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**BCIC - Session on**  
**Legal Framework**  
**Governing**  
**Aerospace**  
**Industry**

**BY PRASHANTH SABESHAN**  
**PARTNER, ARGUS PARTNERS**  
**INDIAN CORPORATE LAW**  
**FIRM**

## A. LEGAL FRAMEWORK GOVERNING THE MANUFACTURING OF AIRCRAFT AND AEROSPACE COMPONENTS

### □ Aircraft Act, 1937 and rules thereunder

1. The Aircraft Act, 1937 and the Aircraft Rules, 1937 regulate the manufacturing, possession, sale, use, operation, export and import of aircraft. Among other things, they also stipulate the parameters pertaining to airworthiness, aircraft maintenance, general conditions of flying, registration of aircraft and the conduct of investigations.
2. The Aircraft Rules, 1937 stipulate provisions pertaining to (i) general conditions of flying; (ii) registration and marking of aircraft; (iii) Personnel of aircraft; (iv) provisions pertaining to airworthiness; (v) investigation of accidents and incidents and (vi) licensing of aerodromes.

### □ Industries (Development and Regulation) Act, 1951

1. Manufacturing in the defence sector is governed through industrial licensing under the Industries (Development and Regulation) Act, 1951 (“IDR Act”). Before 2001, manufacturing in Defence sector was limited to public sector companies. However, in 2001, the Government allowed 100% Indian private sector participation in defence manufacturing sector subject to licensing under IDR Act.
2. The list of defence items mentioned in Annexure I (which includes military aircrafts and unmanned air vehicles) of the notification dated January 4, 2019 issued by the Ministry of Commerce & Industry, Government of India will require licence for manufacturing under the IDR Act.

## B. FOREIGN DIRECT INVESTMENT IN AEROSPACE/AVIATION SECTOR

- ❑ **Framework for FDI in Indian entities** - provisions of the Consolidated FDI Policy, 2020 (“**FDI Policy**”) issued by the Department of Promotion of Industry and Internal Trade (“**DPIIT**”), Ministry of Commerce & Industry and the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.
- ❑ **Eligible Investee Entities** – FDI may be made into an Indian Company, partnership firm/LLP subject to certain conditions, investment vehicles and start-up companies, subject to certain conditions.
- ❑ **Sectoral Conditions and Entry Routes** – The provisions of the FDI Policy lay down (i) the maximum % of FDI allowed in an entity in a particular sector, (ii) whether such investment would require prior approval of the government and (iii) the conditions to be met for such investment.
- ❑ **FDI in manufacturing sector:** Subject to the provisions of the FDI policy, *foreign investment in ‘manufacturing’ sector is allowed up to 100% under the automatic route*. Manufacturing activities may be either self-manufacturing by the investee entity or contract manufacturing in India through a legally tenable contract, whether on Principal to Principal or Principal to Agent basis. Further, a manufacturer is permitted to sell its products manufactured in India through wholesale and/or retail, including through e-commerce, without Government approval.

## B. FOREIGN DIRECT INVESTMENT IN AEROSPACE/AVIATION SECTOR (Contd.)

### □ FDI in Defence Sector

Sector/Activity	% of equity/FDI cap	Entry Route
Defence Industry subject to Industrial license under the Industries (Development & Regulation) Act, 1951 and Manufacturing of small arms and ammunition under the Arms Act, 1959	100%	Automatic up to 74% Government route beyond 74% wherever it is likely to result in access to modern technology or for other reasons to be recorded.

### □ The following conditions must be adhered to for FDI in defence sector:

1. FDI up to 74% under automatic route shall be permitted for companies seeking new industrial licenses.
2. Foreign investment in the sector is subject to security clearance by the Ministry of Home Affairs and as per guidelines of the Ministry of Defence.
3. ***Investee company should be structured to be self-sufficient in the areas of product design and development. The investee/joint venture company along with the manufacturing facility, should also have maintenance and life cycle support facility of the product being manufactured in India.***

## B. FOREIGN DIRECT INVESTMENT IN AEROSPACE/AVIATION SECTOR (Contd.)

### □ Examples of FDI in the aerospace/defense sector

- ▶ In September 2021, Fokker Elmo SASMOS Interconnection Systems Limited (“FE-SIL”), **a joint venture between GKN Aerospace and Bengaluru based SASMOS HET Technologies Limited**, has been awarded a USD multi-million-dollar contract from Saab to manufacture Electrical Interconnection Systems (EWIS) for the Boeing-Saab T-7A trainer aircraft aft-section in the advanced jet. Under the multi-year contract, FE-SIL will deliver the required wiring systems for the aft fuselage of the advanced jet that will train the next generation of fighter and bomber pilots.
- ▶ In September 2021, **the Defence Ministry of India signed a nearly Rs 20,000 crore deal with Airbus Defence and Space of Spain to procure 56 C-295 medium transport aircraft** which will replace the ageing Avro-748 planes of the Indian Air Force. Under the deal, 16 aircraft will be delivered in a flyaway condition by the Airbus Defence and Space within 48 months of signing the contract. The remaining 40 planes will be manufactured in India by a consortium of the Airbus Defence and Space and Tata Advanced Systems Limited (TASL) within 10 years of signing the contract. It is the first project of its kind under which military aircraft will be manufactured in India by a private company.
- ▶ Announced in April 2018, **Boeing has entered into a partnership with Hindustan Aeronautics Limited (HAL) and Mahindra Defence Systems (MDS)** for manufacturing the F/A-18 Super Hornet in India for its armed forces and pursuing the joint development of future technologies.
- ▶ Announced in June 2016, **Boeing and Tata Advanced Systems have entered into a joint venture** named Tata Boeing Aerospace Limited, to co-produce Boeing AH-64 Apache helicopter fuselages and other aerostructures, as well as to pursue integrated systems in aerospace

## C. JOINT VENTURES – AN EFFECTIVE MEANS OF CO-OPERATION BETWEEN TWO ENTITIES

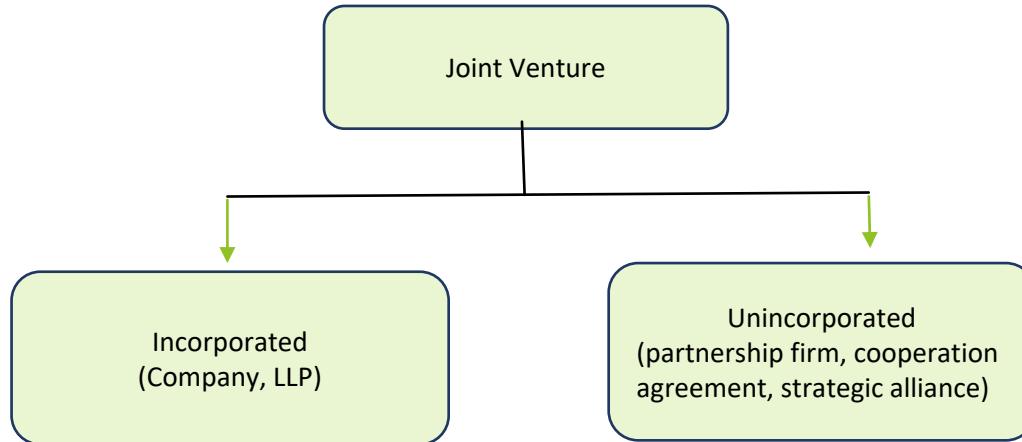
- 1. What is a Joint Venture?** A Joint Venture (“JV”) may be defined as any arrangement whereby two or more parties co-operate in order to run a business or to achieve a commercial objective. This co-operation may take various forms, such as equity-based or contractual JVs. It may be on a long-term basis involving the running of a business in perpetuity or on a limited basis involving the realization of a particular project. It may involve an entirely new business, or an existing business that is expected to significantly benefit from the introduction of the new participant.
- 2. Why should a company enter into a JV?** JVs are envisaged as alliances that yield benefits for the JV partners by offering a platform to attain their business goals which would be difficult or uneconomical to attain independently. Establishing a JV with an ideal partner provides a fast way to leverage complementary resources available with the other partner, share each other’s capabilities, access new markets, strengthen position in the current markets, or diversify into new businesses.

## C. JOINT VENTURES (Contd.)

1. A few important advantages of a JV are:
  - a) **Enhanced access to labour, capital and technological resources** - businesses in today's world need a huge pool of resources like massive financial backup and plenty of skilled manpower, especially the aerospace sector;
  - b) **Exploiting complementary skills/capabilities or experiences** – this grants a competitive advantage to the JV over other players in the market;
  - c) **Opportunity to jointly manage the risks and liabilities** – this limits each partner's individual exposure to risk;
  - d) **Better market access** - gives an opportunity to expand business into other geographies, consumer segments;
  - e) **Flexible business diversification** - offers a convenient way for companies to enter into non-core businesses with an easy exit option; and
  - f) **Provides an opportunity to participate in future bids** – If a joint bid agreement has to be submitted, usually liability under such an agreement is joint and several. Under the JVA, the liability of the Indian partner may be limited.

## C. JOINT VENTURES (Contd.)

### □ Forms of JV



### □ Three most common ways of creating a JV company are:

- a) *Parties Subscribe to Shares on Agreed Terms*
- b) *Transfer of Business or Technology by one Party and Share Subscription by the Other; and*
- c) *Collaboration with the Promoters of an Existing Company.*



## C. JOINT VENTURES (Contd.)

- ❑ **Joint Venture Agreement:** A Joint Venture Agreement (“**JVA**”) or a shareholders’ agreement JVA/SHA provides for the method of formation of the JV company and sets out the mutual rights and obligations of parties for the purposes of conducting the JV and the manner in which the parties will **conduct** themselves in operating and managing the JV. A further purpose is to prescribe, as far as possible, for what will happen if difficulties occur. However, the JVA agreement is between partners and does not bind the JV company unless its terms are included in the Articles of Association (“**AoA**”) of the JV company. Therefore, it is necessary to specifically incorporate the terms of the JVA / SHA into the AoA of the JV company.
  
- ❑ **Important clauses to be incorporated into a JVA:** Object and scope of the joint venture, Equity participation by local and foreign investors and agreement to future issue of capital, Financial arrangements, Composition of the board and management arrangements, Specific obligations, Provisions for distribution of profits, Transferability of shares in different circumstances, Remedying a deadlock, Termination, Restrictive covenants on the company and the participants, Casting vote provisions, Appointment of CEO/MD, Change of control/exit clauses, Anti-compete clauses, Confidentiality, Indemnity clauses, Assignment, Dispute Resolution, Applicable law, Force Majeure etc.

## C. JOINT VENTURE

### ❑ Checklist of things to keep in mind while entering into a JV

- ▶ **Due Diligence:** Irrespective of the form the transaction takes, each joint venture partner must ensure, whether through a diligence or through representations, warranties and corresponding indemnities, that the other has the ability to perform and carry on the business proposed through the joint venture entity.
- ▶ **Term sheet/Memorandum of Understanding:** This ensures that parties are clear on the envisaged transaction and facilitates drafting and negotiation of legal documentation.
- ▶ **Shareholding and Control:** The strategic imperatives behind the JV will usually determine the shareholding of each JV Partner.
- ▶ Under the Companies Act, 2013, any matter to be decided by the shareholders of a company may either be (i) ordinary matters – requiring the consent of at least a simple majority of the shareholders present and voting in any shareholders' meeting; or (ii) special matters – requiring the consent of at least 75% of the shareholders present and voting in any shareholders' meeting. As such, any JV Partner holding more than 25% in the JV Company would be able to exercise a certain amount of control as such a shareholding would endow the JV Partner with the right to block resolutions on special matters.

## C. JOINT VENTURES (Contd.)

- ▶ **Representations and warranties:** These are basically presentations of the underlying facts, past, present and future, on the basis of which parties are induced to enter into and consequently arrive at a consensus on the transaction.
- ▶ **Intellectual Property:** Once a joint venture company is formed, the ownership and protection of intellectual property that the joint venture company creates is usually of prime significance and must be clearly specified in the JVA.
- ▶ **Indemnity:** As a legal concept, an indemnity is a contractual obligation to compensate another party for any loss incurred by such other party due to a breach of a contractual obligation undertaken by the indemnifying party.
- ▶ **Limitation of Liability:** Parties may limit their liability by any or all of the following ways:
  - a) Monetary liability of a party, under the indemnity clause, may be limited to the amount of money brought in by the JV partner seeking the indemnity;
  - b) By including a de-minimum clause, wherein the party claiming indemnity will not be able to claim for every minor breach, but only if the breaches individually and/or collectively add up to a certain amount;
  - c) By limiting the time period during which the other party may claim indemnity;
  - d) By including a disclosure schedule accompanying the representations and warranties, wherein the party giving the reps and warranties discloses specific liabilities and issues, for which it may not be subsequently prosecuted for misrepresentation.

## C. JOINT VENTURES (Contd.)

- ▶ **Board of Directors:** Representation on the board of directors of a joint venture is dependent on the shareholding agreed to between the joint venture parties. It is important to note that not all corporate decisions require the approval of the shareholders and hence can be made with approval of the board. Generally, decisions of the board of directors are subject to the approval of the majority of directors present and voting, subject to quorum requirements.
- ▶ **Resolving Deadlocks:** If in a JV, both partners have an equal representation on the board, such equal representation may lead to deadlock situations hampering the business of the JV. One of the most common ways of resolving a conflict may be to give the chairman of the board a casting vote, so that neither party is deadlocked out of a disagreement.
- ▶ **Exit Options:** An Exit may be affected in various ways, including winding up/liquidation, third party sale and an initial public offering (“IPO”). Further, in the event that only certain of the partners want an exit, rights such as drag-along rights can provide them the option to affect the exit.
- ▶ **Termination and its Consequences:** JVAs often enumerate certain ‘events of default’ or ‘material breaches’ upon the occurrence of which non-defaulting parties will have the right to terminate the JVA. Safeguards must also be inserted to ensure the equitable distribution of assets in case of termination of JVA.

## C. JOINT VENTURES (Contd.)

- ▶ **Corporate Governance:** Lack of good internal control systems in the JV may create issues for the JV, especially for the foreign partners, in light of the Foreign Corrupt Practices Act, 1977, the UK Bribery Act, 2010 etc. Accordingly, foreign joint venture parties normally insist on stringent anti-corruption provisions in the JV documentation. Parties may adopt a variety of checks and balances to monitor these aspects of the business of the JV.
- ▶ **Governing Law & Dispute Resolution:** JVs may often face disagreements between the partners. Thus, it is imperative to provide a clear mechanism for dispute resolution. Parties should make an informed choice in choosing the governing law for the JVA – this is critical where multiple jurisdictions are involved.
- ▶ **Transfer Pricing Regulations:** In the context of a JV with foreign enterprises, it is pertinent to note that as per the Indian transfer-pricing regulations, the Indian JV and the foreign shareholders would be considered “associated enterprises” and any transactions between them would be required to be conducted on an arm’s length basis.
- ▶ **Example:** All examples of FDI in aerospace & defence sector mentioned in Section A ## on FDI above are examples of joint venture corporations.

## D. TECHNOLOGY TRANSFER AGREEMENTS/LICENSING AGREEMENTS

- ▶ **Meaning:** “Technology transfer” includes a range of formal and informal cooperation between developers of technology and seekers or users of technology. In addition, technology transfer involves intellectual property, the transfer of knowledge, physical devices/equipment and of course technical knowhow.
- ▶ **Documentation:** Parties would need to enter into a technology transfer agreement (“TTA”) or a licensing agreement, to specify the exact technology/know how being transferred and rights and obligations of the parties.
- ▶ **FEMA provisions:** Earlier there were monetary caps on remittances (both lumpsum fees and royalties) made for technology collaborations and license or use of trademark / brand name. Now there are no restrictions and the payments towards the lumpsum fees or royalties for technology collaborations and license or use of trademark / brand name can be made under the automatic route, without any monetary cap.
- ▶ **Taxation:** Note that the rate of TDS on any sum paid or payable towards fees for professional or technical services is 2% in India. However, in case of JV with a foreign partner, the taxation of royalties will depend upon the provisions of the double taxation avoidance agreement with the country of which the foreign partner is a resident.

## D. TECHNOLOGY TRANSFER AGREEMENTS/LICENSING AGREEMENTS (Contd.)

### □ Important Clauses under a Transfer of Technology Agreement

- ▶ **Scope:** Parties must decide on the mode of transfer and extent of transfer of knowledge. While determining the extent of the transfer, the parties should explicitly identify what is being transferred. The provision should also explicitly provide the things which are excluded from the purview of the license, to avoid any disputes in the future.
- ▶ **Territory and Exclusivity:** A TTA must explicitly identify the territory of the license granted and should also mention whether the license is exclusive (sole licensee) or non-exclusive (license may be granted to other parties as well).
- ▶ **Rights and obligations of the parties:** A TTA should clearly define the rights and obligations of the parties. The licensor's obligations must include a guarantee of the product quality, providing technical assistance and training for use of the licensed IP. Licensee's obligations would include payment of the royalties and maintaining confidentiality.
- ▶ **Intellectual Property:** In a TTA, there is a possibility that a new IP is created, or it is improved or the existing IP is used by the parties. *In the case of a newly created IP, it is essential to identify who will have ownership of the IP, and whether the licensee will have certain rights regarding its usage or will it be joint ownership.* In the case of joint ownership one should review the applicable laws of the country and its possible consequences.

## D. TECHNOLOGY TRANSFER AGREEMENTS/LICENSING AGREEMENTS (Contd.)

- ▶ **Confidentiality:** A TTA often involves transfer of know how or sensitive business information and trade secrets. Thus, it is essential that the TTA contain certain strong confidentiality protection clauses and specify the standard of care to be taken by the licensee in handling of the data, which might include provisions for physical security, signing of non-disclosure agreements with the employees of the vendor, internal security protocols etc.
- ▶ **Fees and Payment:** In a TTA, fees can be determined on the basis of lump-sum payment or royalty based or a combination of both. While laying down the terms, it is possible to have separate modes of calculation for different type of IP and even different pricing mechanisms. Royalties may be based on a percentage of net sales of the licensed product, fixed royalty on per product sale.
- ▶ Some agreements may provide for a minimum royalty to be paid irrespective of the volume of sales. However, in this case, the licensee may end up incurring financial obligations even if the production gets delayed. ***The minimum royalty provision may be diluted by providing that the minimum royalty period would start only after commercialization of the licensed technology.*** The Licensee may also seek to include provisions in the TTA for ***reduced royalty rates after a certain volume of sales have been achieved or a certain time period has passed*** after execution of the TTA.
- ▶ **Warranties:** A TTA must always contain warranties from the licensor regarding the licensed IP, including ***that the licensor has absolute ownership over the transferred IP, the IP is valid and that the IP does not violate any third party rights.***



## D. TECHNOLOGY TRANSFER AGREEMENTS/LICENSING AGREEMENTS (Contd.)

- ▶ **Term:** The term of a TTA may be mutually decided by the parties. However, it must be noted that different types of IP have different statutory periods of protection in different countries. As such, the term of a TTA granting license to a particular IP should not exceed the time period for which such IP has been granted statutory protection under the relevant jurisdiction.
- ▶ **Termination:** The TTA should expressly set out the events which might lead to termination of the TTA, by either party or one of the parties. Termination rights of the licensee may include a material breach of the warranties by the licensor. The TTA should ideally also provide for the return of technical manuals, machinery which embodies the technology, etc., upon termination.
- ▶ **Dispute Resolution:** Like any other agreement, a TTA should explicitly identify a suitable governing law and jurisdiction for resolution of disputes.
- ▶ **Example:** ISRO has developed technology to produce space grade lithium ion cells of various kinds, to power its rockets and satellites. In March 2019, **ISRO entered into a MoU with Tata Chemicals Limited (TCL)**, a world class manufacturer of basic chemistry products (Soda Ash, Sodium Bicarbonate) for transfer of ISRO's lithium-ion cell technology. Under the MoU, ISRO would transfer the technology to TCL, so that it may utilise the knowhow for the manufacture of lithium-ion cells in India. ISRO would be providing this technology to TCL on a non-exclusive basis, to manufacture cells of varying capacity, size, energy density and power density - catering to a wide spectrum of power storage requirements.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY

### ❑ Defence Acquisition Procedure

- ▶ The Defence Procurement Procedure (DPP) (Renamed Defence Acquisition Procedure - DAP in 2020) is a set of guidelines approved by the Defence Acquisition Council (DAC) that govern capital procurements in terms of defence equipment, manufacturing capabilities and technology. It provides framework and criteria for allotment of defence contracts.
- ▶ The DAP eases the procurement and acquisition of upgraded technology, products and services for the Tri-Services (Navy, Army and Airforce) and other allied defence services.
- ▶ Through its many improved features, it hopes to provide a boost to the Make in India efforts in the field - especially to MSMEs. It also establishes a greater degree of public accountability, transparency, fair competition and a level playing field in the sector.
- ▶ In the Defence Acquisition Procedure 2020, a new category of Foreign Manufacturing in India was incorporated to include provisions for encouraging FDI to establish manufacturing hubs. The new category involves manufacturing of equipment (Maintenance Repair and Overhaul) through subsidiary of a foreign corporation in India.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY (Contd.)

### ❑ Defence Production and Export Promotion Policy, 2020

- ▶ Defence Production & Export Promotion Policy (DPEPP) 2020 issued by the Ministry of Defence is an overarching guiding document to provide a focused, structured and significant thrust to defence production capabilities of the country for self-reliance and exports.
- ▶ The goals and objectives of DPEPP inter alia include (a) to achieve a turnover of Rs 1,75,000 Crores (US\$ 25Bn) including export of Rs 35,000 Crore (US\$ 5 Bn) in aerospace and defence goods and services by 2025 and (ii) to develop a dynamic, robust and competitive defence industry, including aerospace and naval shipbuilding industry to cater to the needs of armed forces with quality products.

### ❑ Make in India Scheme

- ▶ Make in India is a major national programme of the GoI designed to facilitate investment, foster innovation, enhance skill development, protect intellectual property and build best in class manufacturing infrastructure in the country. The primary objective of this initiative is to attract investments from across the globe and strengthen India's manufacturing sector. The focus of this programme is on 25 sectors, including automobiles, automobile components, aviation, defence manufacturing, electrical machinery and space.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY (Contd.)

### □ Make in India Initiatives in the aerospace manufacturing sector

- ▶ Defence and aerospace continues to be a strong pillar for India and key government systems such as Make in India to succeed. Government policies have centred on the implementation of advanced technologies in the defence sector, thus improving the potential of domestic manufacturing. The Defence Ministry has set a target of 70% self-reliance in weaponry by 2027, creating huge prospects for players in the industry.
- ▶ The Indian government has implemented several policies to promote self-reliance in defence and aerospace manufacturing under the Aatmanirbhar Bharat Scheme. In April 2018, an innovation platform called Innovations for Defence Excellence (iDEX) was launched. IDEX aims to build an ecosystem to encourage defence & aerospace innovation and technology initiatives.
- ▶ GoI is also supporting start-ups and promoting active participation in the industry. Describing MSMEs as 'rising stars' in aerospace and defence, the Defence Ministry estimates that their numbers would double to 16,000 over the next five years (by 2026) as they were integrated into global supply chains. For example, in September 2020, Dynamatic Technologies Ltd., an aerospace company based in Bengaluru, announced a contract for constructing parts for the T-7A Red Hawk trainer, one of the largest and most advanced aircraft programmes built by Boeing and Saab in the world.
- ▶ Defence Minister on August 9, 2020, released a list of 101 items which will be banned for import and can only be purchased from within India. The list is not limited to simple parts and components, but also includes sophisticated items such as light combat helicopters, armoured fighting vehicles and submarines.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY (Contd.)

### □ Make in India Initiatives in the aerospace manufacturing sector (Contd.)

- ▶ The Government has paved the way for foreign Original Equipment Manufacturers (“OEM”) to show that they are dedicated to the ‘Make-in-India’ initiative, and that to be able to continue to actively participate in Indian defence sales, OEMs will have to become partners in the India growth story.
- ▶ SRIJAN portal launched on August 14, 2020, is meant to convey indigenization opportunities to the private sector. It provides detailed information such as the name of the OEM from which the product is presently being imported, annual import value, product specifications and the ‘Make-in-India’ target year for the product.
- ▶ In addition, the Defence Research and Development Organisation (“DRDO”) which is the primary research and development wing of the Ministry of Defence, has released a policy under which DRDO patents will be made available to the Indian industry at zero cost. The patent licensing policy covers all Indian patents granted to the DRDO. Licensing will be undertaken on a non-exclusive basis and the DRDO will retain ownership.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY (Contd.)

### ❑ Production Linked Incentive (PLI) Scheme for Drones and Drone Components

- ▶ The PLI scheme is meant to provide companies incentives on incremental sales from products manufactured in domestic units. It is a focused scheme applicable to few selected sectors which encourages the domestic manufacturers by providing incentives that are linked to increase in sales. The incentives of the PLI scheme accrue after production unlike Make in India, where the government relaxation/incentives which are already there attract and encourage the domestic and foreign players to augment the manufacturing capabilities in India.

### ❑ Salient features of the scheme

- ▶ The Central Government has approved the PLI scheme for drones and a wide variety of drone components on 15 September 2021.
- ▶ The total amount allocated for the PLI scheme for drones and drone components is INR 120 crore spread over three financial years.
- ▶ The incentive for a manufacturer of drones and drone components shall be as high as 20% of the value addition made.
- ▶ The Government, has agreed to keep the PLI rate constant at 20% for all three years, an exceptional treatment given only to the drone industry
- ▶ Coverage of the scheme will be increased to include developers of drone-related IT products also.
- ▶ The eligibility norm for MSME and startups in terms of annual sales turnover at a nominal level - INR 2 crores (for drones) and INR 50 lakhs (for drone components). This will allow widening the number of beneficiaries.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY (Contd.)

### □ Defence Offset Policy

- ▶ The Indian Defence Offset is an obligation by foreign suppliers, to invest in India and aid the domestic defence industry either through direct investment or by partnering with domestic defence players or by transfer of technology to Indian defence enterprises. The offset policy is applicable only if the procurement value exceeds INR 300 crore. India recently made changes to its offset guidelines to drop a clause requiring foreign firms to invest 30 percent of the contract value in the Indian manufacturing sector for government-to-government agreements or single vendor contracts.

### *Obligations of a Foreign Contractor under the Indian Defence Offset*

- ▶ Foreign Direct Investment (FDI) or joint ventures with Indian defence companies to manufacture products locally in India;
- ▶ Investment in terms of transfer of technology through joint ventures for eligible products and services;
- ▶ Investment in Indian defence companies in terms of provision of equipment for manufacture and/or maintenance of products and services;
- ▶ Provision of equipment and/or transfer of technology to government establishments engaged in the manufacture and/or maintenance of defence products;
- ▶ Technology acquisition by DRDO in the areas of advanced defence and communication technologies; and
- ▶ By transfer of technology and collaborating with internationally competitive enterprises, the Indian Defence Offset Policy augments research, design and development capabilities of domestic defense companies.

## E. POLICIES INCENTIVIZING AEROSPACE MANUFACTURING INDUSTRY (Contd.)

### ❑ *Diminishing impact of Defence Offset Policy*

- ▶ Through Defence Acquisition Procedure 2020 (DAP 2020), an exemption from offsets has been extended to all procurement contracts which have been from the beginning single vendor cases (SVCs), including government-to-government (G-to-G) contracts. Therefore, all ab-initio SVCs, those not just covered under inter-governmental agreements but also under direct contracts with OEMs shall no longer be subject to offset regulations.
- ▶ With a more inward-looking DAP 2020 based on the cornerstone of indigenisation, Government of India (GoI) seems to be phasing out offsets. This is evident in the significantly reduced scope of offset applicability. Even in cases where offsets are triggered, the avenues for discharging them have been reduced. GoI has introduced various deterrents, such as the abolition of services and exclusion of civil aviation and homeland security products for generation of offsets in future contracts.
- ▶ A lot of players have already made significant investment in this space, and the same is on the drawing board strategy for a large number of other industry participants. It is in the interest of the sector and its long-term growth that Ministry of Defence reconsiders the impact of a dwindling offset market on the Indian industry



## F. PRIVATE SECTOR PARTICIPATION IN THE AEROSPACE AND DEFENCE SECTOR

- ❑ **Initiatives taken by the Ministry of Defence to attract private sector participation in manufacturing of defence equipment**
- ▶ Ministry of Defence by notification dated July 26, 2021, has announced inter alia following initiatives to promote private sector participation in defence sector and provide an incentive to the private participants to contribute to manufacturing of defence components.
- ▶ Defence Procurement Policy -2016 has been revised as Defence Acquisition Procedure (DAP)- 2020, which is driven by the tenets of Defence Reforms announced as part of 'Aatmanirbhar Bharat Abhiyan'.
- ▶ In order to promote indigenous design and development of defence equipment 'Buy {Indian-IDD (Indigenously Designed, Developed and Manufactured)}' category has been accorded topmost priority for procurement of capital equipment.
- ▶ Positive indigenisation list: Ministry of Defence has notified a 'Positive indigenisation list' of 209 items for which there would be an embargo on the import beyond the timeline indicated against them. This would offer a great opportunity to the Indian defence industry to manufacture these items using their own design and development capabilities to meet the requirements of the Armed Forces in the coming years.

## F. PRIVATE SECTOR PARTICIPATION IN THE AEROSPACE AND DEFENCE SECTOR (Contd.)

### ❑ Initiatives taken by the Ministry of Defence to attract private sector participation in manufacturing of defence equipment (Contd.)

- ▶ The 'Make' Procedure of capital procurement has been simplified. There is a provision for funding upto 70% of development cost by the Government to Indian industry under Make-I category. In addition, there are specific reservations for MSMEs under the 'Make' procedure.
- ▶ An innovation ecosystem for Defence titled Innovations for Defence Excellence (iDEX) has been launched in April 2018. iDEX is aimed at creation of an ecosystem to foster innovation and technology development in Defence and Aerospace by engaging Industries including MSMEs, Start-ups, Individual Innovators, research and development institutes and Academia and provide them grants/funding and other support to carry out research and development which has potential for future adoption for Indian defence and aerospace needs.
- ▶ Government has notified a 'Policy for indigenisation of components and spares used in Defence Platforms' in March 2019 with the objective to create an industry ecosystem which is able to indigenize the imported components (including alloys & special materials) and sub-assemblies for defence equipment and platform manufactured in India.
- ▶ Government has established two Defence Industrial Corridors, one each in Uttar Pradesh and Tamil Nadu. The investments of Rs 20,000 Cr have been envisaged in Defence corridors of Uttar Pradesh and Tamil Nadu by the year 2024. So far, investment of approx. Rs 3342 Cr has been made in both the corridors by public as well private sector companies. Moreover, the respective State Governments have also announced their Aerospace & Defence Policies to attract private players as well as foreign companies including Original Equipment Manufacturers (OEMs) in these two corridors.

## F. PRIVATE SECTOR PARTICIPATION IN THE AEROSPACE AND DEFENCE SECTOR (Contd.)

- ❑ **Examples of private players who have successfully participated in the defence and aerospace sector**
- ▶ Tata Sons Ltd. in 2020 announced that it was consolidating its various business interests across aerospace and defence verticals under Tata Aerospace & Defence (Tata A&D). These include mobility solutions, aerospace, weapon systems and. The stated aim was of course to design and develop equipment and platforms uniquely suited to the Indian defence forces. In the past, the company tied up with Honeywell International to build defence navigators. Tata Boeing Aerospace Ltd. (TBAL), a joint venture between TASL and Boeing Company, the world's largest aerospace company, was inaugurated in Hyderabad last year as a facility to produce fuselages for AH 64 Apache attack helicopters.
- ▶ The Tata Group has already demonstrated the capability to build aero structures such as those for Sikorsky helicopters, Pilatus trainers and the Lockheed Martin C-130 tailplane. Several Tata factories in Hyderabad work for different aerospace and defence companies and are fully functional separate units with high-grade security. Many of the arrangements outlined above are a part of the mandatory 30 per cent offset obligations foreign defence manufacturers have to invest in India. For example, Pilatus moved its manufacturing to Tatas from Poland-based PZL-Swidnik under the offset clause related to the Pilatus PC7 sale to the IAF.

## F. PRIVATE SECTOR PARTICIPATION IN THE AEROSPACE AND DEFENCE SECTOR (Contd.)

- ❑ **Examples of private players who have successfully participated in the defence and aerospace sector (Contd.)**
- ▶ Tata Lockheed Martin Aerostructures Limited (TLMAL), a joint venture between TASL and Lockheed Martin Limited, is producing— as the single source – empennage assemblies for all new CJ130J Super Hercules aircraft being produced in the United States (US). The hundredth one was delivered just before the Aero India Air Show 2019.
- ▶ Set up in 2017, Dassault Reliance Aerospace Limited (DRAL) is a joint venture between Anil Ambani's Reliance Group (51 per cent stake) and Dassault Aviation SA, an aircraft manufacturing subsidiary of Dassault Group. At its Dhirubhai Ambani Aerospace Park manufacturing facility in Nagpur, it is producing components for business jets of Dassault. DRAL was established to cater to Dassault's projected offset obligations from the 36 Rafale order hanging fire since 2016. Eric Trappier, CEO Dassault Aviation has reportedly stated that if the 36 Rafale order was followed through with another order for more Rafale jets, Dassault would consider producing them in India.
- ▶ Reliance Naval and Engineering Limited (RNAVAL), formerly Reliance Defence and Engineering Limited/Pipavav Defence and Offshore Engineering Company Limited, has the largest engineering infrastructure in India and is one of the largest in the world. RNAVAL is the first private sector company in India to obtain the license and contract to build warships.

## F. PRIVATE SECTOR PARTICIPATION IN THE AEROSPACE AND DEFENCE SECTOR (Contd.)

### □ Examples of private players who have successfully participated in the defence and aerospace sector (Contd.)

- ▶ Dynamatic Technology Limited, a Bengaluru-based world-class design, engineering and manufacturing company which designs and builds highly-engineered products for hydraulic, automotive, aeronautic and security applications. It is a leading private research and development organization with numerous patents and inventions to its credit and its partners include airbus, boeing and bell helicopter. It is a single source supplier for power and mission cabinets for Boeing P8 Poseidon aircraft. Dynamatic has also won the contract for manufacture of the main fuselage structure for the Light Combat Aircraft (LCA) Tejas.
- ▶ Mahindra Defence is developing the iconic ultra-light Howitzer battlefield guns in partnership with the British company BAE Systems. It has shown interest in aerospace for more than a decade and ventured into it through Mahindra Aerospace in 2008, acquiring Gipps Aero and Aerostaff, Australia in 2010. It has a manufacturing plant near Bengaluru since 2013 and manufactures airframe parts and assemblies. Among its successful projects was the development of a new utility aircraft – the C-NM5 – together with India's National Aerospace Laboratories (NAL) in a first of its kind co-development effort.
- ▶ In 2013, Wipro Infrastructure Engineering (WIN) set up India's first Aerospace actuator manufacturing facility at the Devanahalli Special Economic Zone in Bengaluru.
- ▶ The Kalyani Group, known for its company Bharat Forge which claims to be the largest forging company in the world, entered defence manufacturing seven years ago through Kalyani Strategic Systems. It also makes and exports aero defence systems to Israel's Rafael Advanced Defence Systems and is looking for opportunities in manufacturing jet turbo engines and drones for the Indian defence market.

## G. COMPETITION LAW ISSUES

- ▶ It must be noted that Section 6 of the Competition Act, 2002 (“Competition Act”) makes void any combination which causes or is likely to cause an appreciable adverse effect on competition within India and requires every acquirer to notify the Competition Commission of India (“CCI”) of a combination and seek its approval prior to effectuating the same unless such combination has been specifically exempted. As per Section 5 of the Competition Act, an “acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises”.
- ▶ The Competition Act requires that any acquisition of control, shares or voting rights or assets of an enterprise by a person that crosses the financial thresholds prescribed under the said Act needs to be notified to the CCI. As such, in case a JV involves acquiring shares or control over an existing company or merger/amalgamation with an existing company, the parties would need to check if such acquisition/merger/amalgamation would cross the thresholds specified in the Competition Act.
- ▶ Applicability of the De-Minimis Exemption: The Government of India has notified certain thresholds, whereby all transactions which do not meet such thresholds need not be notified to the CCI. Therefore, if the JV partners were to setup a fresh joint venture, which has nil or negligible assets and no value attributable to its turnover at the time that the partners to the JV subscribe to the shares of such JV company, it may be argued that such acquisition may not need to be notified.

## H. TAX INCENTIVES

### ❑ **KIADB Hitech Defense and Aerospace Park, Devanahalli**

- ▶ With the establishment of Hindustan Aeronautics Limited in Bangalore in 1940, Karnataka has come to be regarded as a pioneer in the aerospace industry. The State is positioned as an aerospace destination due to the presence of numerous aerospace companies and PSUs engaged in manufacturing, design and development and maintenance, repair and overhaul service.
- ▶ The Karnataka Industrial Area Development Board has set up an aerospace SEZ near Devanahalli in Karnataka (“Aerospace Park”). The Aerospace Park has attracted big names, such as Eaton Industrial Products Private Limited, Collins Aerospace, Centum, and Boeing. Several prominent global players have also confirmed their presence in the SEZ. As per latest figures by the Karnataka Udyog Mitra, more than 140 aerospace and defence projects have been confirmed at the Aerospace Park. It has already attracted an investment of more than Rs 13, 000 crores.
- ▶ The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:
  - Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units
  - No GST - Supplies to SEZs are zero rated under the IGST Act, 2017.
  - Exemption from other levies as imposed by the respective State Governments.
  - Single window clearance for Central and State level approvals.

## H. TAX INCENTIVES (Contd.)

### ❑ KIADB Hitech Defense and Aerospace Park, Devanahalli (Contd.)

- ▶ It was reported in June 2021 that in order to attract fresh investment, Karnataka is expected to come up with a new aerospace and defence policy soon. Such a policy will offer many incentives to aerospace companies.
- ▶ Munich-based TUV SUD laid the foundation stone for an additional testing lab and office facility at KIADB Hitech Defense and Aerospace Park, Devanahalli. The facility would be used for testing and certifying electrical and electronic products.

### ❑ Concessional rate of tax under the IT Act

The Central Government inserted a new Section 115BAB in the Income Tax Act, 1961, in September 2019, which gives an option to newly set up manufacturing companies to pay income tax at concessional rate (15%) on profits earned by them from business, subject to certain prescribed conditions.

- ▶ Eligibility Criteria: Sub-section (2) of Section 115BAB puts forth a few conditions to be satisfied by newly setup manufacturing company in order to become eligible for this scheme. Some of the major conditions are as follows:
- ▶ the company is set up and registered in India on or after October 1, 2019, and commences manufacturing or production on or before March 31, 2023 and the business is not formed by splitting up, or the reconstruction, of a business already in existence and the company does not use plant and machinery that was previously used for any purpose, subject to certain exceptions;
- ▶ the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and
- ▶ company shall not have claimed certain deductions provided for under the IT Act including Section 10AA (SEZ) and additional depreciation under Section 32.



# I. GENERAL TRENDS/CHALLENGES IN THE AEROSPACE SECTOR

- ▶ The impending 'digitization of manufacturing' ("DOM"), also known as 'Industry 4.0', 'Industrial Internet of Things (IIoT)' and 'smart manufacturing' will create profound changes in the process and the life cycle of manufactured products – be it ideation, design, assembly process, shipping or repair. Smart manufacturing is being driven by the advent and maturation of many technologies, including high-performance computing, cloud computing, the Internet of Things ("IoT"), advanced sensor technologies, 3D printing, industrial robotics, machine learning and wireless connectivity that better enables machine-to-machine (M2M) communications. The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:
  - ▶ Amongst the most important of these is IoT, which refers to the use of sensors in production equipment (such as robots, actuators, 3D printers etc.), and the products they make (such as jet engines, gas turbines, vehicles, etc.) to enable a real-time flow of information about the operational status and condition of the equipment or product.
  - ▶ General trends in the aerospace sector are as follows:
    - ▶ environmental necessity for having an imperative push towards sustainable development practices - There are already steps being taken in the right direction, specially with research and development of innovations such as blended wing bodies, hybrid or fully electric (fuel cell and battery based), hydrogen combustion mechanisms, advanced flight management, biofuel, advanced aerodynamics and auxiliary systems.

## I. GENERAL TRENDS/CHALLENGES IN THE AEROSPACE (Contd.)

- ▶ markets and technologies related to 'outer space' ventures are what will drive a large chunk of aerospace business in the coming years.
- ▶ there is an ongoing trend of consolidation across global supply chains - As the DOM permeates deeper into the aerospace sector and environmental considerations become more imperative, the consolidation and assimilation across the sector will continue to rise. As with any consolidation/assimilation, this has resulted in a downward pressure on costs (with consolidating / acquiring companies seeking to drive them down in order to establish a foothold in the market), which translates into a need for process and organizational innovation for those who cannot consolidate as they seek to remain competitive.
- ▶ aerospace companies in India should be ready for a lot of M&A activity in the coming years. As explained in the section on JV above, due diligence is the first step in any M&A and the results of diligence on a target company may make or break the deal. As such, companies whose documentation and compliances are in place, would be in a position to take advantage of this opportunity and receive investment for their business.

## J. OPPORTUNITIES FOR GROWTH IN THE AEROSPACE INDUSTRY

- ▶ In India, the aerospace industry is growing significantly with the rising activities from both the defence and civil aviation sector. Similarly, as India's defence capital expenditure spending is continuously growing, there are also many opportunities in defence aerospace. This offers opportunities for start-ups as well as further expansion for existing players. The Indian aerospace & defence (A&D) market is projected to reach ~US\$ 70 billion by 2030, driven by the burgeoning demand for advanced infrastructure and government thrust.

### **Drivers for growth in the aerospace industry**

- ▶ **Rising passenger traffic:** Domestic air travel demand continued an upward trend in October 2020, with a 33% increase (over September) to ~ 52 lakh passengers. In June 2020, the Ministry of Civil Aviation approved capacity increase to 45% from one-third, soon after domestic flights resumed from May 25, 2020. It further increased to 60% from September 2, 2020.
- ▶ **Increasing military and defence expenditure:** India's defence budget for 2020-21 is Rs. 4,71,378 crore (US\$ 67.4 billion), 9.37% higher than that in 2019-20. Of the Ministry of Defence total allocations, Rs. 323,053 crore (US\$ 46.2 billion) has been provided under the Defence Services Estimates (DSE), which deals with expenses of the three-armed forces and the Defence Research and Development Organisation (DRDO). Further, to support development of military procurement, in October 2020, the Modi government lifted expenditure restrictions on defence spending amid the ongoing stand-off with China. As a result, the Ministry of Defence, would be able to spend in line with its quarterly expenditure plan, which includes emergency procurement processes of over 100 contracts, each with a budget of Rs. 500 crore (US\$ 67.10 million).

## J. OPPORTUNITIES FOR GROWTH IN THE AEROSPACE INDUSTRY (Contd.)

### Opportunities in the Aerospace manufacturing sector

- ▶ **Strong industry support:** As India is rapidly modernizing its military sector, the aerospace and defence industry is expected to consume electronics worth US\$ 70-72 billion over the next decade in agreement with two industry associations—the National Association of Software & Services Companies (NASSCOM) and the India Electronics and Semiconductor Association (IESA).
- ▶ **Rising initiatives by industry players:** Industry players, innovators and researchers, backed up by the Indian government and space agencies, are focusing on creating new aerospace opportunities. For example, in October 2020, Starburst Aerospace announced plans to expand presence in India and develop an innovation Centre in Mumbai and conduct engagement activities in Delhi, Bangalore and Hyderabad through partners in the aerospace and defence community.
- ▶ **Cost-effective environment:** Aerospace requires highly qualified workers and precision capabilities. India presents an ecosystem, which ensures quality and improves performance for the overall effectiveness of business operations.
- ▶ **Opportunities to augment export in the Aerospace sector:** India is actively scouting for export potential for the indigenous Light Combat Aircraft (LCA) Tejas at a price of just Rs 309 crore per aircraft, as countries from Southeast Asia and the Middle East have evinced interest. HAL is looking at setting up logistics facilities in Malaysia, Vietnam, Indonesia and Sri Lanka to woo the countries to buy Tejas and military helicopters. This is because having logistics facilities is key to selling the products and ensuring after-sales services. Prime Minister Narendra Modi had last year set a defence export target of \$5 billion in the next five years.

▶ THANK YOU