

Regulatory Hotline

August 05, 2024

PUBLIC PROCUREMENT FRAMEWORK FOR MAKE IN INDIA – REVISED TO STRENGTHEN DOMESTIC MANUFACTURING OBJECTIVES

- Revision order provides clarity on calculation of local content percentage
- Imported items to be excluded from local content calculation
- Clarity provided on contracts for supply of multiple items
- Relaxation on timeline for submission of local content verification certificates

INTRODUCTION

The Public Procurement (Preference to Make in India) Order, 2017 (“**General Order**”) implemented a system for giving preferences to ‘Make in India’ products and service in public procurement. It was issued by the Department for Promotion of Industry and Internal Trade (“**DPIIT**”), under the Ministry of Commerce and Industry. DPIIT has recently issued a revision order (“**Revision Order**”)¹ providing much sought after clarifications to address several concerns raised by bidders (from varied industries) over the years, with respect to interpretation of the General Order.

For those new to the subject of ‘Make in India’ preference for public procurement – please refer to our previous [article](#), which sets out the background of the General Order.

Although the general rules on eligibility, purchase preference, and minimum local content requirements remain unchanged, the Revision Order clarifies certain aspects of the General Order, particularly in calculating ‘Local Content’ percentages. However, it seems that some important issues, especially for industries like software products and related services, have not yet been fully addressed (especially on local content calculation).

The clarifications and changes made by the DPIIT to the General Order have been analysed by us in detail below.

ANALYSIS OF THE REVISION ORDER

A clarification order of March 4, 2021,² (“**Clarification**”) clarified that bidders offering imported content in public procurement would not qualify as Class I /Class II local suppliers by claiming related services (such as transportation, insurance, installation, commissioning, training and after sales service support) as local value addition. Such suppliers were to be deemed as non-local suppliers. The Revision Order reiterates this intent, making it clear that domestic manufacturing, setting up of domestic production units, increased partnerships and cooperation with local companies, and increased participation by local employees, are indeed the key objectives promoted by the Make in India framework.

I. Calculation of Local Content

- *Imported Items forming part of the Product Offered*

For products and services containing imported content (which may either be imported directly or through resellers/distributors in India) - the imported content is required to be excluded from the calculation of local content, in accordance with the formula set out in General Order.

Generally, the difference in the cost of the imported content and the potential selling price of the imported content has been relied upon by bidders for establishing local value addition on a cost-basis. To prevent the misuse of the cost basis approach for calculation of local content, the DPIIT has included a provision requiring procuring entities to obtain details pertaining to the costs of the locally sourced imported items from the bidders. To this extent, the bidders are required to provide detailed workings containing a cost break-up of the license fees/royalties paid/technical expertise cost, incurred outside India, for products or services sourced from outside India, to ensure that imported items are excluded from local content calculation.

- *License fees, royalties and technical charges*

License fees, royalty and technical charges paid from India will have to be excluded in calculating local content for the relevant products.

Thus, where the Indian subsidiary pays a license fee to its overseas related party for the technology exchange/IP; and charges Indian customers for post-sale services), such amounts will have to be deducted.

This is also likely to impact the software products and services industry (which lacks a specific order or guidance from the MEITY with respect to the calculation of local content; and accordingly would be guided by the Revision

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Order). Numerous generic models noted in the software industry exhibit (a) licensing of software or technology by Indian entities from their foreign counterparts; (b) intellectual property in the software being developed by Indian R&D centres, while the ownership of such software lies with foreign entity (and then licensed back to India); and (c) development of base software outside India while upgrades and modifications are developed in India, amongst other models. For all such models, whether IP ownership overseas (despite Indian R&D and IP development), this provision will have to be taken into account.

■ Repackaged/Refurbished/Rebranded Imported Products

The procurement or supply of imported goods by undertaking repackaging/rebranding/refurbishing which does not lead to the coming into existence of a new good, is to be treated as resale of imported products.

To this extent, the Revision Order clarifies that costs incurred by the bidder in undertaking such activities for imported products would be excluded from calculation of local content. Specifically, these have been defined to mean:

- *“Refurbishing’ means repair or reconditioning of an imported product does not amount to manufacture because no new goods come into existence.*
- *‘Repackaging’ means repacking of imported goods from bulk pack to smaller packs would not ordinarily amount to manufacture of a new item.*
- *‘Rebranding’ means relabelling or renaming or change in symbol of logo/makes or corporate image or a company/organization/firm for an imported product would amount to rebranding.”*

Foreign manufacturers (either on their own or through resellers or distributors), seeking to establish initial production units in India by importing items and incurring cost for repackaging, relabelling and rebranding are likely to be impacted by the change brought about by the Revision Order.

■ Contracts for Supply of Multiple Items

For contracts involving supply of multiple items, weighted average of all items to be taken while calculating local content. This brings significant clarity for composite supplies, or software and platform aggregators, where different parts of the software / platform / cloud architecture could be developed and owned in India vs overseas. For all such instances, if the average of the various parts, qualifies the local content thresholds – then despite certain parts not qualifying the local content requirements on their own – composite supply should nonetheless satisfy the relevant local content requirement. However, tracking and documentation of the cost split-up in such cases, may prove to be challenging.

II. Verification of local content

For bid with procurements value above INR 10 crore (approximately 1.19 million USD), a certificate from the statutory auditor/cost auditor of the company/practising cost accountant/practising cost accountant has been a mandatory requirement. The Revision Order provides a relaxation, where such a certificate cannot be provided by the bidder at the time of execution of the contract - by allowing the bidder to (a) initially provide self-certification for the products or services, stating the satisfaction of local content requirements for such items, followed by (b) the required certificate after completion of the contract within the time limit prescribed by the procuring entity.

The responsibility of making truthful claims by the bidder in the self-certification is also strengthened by the bidder becoming liable to a penalty where the eligibility/category (under which he falls by virtue of the local content percentage of his products) is mis-stated.

The failure of meeting the local content requirement as per the contract, and where there is change in the category of such supplier (i.e. where the category of the supplier changes from Class I to Class II or to Non-local supplier pending the submission of the certificate) - a penalty of up to 10% of the contract value may be levied on the supplier.

However, despite such a penalty, the Revision Order does not stipulate for the awarded contract to be terminated on this account (and such contract may continue). An interesting dilemma which thus arises, is whether payment of penalties on account of incorrect representations would in effect lead to the acquiescence of the remaining contract (despite such contract being incongruent with the terms and the intent of the law). But may lead to the debarment of the bidder from participation in future bids by the procuring entity.

III. Items covered under PLI Schemes

The Revision Order prescribes special treatment for the manufacturers manufacturing items under various Production Linked Incentive Schemes (“**PLI Schemes**”). Such manufacturers would be treated as deemed Class II suppliers (unless the minimum local content of their product is higher or equal to the requirement stipulated for Class I local suppliers) for the item for which the manufacturer has received incentive under the applicable PLI Scheme from the responsible Ministry.

For example, where a manufacturer receives incentives under the applicable PLI Scheme for manufacturing electronic products. Where such a manufacturer is seeking to participate in the public procurement process, he will be deemed to be a Class II local supplier for the specific item, unless they have minimum local content equal to or higher than that notified for Class I local supplier for that item.

It is not clear whether this special treatment would be applicable for the time period of validity of the applicable PLI Scheme or for the specific time period as may be specified by the relevant PLI Ministry.

IV. Mandatory Sourcing of certain items from Class I local suppliers

The Ministry or Department identified by the DPIIT in respect of a particular item of goods, services or works under the General Order (“**Nodal Ministry**”) are empowered to notify a list of items as Class I for which there is sufficient local capacity and competition. Such notified items are required to be mandatorily procured from Class I local suppliers in SI/EPC/Turnkey Contracts/Services tenders.

The Revision Order provides that where it is not feasible to source such notified items from Class I local suppliers, the procuring entity may take relaxation by obtaining an approval of the Secretary of the administrative

V. Exemptions

The Revision Order exempts procurement of spare parts, consumables for closed systems and maintenance/service contracts with OEMs/Original Equipment Supplier/ Original Part Manufacturer from its applicability. Procuring entity may now procure such items or services in connection with the products directly from the suppliers/service providers. It may be now possible to procure such items directly from foreign suppliers and services providers.

This revision is likely to benefit the medical devices and healthcare industry, given that in majority instances spare parts and consumables for the devices may not be available domestically.

CONCLUSION

Revision Order favours the intent of the DPIIT in encouraging local value addition and seeks to address the misuse of cost basis calculation of local content by simply replying on the cost difference in imported goods. However, a number of key concerns faced by the software products and services industry remain unanswered and would need to be addressed by the DPIIT and the Ministry of Electronics and Information Technology by undertaking stakeholder consultations to take note of the unique requirements of this industry and to give impetus to the companies to increase local production in the future.

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You can direct your queries or comments to the relevant member.

¹ Accessible at: https://dpiit.gov.in/sites/default/files/PPP-MII_Revision_Order_19July2024.pdf

² Accessible at: https://dpiit.gov.in/sites/default/files/Letter%20to%20All%20Ministries03042021_clarification_0.pdf

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