

India's Defence Procurement Procedure: Assessing the Case for Review and Reforms

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October 17, 2014

Summary

This Issue Brief examines certain provisions relating to intellectual property rights and transfer of technology in India's defence procurement procedures, together with suggestions on streamlining the same for achieving enhanced procurement efficiencies in capital acquisitions.

Introduction

Given that “Buy & Make” with *Transfer of Technology* (ToT) is the principal category of capital acquisitions relied upon under India’s *Defence Procurement Procedure* (DPP) for encouraging domestic manufacturing of foreign-origin equipment¹, one intuitively expects the DPP to contain a robust set of contractual provisions outlining MoD’s *intellectual property rights* (IPRs) in technologies being received by *Indian Production Agencies* (IPAs). On the contrary, as analysed in this note, a quick reading of the DPP reveals that there may be very little guidance of use to procurement professionals on the subject: a situation that is quite different from international best practices such as EU and US’s exhaustive guidance on government’s IPRs in defence acquisitions² and in procurement of R&D and innovation.³

Management of IPRs, whether in *procurement-cum-manufacturing* contracts such as “Buy & Make”, or public-funded *R&D-cum-productionisation* contracts such as “Make” cases, or licensing of DRDO-developed technologies for that matter, has remained one of the relatively unaddressed areas in the DPP. In fact, DRDO practices in technology-licensing have been rather unique, with perhaps the only known case in the world where transfer of IPRs in public-funded technology was effected to a foreign entity without insisting on domestic manufacturing in India⁴: a practice that appears to be vastly different from the principles approved by the Government of India (GoI) in *The Protection and Utilisation of Public Funded Intellectual Property Bill*⁵ and guidelines⁶ issued by the Ministry of Science & Technology on the subject. In contrast, the US Government (USG) places strong restrictions on foreign transfer of technologies through instruments such as the *International Traffic in Arms Regulation* (ITAR), while also requiring preferential consideration for its small businesses and for domestic manufacturing in case of USG-funded R&D programmes⁷: a

¹ See, 4(b), DPP-2013, p.3. For details of ToT; see, Appendix L to Schedule I, DPP-2013, pp.161-185.

² See DFARS Part 227 *rw* Part 252 for government IPRs in defence acquisitions in the United States.

³ See, e.g., CORDIS, *Pre-Commercial Procurement*, available online http://cordis.europa.eu/fp7/ict/pcp/overview_en.html.

⁴ DRDO and FICCI’s *Joint Initiative for Accelerated Technology Assessment and Commercialisation* (www.drdoficciatac.com) does not list terms and conditions of the standard licensing agreement for public-funded technologies. However, broad elements of the same can readily be inferred from a number of official communiqués; PIB (2011), *US Firm signs Pact to Acquire DRDO’s Technology for Explosive Detection Kit*, available online <http://pib.nic.in/newsite/erelease.aspx?relid=71788>; DRDO (2013), *DRDO’s Explosive Detection Kit launched in the US*, available online http://www.drdo.gov.in/drdo/pub/nl/2013/NL_Sept_2013_web.pdf; and (a)-(b), *Answer dated 26.08.2013 to Unstarred Parliament Question No. 2583*.

⁵ §12, Bill No. LXVI of 2008.

⁶ MoS&T (2000), 4 of *Instructions for Technology Transfer and Intellectual Property Rights*.

⁷ See, e.g., Department of Energy, *The TTWG Licensing Guide and Sample License*. See, also, Principle#10 and #11 of AMNPO (2013), *Draft Guidance on Intellectual Property Rights for the National Network for Manufacturing Innovation*, pp.2-3.

framework that has been increasingly finding mention in EU proposals on account of its obvious public policy advantages⁸.

This short note accordingly outlines some of the key aspects of the DPP that may need quick course correction, in order that some of the new international defence cooperation initiatives for co-development and co-production of defence equipment being progressed by GoI for implementing the new “Make In India” vision can achieve quick traction, while simultaneously ensuring that the MoD, including the Indian defence industry, can obtain their fair share of reciprocal benefits from these emerging partnerships.

IPRs in ToT as Offsets

ToT is also recognised as a permissible method for discharging offset obligations by foreign vendors in the revised defence offset guidelines (“RDO Guidelines”) of 2012, where in order to be eligible, ToT to (non-Government) Indian enterprises needs to come with “no license fee” and “no restrictions on *domestic* production, sale or export” stipulations⁹. However, there is no clarity on, inter alia, the following important legal aspects of the ToT arrangements: (i) whether *other-than-license* fees or charges can be levied by a foreign vendor on the Indian recipient, either directly or indirectly, in the form of running royalty payments, goodwill charges, lump-sum capital charges, counter-purchase requirements for equipment or training etc., in which case the restriction on “no license fees” could easily be rendered dysfunctional; (ii) whether foreign manufacturing by Indian recipient(s) can be restricted by the transferor, in which case commercial and operational flexibility of the Indian recipient can take a major hit; (iii) whether MoD as an offset contracting party has any IPRs in the technologies being transferred to Indian entities; and (iv) whether the Indian entity receiving ToT in the first instance can subsequently transfer the same to another Indian entity. By way of comparison, offset program guidelines of the Republic of South Korea stipulate ToT to be free from any charges, and vest proprietary rights/ licenses in ToT, including the right to sub-license, with the Korean Government¹⁰, even if the instant possession thereof is with a domestic (Korean) offset partner.

The RDO Guidelines also permit *ToT to government institutions* to be eligible for discharge of offset obligations¹¹, but quite unlike the provision on *ToT to non-government Indian enterprises*, the relevant sub-clause does not contain any bare guidance on restrictions vis-à-vis license fees and domestic manufacturing, sales or exports, or on any other government IPRs for

⁸ See, generally, European Commission (2004), *Management of Intellectual Property in Publicly-funded Research Organisations: Towards European Guidelines*.

⁹ 3.1(c), *supra* n.2, p.53.

¹⁰ Article 4(5) of DAPA’s 2014 Offset Guidelines.

¹¹ 3.1(e), *supra* n.2, p.53.

that matter. In the case of *technology acquisition by DRDO* for discharge of offset obligations, the relevant guidelines¹² are once again silent on the *minimum government-purpose rights* that need to be offered by the foreign vendor for claims with a multiplier of one. In addition, while the RDO Guidelines allow higher multipliers to be claimed in cases of technology acquisition by the DRDO depending upon permissions for production and/ or exports¹³, the relevant sub-clause contains no guidance on legal and commercial terms and conditions, including rights and limitations thereon, in respect of possibilities for *further transfer* of these technologies by DRDO to Indian production/ exporting entities: an issue that is obviously important given that DRDO is an R&D agency and not a production or exporting entity. In the absence of clear language, RDO Guidelines could therefore lead to a situation where a foreign vendor could claim higher multipliers even while DRDO's ability to sub-license "acquired" technologies could remain restricted, curtailing the latter's ability to *actually practice* the technology under transfer.

ToT and IPRs under Buy & Make

Returning to *Buy & Make*, it is interesting to note that while the DPP defines "technologies" for transfer under this category, namely, technologies for: (i) repair and overhaul; (ii) production from *Completely Knocked Down* (CKD)/ *Semi Knocked Down* (SKD) kits; and (iii) production from raw material and component level (IM kits)¹⁴; the phrase "Transfer of Technology" itself is left undefined in terms of minimum IPRs to be acquired by MoD/ IPAs, even while devoting an entire Appendix¹⁵ of the standard RFP to transfer of technology. Similarly, in the case of *ToT for Maintenance Infrastructure* in "Buy (Global)" cases, while the DPP defines the *scope* of technologies as one for maintenance to an Indian entity which would be responsible for providing base repairs and spares for the entire life cycle of the equipment¹⁶, the issue as to what IPRs need to vest with the IPA or with MoD is left largely unaddressed, just as "global rights" (another phrase left undefined) of an IPA¹⁷ are left at the absolute discretion of the seller¹⁸.

¹² 3.1(f), *ibid*, p.54.

¹³ 5.12, *ibid*, p.57.

¹⁴ 1(c), *ibid*, p.161 *rw* Note to 17, *ibid*, p.97.

¹⁵ Appendix L, *ibid*, pp.161-185.

¹⁶ Appendix E to Schedule I, *ibid*, pp.119-125.

¹⁷ The reference to an "IPA" is unclear, since the rest of the schedule only talks of a "maintenance agency" and not a production agency. The term has more relevance in a normal ToT agreement, rather than an agreement only for setting up of maintenance infrastructure.

¹⁸ 19, *supra* n.17, p.125. In this case, it is not even clear how acquisition officials can possibly compare price bids from two or more competitors offering entirely different global rights to the nominated IPA, in the absence of any defined minimum/ baseline global rights.

In addition, while “Buy & Make with ToT” creates the impression that *complete* ToT is obtained by MoD/ IPA for *all* items and assemblies, a closer look at the DPP shows this perception could be misplaced. For instance, the procedures leave complete discretion with a foreign vendor to *deny design/engineering documentation and manufacturing documentation* for items *it may choose to classify* as Category-5 items¹⁹, while also denying such documentation for items *it may classify* under Categories 3 and 4²⁰. What this implies is that a vendor is at complete liberty to deny requisite documentation for a very significant numbers of items in proportion to the contracted value of final products, given that most large foreign vendors are integrators rather than in-house manufacturers. In addition, the DPP appears to erroneously classify engineering documentation for Category-2 items as “complete” ToT even though manufacturing documentation is not provided to MoD in such cases²¹, quite unlike Category-1 items where *both* engineering and manufacturing documentation are mandatorily required to be made available to an IPA²².

While the DPP contains a provision requiring ToT for *all* single sub-systems, assemblies and sub-assemblies *individually* costing more than 10% of the licensed product²³, it can be easily circumvented by a vendor by classifying sub-systems and sub-assemblies at the *lowest possible levels* to avoid attracting the “single item *individually* costing more than 10% of cost of licensed product” stipulation. The DPP also measures the *depth* of ToT *only by cost percentages*²⁴, rather than using an IPR-based approach that could yield more insightful outcomes²⁵.

DPP may also need to rid itself of some rather self-contradictory substantive provisions, for instance, it presently requires mandatory sharing of source code for all embedded software²⁶, even while capping the number of weapons (fully formed or CKD kit-/ SKD kit-/ IM kit-based) that can be manufactured under license²⁷. This could most likely lead to one of the following two possibilities: (i) that source code is actually not provided and vendors receive

¹⁹ 1(k)(v), *ibid*, p.164.

²⁰ 1(k)(iii)-1(k)(iv), *ibid*, pp.163-164.

²¹ 1(k)(ii), *ibid*, p.163.

²² 1(k)(i), *ibid*, p.163.

²³ 1(m), *ibid*, p.165.

²⁴ 2, *ibid*, pp.165-167 (for CKD- and IM-based kits only).

²⁵ See, generally, Satyanarayana, K., *In-Licensing Strategies by Public Sector Institutions in Developing Countries*, in Krattiger, A. (Ed.), *ipHandbook of Best Practices* (2010), available online www.iphandbook.org. See, also, Bobrowicz, D., *A Checklist for Negotiating License Agreements*; and Potter, R.H., *Technology Valuation: An Introduction*, in the same publication.

²⁶ 5(a)(ii), *supra* n.2, p.169 *rw* 5(e), *supra* n.2, p.170.

²⁷ 3(a), *ibid*, p.167.

full payments despite contractual requirements for delivery of source code; or (ii) that source code is provided but is rendered unusable given mutually agreed limitations on manufacturing of hardware in terms of numbers – a case of MoD paying for source code when it may not be able to use or modify it in the first place for subsequent manufacturing or modifications beyond contractually agreed numbers.

To make matters even more difficult, some important issues appear merely as aspirational clauses under ToT guidelines rather than binding ones, such as one²⁸ requiring an OEM “...to assist and take the lead to obtain maintenance-related ToT to the *maximum possible extent*...” for items under Categories 3 and 4; just as another aspirational provision requires a vendor to *facilitate* ToT of the sub-systems from his sub-vendors/ OEMs²⁹. Some parts of the ToT guidelines also appear to be overly verbose, for instance, paragraph 1(h) of the guidelines³⁰ may be largely redundant when the same explanations for Category-3 and Category-4 items are also contained in paragraphs 1(k)(iii) and 1(k)(iv) respectively³¹. In contrast to such excessive use of text, the DPP then goes on to leave various important phrases such as “production mortality”³² and “ToT absorption”³³ completely undefined.

In sum, ToT provisions under the DPP seem to be essentially about *licensed production* based largely on vendor-supplied CKD and SKD kits, rather than taking the form of minimum government-purpose IPRs in contractually-mandated deliverables in terms of design, form, fit and function data and other technical documentation, irrespective of manufacturing by the supplier or by the supplier’s sub-contractors. The extant guidelines elsewhere also talk of vendor-imparted training, technical assistance and programme management – all service deliverables – and issues such as documentation (a data deliverable) and fees for licensed production (a commercial aspect of the bid) in the same breath³⁴, despite each element requiring completely different treatment and placement in the rules of contractor engagement and obligations.

The “Buy & Make” category was first introduced in 2003, but the corresponding text in the DPP has remained largely unchanged for almost a decade in its subsequent editions. Given the critical need for clarifications on a number of operational and legal issues, as well as the need for standardisation of the legal language used for IPRs in the ToT as

²⁸ 1(n), *ibid*, p.165.

²⁹ 1(f), *ibid*, p.162.

³⁰ 1(h), *ibid*, p.162.

³¹ 1(k)(iii)1(k)(iv), *ibid*, pp.163-164.

³² 3(c), *ibid*, p.168.

³³ 3(a), *ibid*, p.167.

³⁴ 1(g), *ibid*, p.162.

analysed in this note, the DPP may need a substantial overhaul and streamlining. This reforms process could perhaps include other specific and important contracting issues as well, for instance, the cost comparison methodology prescribed in the ToT guidelines is silent on modalities of comparison of price bids of two or more bidders, whose technologies on offer may require completely different capital investments and running costs to be incurred by the IPA, or where the IM requirements differ from one bidder to another with differing implications for input costs, either of which could substantially affect L1-vendor ranking relied upon by MoD for identification of a successful, lowest-priced, technically-acceptable bidder in the first place.

Conclusions

As highlighted above, the DPP appears to be in need of a complete rewrite of its ToT and IPRs provisions so as to ensure legal consistency, contractual clarity and effectiveness in achieving intended procurement objectives. The rewrite could perhaps be modeled on international best practices such as, *inter alia*, the *Defence Federal Acquisition Regulation Supplement* in the US, or the guidance on IPR acquisition during *pre-commercial procurement* under EU Public Procurement Directives. Each one of these regulatory regimes focuses on outlining minimum contractual deliverables such as “Technical Data”, “Computer Software” and “Computer Software Documentation” in respect of various supplies and services required under contract, while simultaneously outlining a specific bundle of required IPRs (such as unlimited rights, government-purpose rights, limited rights or restricted rights) for each one of these data, software and documentation deliverables.

Eventually, a clear and unambiguous DPP containing explicit and detailed guidelines on IPRs and ToT may help in reducing processing delays, contracting timelines and contractual disputes, while also ensuring that MoD’s core procurement objective of using a procurement-cum-manufacturing route for achieving self-reliance through transfer of technology is satisfactorily achieved during its capital acquisition processes.