4

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DPP 2016

- Realise vision of Make in India
- BUY- Indian Designed Developed and Manufactured Category (IDDM) (Priority)
- Greater impetus to MSME
- Probity and Trust
- Best in the class of equipment at the most competitive price: Manohar Parrikar

CAPITAL ACQUISITION: CATEGORIST

- Buy (India – IDDM) (40% contract)
- Buy (India) (40%)
- Buy and Make (India) (50% IC)
- Buy and Make
- Buy (Global)
- Make
- CISC Recommends Categorisation
- Defence Acquisition Council Approves

STANDARD CLAUSES OF CONTRACT

- Law (Laws of Republic of India)
- Arbitration (Three), Seat in India
- Arbitration & Conciliation Act 1996
- Force Majeure; Fires, Floods, Natural Disaster or other acts such as War, Turmoil, strikes, sabotage, explosion beyond the control of either party

Penalty for undue Influence

- Integrity Pact –IPBG
- Agents – 2% + LIBOR
- Cancellation
- Blacklisting

ACQUISITION PROCESS

- RFI, SQRs, AON, Solicitation of Offers, TEC, Field Trials, Staff Evaluation, TOC, CNC, CFA, Contract
- SQR: (a) Essential Parameters (b) Enhanced Performance Parameters
- Broad Based SQRs
- Approved of SQRs (SHQs)
- Offset – Buy (Global) or (Buy and Make), $\geq(2000cr)$
- Single Stage – Two Bid System

C&AG SPECIAL REPORT ON **KARGHIL PURCHASE**

- 129 Contracts worth Rs.2175.4 crore
- Stores received six months after operation
- Contracts placed after Karghil operation
- 64% of purchase: material departure made from Established procedure
- Coffin Scandal: unreasonable price
- Price differential $>10\%$ of L_1 (BPJ)
- Phukan Commission report on Tehlaka expose

PAYMENT TO FOREIGN BIDDER

- 15% Advance Pay
- Clean on Board Airways Bill/Bill of Lading
- Commercial Invoice
- Certification of Conformity
- Acceptance Test Certification
- Certification of Country of Origin
- Dangerous cargo Certification
- Packing list
- Insurance and freight Documents
- Training Certificates

OECD REPORT ON CORRUPTION IN PUBLIC PROCUREMENT

- Transparency of the criteria and process of bid evaluation crucial in bolstering bidders' trust
- Legislation in India does not explicitly require announcement of tendering results to the unsuccessful bidders.
- Reasons for selection of the winner bidder must be recorded and made available to the bidders
- No Debriefing To Unsuccessful Bidders.

STANDARD CONDITION OF CONTRACT

- Applicable Law
 - Arbitration
 - Penalty for Use of under influences
 - Agent/Agency commission
 - Access to books of account
 - Liquidated damages
 - Termination
- (a) Delayed beyond DP
- (b) Bankruptcy
- (c) Using agent

PRE BID CONFERENCE: TURNKEY CONTRACTS

- Pre bid conference: Turnkey contracts of special nature for sophisticated equipment for clarifying doubts about specialization
- Negotiation after bid opening to be severely discouraged
- Negotiation with L_1 :
- Contract to the lowest evaluated bidder
- If L_2 can't supply full quantity, obtain for L_2 at L_1 's rate
- Advertised, reasonable price
- Code of integrity: No solicitation of bids, conflict of interest

TWO STAGE BIDDING

- Obtain financial bids of technically short listed firms if it is not possible to formulate detailed specifications, rapid technological advances, R&D
- Late bids not to be entertained
- Single tender enquiry: PAC, certificated ,emergency, compatibility of spares to machine

STANDARD CONDITION OF CONTRACT

- Patents and IPR
- Performance Bank guarantee
- Option clause
- Repeat Order
- Tolerance
- Fall clause
- ERV
- Force majeure
- Buy-back
- Warranty
- AMC

CONTRACT ACT

- Types of damages: Compensation damages
- Consequential damages: Special damages
- Punitive damages: Punish the wrong doer: Example-
- Liquidated damages: Make recovery easier
- Penalty if disproportionate to damage
- Indemnity and Guarantee
- Protect against loss or damages to goods: Two parties
- Guarantee: A Contract to perform promise
- Three parties including surety
- Contract of Agency: Dealing with a third-party on behalf of the principal (S182)
- Bank Guarantee Bond, Sovereign Guarantee, Letter of Comfort

OFFSET PROVISIONS

- Buy (Global) or Buy and Make (2000 crore), 30%
- Leverage capital age to develop Indian defence industry
- Augmenting R&D capacity
- Fostering internationally competitive enterprise
- Encouraging development of synergistic sectors like civil aerospace and internal security
- Direct purchase of products by inter enterprises
- Executing export orders
- FDI in JV with Indian enterprises
- Involvement in ToT to Indian enterprises- JV, Co Production
- Technology Acquisition in high technology areas
- Indian Offset partner
- OEM free to choose IOP

OFFSET PROVISION

- Offset credits for ToT: 10%
- Offset banking-Preapproved Banked Offset Credit upto 50%
- Multiplier of MSME (1.5)
- Multiplier for technology acquisition by DRDO
- 2.0 (Use by Indian Armed Services)
- 2.5 (Military and Civil Application)
- 3.0 (No restriction), including right to export
- Defence Offset Management Wing
- Technical offset proposal and commercial offset proposals
- Change in IOP
- Penalty: 5% of unfulfilled obligation
- No indirect offsets
- Dual use: Aerospace and MHA

IMPACT ANALYSIS

- 25 offset contract valued \$4.97B
- CAG report: Zero value addition, equipment transfer, weak military mechanism
- FDI inflow: \$4.94M
- Impact on Export of parts and components of civilian aerospace items, of BEL a beneficiary
- Not a catalyst to bring in TOT
- Very little impact on 'manpower' addition
- Keith Hartley's study of F-16 Contract with UK
- Brazil's Embraror experience
- Parle Freeman: Massive government interest, pooling together of R&D talent, subsidy, tax holding, synergy between Military and Civil Technology
- Economic benefits are uncertain: Paul Dunne
- It's doubtful if relevant technology will be transferred: Brauer

GLOBAL PRACTICES IN OFFSET

Counting	Minimum Threshold	Level of Offset Obligation	Types of Offset
Brazil	\$1M	100-120%	Direct, Aeronautics
India	\$281M	30-50%	Direct & Indirect
Israel	\$5M	50%	Direct & Indirect
Malaysia	\$10M	50%	Direct & Indirect
Taiwan	\$5M	40%	Direct & Indirect

CRITICAL TECHNOLOGY AREAS

Sl. No.	System/ Sub System	Critical Technology
1.	Gas Turbine Engines	Single Crystal, Special Coaling
2.	Missiles	FPP Seeker
3.	Aeronautics	Stealth, Smart Aero Structure
4.	Naval System	Super Cavitations Technology
5.	Sensors	AESA Radar, RLG, SAAR, Nano Technology
6.	Material	Carbon Fibres
7.	Avionics	Gen III Tubes
8.	Surveillance	UAVs, AESA Radar

Source: Defence Procurement Procedure (DPP) 2016 & Ministry of Defence, GOI, <https://mod.gov.in/>

ISSUES, CONCERNS AND EXPERIENCE

- Long Term Requirements (LTIPP) not known
- Insufficient FDI limit, China (76%)
- Undue Preference to DPSUs
- Unfavourable tax regime
- Defence Offset valuation
- Include Indirect Offsets
- Dual Use Sector: Ship Building
- Brazil's experience (Embrarer)
- Lockheed Martin-Taiwan for 150F-16: Repair facilities for Aviation Maintenance Centre

Major Issues In Capital Acquisition

- Tailor Made Specification , Single Tender
- Long Drawn Trials
- Compatibility : UAV from IMI Israel
- Price Negotiation in Single Tender
- Agents & Commission
- Post Contract Management
- Make In India : Challenges & Way Forward

Way Forward

- Structural & Functional Reforms
- DGA (France) : Design, Development, Production, Acquisition, Maintenance, Disposal : Sisodia Committee
- DARPA (USA): No Public Funding
- DRDO & Production Agency, Services
- Make in India: Know Why(Design to Build)
- Build to Design : Know How
- Investment in R & D , Collaboration with Design Houses (MR SAM), FGFA