ICC-ECCO GUIDE TO INTERNATIONAL OFFSET CONTRACTS

ICC INTERNATIONAL CHAMBER OF COMMERCE

ECCO European Club for Countertrade & Offset

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FOREWORD

International offset and countertrade transactions are important mechanisms to spur capacity-building, transfer of technology, and growth in developing countries' infrastructures and economies. The International Chamber of Commerce (ICC) and ECCO (The European Club for Countertrade & Offset) have joined forces to prepare this practical guide for businesses considering entering into an international offset contract.

The ICC-ECCO Guide to International Offset Contracts is a practical tool that analyses global trends in offset contracts, explains their legal context and status, and takes a critical look at how offset contracts are concluded and what legal risks may be involved.

We are grateful to the following members of the joint ICC-ECCO working group that prepared this Guide: Felipe Braz (Brazil); Jean-Jacques Brullot (France); Jason Chua (UK); Chantal Dagnaud (ECCO/France); Lauri Railas (Finland); Christian Sylvain (France); Michele Lyra Tostes (Brazil). Thanks also go to ICC Secretariat staff Florence, B.Diao-Gueye; Alex Kolev; and Emily O'Connor.

INTRODUCTION

In public procurement, offsets have become an important tool that is increasingly used to generate economic compensation for, as well as improve the infrastructure of, buyer countries. The acquisitions in question involving states or state-owned companies are usually linked to the development of strategic sectors of the industry, such as defence, energy, telecommunications and transport.

Since, acquisitions of this type typically amount to large sums for foreign suppliers, while financed by public funds; governments make their best efforts to ensure that the contract creates additional value for the local economy of their country.

Offset contracts arise from this scenario and are considered a growing phenomenon in international trade. Through offset contracts, governments try to create extra value in public procurement with foreign suppliers by, for example:

- acquiring new technologies that enable the country to limit its reliance on foreign suppliers;
- developing the related industry;
- retaining or recovering a share of the economic activity created by the purchase.

Offset contracts can encompass multiple jurisdictions and diverse legal frameworks, depending on the countries involved in the acquisition. In this context, ICC and ECCO (The European Club for Countertrade & Offsets) initiated a partnership in order to work together on the publication of a guide on offsets. The purpose of this guide is to analyse this global trend in international contracts and how to conciliate different interests, from a practical standpoint. The first chapter will explain offsets and their use in more detail, followed by a chapter that clarifies their legal status and acceptability. The subsequent chapters are more practical and take a closer look at the contract – how to conclude an offset contract, what legal risks are involved – and close with guidance on dispute prevention/ resolution mechanisms and principles for managing the ensuing contractual relationship successfully.

This guide has been drafted by a joint working group of the ICC Commission on Commercial Law and Practice and ECCO. The guide has drawn from the practical experience of the members of the working group and is intended to be a useful resource in the complex field of offset contracts.

CHAPTER 1: WHAT, WHY AND WHERE ARE OFFSETS USED?

This chapter provides a general overview of the offset system.

1.1. WHAT ARE OFFSETS?

Offsets are an international fact of life today. More than 130 countries impose offset obligations on suppliers.

While there is no uniform definition of offsets **two common definitions** include:

1. Offsets are non-standard contracts which require that a form of economic activity is transferred from the seller to the government of the purchasing country as a condition for the sale of goods and/or services on government procurement markets. Offsets are applied to government procurement markets in high technology sectors (defence, energy, aeronautics, transportation, etc.), usually to contracts worth more than €10 million.
2. The World Trade Organization (WTO) Agreement on Government Procurement (GPA) defines an offset as "any condition or undertaking that encourages local development or improves a Party's balance-of-payments accounts, such as the use of domestic content, the licensing of technology, investment, countertrade and similar action or requirement."[1] Related terms include compensatory trade agreements, coproduction, barter, and buy backs. The term "offset" is most often used in the aerospace and defence industries, whereas other terms, such as countertrade, may be used in other sectors.

Offsets are generally used by purchasing governments to reduce the cost (at least as perceived by their constituents) of procurement from abroad and/or to achieve related or unrelated policy goals, such as advancing the state of their domestic industry or broader domestic development goals.

Momentum in countering the growth of offsets has stalled since the trend towards liberalizing trade led to the civil offset ban in the WTO GPA in 1994. The 2012 revision to the GPA did not close the loopholes that allowed offsets to continue in the interim.

There are several related terms such as 'industrial cooperation', 'industrial participation', 'countertrade', 'industrial/economic compensations', or 'industrial benefits'. Nevertheless, offsets are frequently categorized with reference to two broad types of transactions: direct and indirect.

Three different kinds of offsets can be found on the market:

DIRECT OFFSETS

Direct offsets are conditions attached to the prime contract that are directly related to the goods or services being sold in the contract, such as coproduction or local subcontracting. Other activities such as licensed production, training, technology transfers, and financing can be characterized as either direct or indirect offsets, depending on whether they are related to the goods or services being sold under the prime contract. Coproduction, one of the most common forms of direct offset, generally involves the transfer of technology to permit foreign companies to manufacture a product on behalf of the seller. Licensed production is local manufacturing activity that is not conducted pursuant to a government coproduction agreement.

SEMI-DIRECT OFFSETS

Semi-direct offsets appear in the form of local co-production, technology transfer, local investment, subcontracting, not directly related to the product being sold, but related to the sector of activity of the product, for example, sale of military helicopters against the creation of a commercial helicopter line.

INDIRECT OFFSETS

Indirect offsets are conditions associated with a prime contract that are unrelated to the subject matter of the contract. For example, the U.S. Government considers purchase conditions always as

1 Agreement on Government Procurement, Apr. 15, 2011, updated Dec. 2011, entered into force Apr. 6, 2014, Marrakesh Agreement Establishing the World Trade Organization, 1867 U.N.T.S. 154, annex 4(b), art. I-1.

indirect offsets. Indirect offsets can also take the form of licensed production, investment, training, credit assistance, or technology transfer, among other things. Indirect offsets are the most flexible type since they only require that some form of value be created in the buyer's country. Because of the complexity of some of these arrangements, a number of offsets consultants, advisors, and brokers exist to assist companies in meeting such obligations.

1.2. WHY ARE OFFSETS USED?

Countertrade and offset agreements are a growing phenomenon in international trade. Such agreements are a way to develop national industries, and to encourage scientific development, including by creating employment. In the context of public procurement, offset contracts are used to require foreign companies to invest in the relevant national economy in order to be allowed to enter into a government procurement arrangement.

The investment typically consists of technology transfer, use of local content, training, and job creation. Offsets are applied to government procurement, mainly in the defence sector, but now more widely across the energy, transportation, telecommunications and pharmaceutical/healthcare sectors.

Offset contracts are signed between a purchasing country and a foreign supplier. As a condition for the sale of goods or services, the foreign firm is required to provide additional economic benefits to the purchasing government's economy.

A state imposes offset obligations to compensate the investment outside the country and encourage national development. Indeed, a government procurement agreement signed with a foreign company is not signed with a local company but with a public entity. Consequently, the funds paid to the foreign supplier leave the public coffers, and are thus no longer available to benefit nationals of the purchasing country, individuals or companies, constituting a potential loss to the country's Gross Domestic Product (GDP).

In light of this, the host country's government imposes an offset obligation with one objective: the creation of added value in order to compensate the investment in a foreign company. . This added value can take several forms, as mentioned above: transfer of technology, local production or assembly (direct offset because directly related to the main contract), training, various construction projects, etc. (indirect offset because not related to the object of the main contract).

The logic behind these contracts is a form of indirect taxation which benefits the development of the buying country: offsets are imposed by the buying country which validates correct performance of the offset contract as regards the expected benefit for the national economy.

Direct	- ACQUIRING NEW TECHNOLOGIES AND NEW CAPACITIES. - CONTAIN ECONOMICAL ACTIVITY ISSUED FROM THE SIGNATURE OF THE MAIN CONTRACT AND CREATE A LOCAL SUPPLY CHAIN.
Semi-direct	-FORMING STRATEGIC ALLIANCES WITH ESTABLISHED MULTI-NATIONAL BUSINESSES. - CREATE A SUSTAINABLE FLUX OF ACTIVITY. - SUPPORTING KEY INDUSTRIES.
Indirect	- CONTRIBUTE TO THE ECONOMIC DEVELOPMENT OF THE LOCAL INDUSTRY IN ANY FIELD. - ACCESSING NEW INTERNATIONAL MARKETS FOR THE LOCAL ENTERPRISES. - CONTRIBUTE TO THE BALANCE OF PAYMENTS. - SECURE THE SOCIAL ENVIRONMENT *(PUBLIC ACCEPTANCE)*.

The current increase in the use of offsets, notably in "emerging" markets which are of strategic interest for companies in the West, represents a resurgence of a bartering economy, to complement purely financialised international trade.

By merging economic and extra-economic development related considerations, offsets contribute to the logic underlying of corporate social responsibility: more monitored, more socially and environmentally responsible, less costly and fairer.

1.3. WHERE ARE OFFSETS USED? A PLURALITY OF TRANSACTIONS

Offset obligations apply only to international government procurement contracts. The fundamental characteristics of these contracts are:

- the customer or buyer is a public institution (public companies, ministries or national, regional and local agencies). This means that purchases are paid from public funds, which must be managed correctly and in line with public policy objectives (safeguarding jobs, industrial development, and support for SMEs);
- these contracts cover infrastructure and high technology products, particularly in the defence, security, aeronautics, energy and transport sectors;
- these are very substantial contracts, usually worth more than 10 million USD; and
- the purchases made by the buying country are imports. These purchases therefore affect its balance of payments and the funds used to pay for them leave the country.

To successfully conclude negotiations on the main contract, an agreement on the offset obligations must be accepted by the bidding company. There are a number of related transactions, tied together by two central contracts:

- The first is the main contract. This contract is a government procurement, which involves infrastructure or high technology assets, goods or services via an international tendering process to a foreign company. During this international tendering process, negotiation of the offset obligations begins for signature of the offset agreement.
- The second transaction is the offset contract. It is an agreement between the foreign company and the national offset authority, which is always part of the government. The offset contract sets the value of the offset obligation to be met by the obligor in line with the proportions set in the applicable offset legislation. This value – a percentage of the main contract – corresponds

to the amount of local added value to be created. This percentage can sometimes be reached by combining direct and indirect offsets to reach the total value of the obligation.

CHAPTER 2: THE LEGAL STATUS AND ACCEPTABILITY OF OFFSETS

2.1. OVERVIEW

This Chapter provides an overview of the legal status of offsets from the perspective of certain important international and supranational legal instruments as well as European Union (EU) and U.S. federal law. The international, regional and national levels may become applicable at the same time, and one must look at the country in question to verify the applicable legal framework in more detail.[2]

The offset provisions of the WTO's Agreement of Government Procurement (GPA)[3] representing the international level of regulation, attracts the attention first. As one of the treaties within the WTO system, the GPA is essentially a trade policy instrument providing market access with substantive provisions. As such, it is compulsory law for its signatories.

The provisions relating to offsets in the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Public Procurement as adopted in 2011 are then examined[4]. Model laws are not, as such, mandatory international law. However, the impact of the Model Law on Public Procurement has been enhanced by the fact that multilateral development banks (MDBs), most notably the World Bank, have regarded its provisions as an adequate level of protection for the purposes of lending under their Procurement Guidelines. [5] Governments wishing to obtain finance for their infrastructure projects from the MDBs, for instance, are thereby in practice compelled to adopt the Model Law, or to apply in practice, its essential parts.

At the international law level, there are trade and investment treaties between states that may provide for procurement and offsets, and which are mandatory. This guide only refers to their potential existence. Companies are advised to consult their national administration to find out any potential treaties relevant in this respect.

As a supranational organization, the EU regulates public procurement and has a significant impact on the international scene. Both the primary law (treaties) and its secondary law (regulations, directives, etc.) of the EU must be examined.

Finally, a brief outline of some domestic content restrictions is provided. Although such restrictions do not necessarily require offsets, they force a bidder external to the target country or customs union to make use of local content.

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2 Reference may be made to the document edited by the European Club for Countertrade and Offset (ECCO) entitled ´Cross Analysis on Compensatory Measures in International Public Procurement Contracts´.

3 The Agreement on Government Procurement (GPA) consists of 19 parties covering 47 WTO members (counting the European Union and its 28 member states, all of which are covered by the Agreement, as one party since the European Union has exclusive competence in this field by virtue of the Lisbon Treaty).
Another 31 WTO members and four international organizations participate in the GPA Committee as observers. 10 of these members with observer status are in the process of acceding to the Agreement. The first version of the GPA was adopted in 1994 and entered into force on 1 January 1996. The revised GPA was adopted in 2012 and entered into force on 6 April 2014. For the revised text of the GPA, see https://www.wto.org/english/docs_e/legal_e/rev-gpr-94_01_e.htm.

4 According to the UNCITRAL (see the Model Law status website at http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/2011Model_status.html visited on 26 January 2018), the UNCITRAL Model Law on Public Procurement forms the basis of or is
reflected in the public procurement laws and regulations in the following states. These states have used the Model Law and accompanying Guide to Enactment in reforming their public procurement law and systems, though the extent to which the resulting regulatory framework incorporates the provisions of the Model Law varies, as that framework also reflects legal traditions, domestic policy and other objectives: Afghanistan, Armenia, Azerbaijan, Belarus, Egypt, Ghana, India, Jamaica, Kazakhstan, Kenya, Kyrgyzstan, Mexico, Mongolia, Myanmar, Russian Federation, Rwanda, Tajikistan, Thailand, Trinidad and Tobago, Tunisia, Uganda, Ukraine, Tanzania, Uzbekistan and Zambia. For the full text of the UNCITRAL Model Law on Public Procurement, see https://www.uncitral.org/pdf/english/texts/procurem/ml-procurement-2011/2011-Model-Law- on-Public-Procurement-e.pdf.

5 According to UNCITRAL (see the website in the preceding footnote), the following organizations use the Model Law and accompanying Guide to Enactment as a benchmark for public procurement law reform in countries of their operation:
African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, Organization for Economic Cooperation and Development and the World Bank.

2.2. WTO AGREEMENT OF GOVERNMENT PROCUREMENT (GPA)

Article II of the revised Government Procurement Agreement sets the scope of its application. The Agreement applies to any measure regarding covered procurement. Covered procurement is defined as procurement for governmental purposes:

a. of goods, services, or any combination thereof:
    2. as specified in each Party's annexes to Appendix I; and
    3. not procured with a view to commercial sale or resale, or for use in the production or supply of goods or services for commercial sale or resale;

d. by any contractual mean, including: purchase; lease; and rental or hire purchase, with or without an option to buy;

e. for which the value, as estimated in accordance with paragraphs 6 through 8, equals or exceeds the relevant threshold specified in a Party's annexes to Appendix I, at the time of publication of a notice in accordance with Article VII;

f. by a procuring entity; and

g. that is not otherwise excluded from coverage in paragraph 3 or a Party's annexes to Appendix I.

Paragraph 3 of Article II excludes certain types of procurement from the scope of the Agreement. Furthermore, as provided for in paragraph 4 of the Article, the parties to the Agreement shall specify, in their annexes to Appendix I, the goods and services covered by the Agreement.

Generally speaking, the GPA bans offsets by providing in its Article IV(6) that with regard to covered procurement, a party, including its procuring entities, shall not seek, take account of, impose or enforce any offset. Offsets are defined by the Agreement as "any condition or undertaking that encourages local development or improves a party's balance-of-payments accounts, such as the use of domestic content, the licensing of technology, investment, counter-trade and similar action or requirement" (Article I(l)). The definition is broad enough to include both direct and indirect offsets.

Article III.1 excludes procurement related to security and defence sectors from the scope of the Agreement by stating that, nothing in [the] Agreement shall be construed to prevent any party from taking any action or not disclosing any information that it considers necessary for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or national defence purposes. Thus, the industry in which offset deals are most common is excluded from the scope of the Agreement, making it possible for the parties to the Agreement to continue imposing offset obligations in their public procurement of defence materials, despite the clear-cut prohibition of offsets set up in Article IV(6). As a result, the offset ban established in the Agreement applies only to public procurement of a ´civil´ nature.

Another exception to the general prohibition of offsets is established in Article V of the Agreement with respect to developing countries. The mentioned Article provides that a developing country becoming a party to the Agreement may, under certain conditions, resort to offsets. The Agreement does not define 'developing country'. There are also no WTO definitions for developed and developing countries, so a party may self-identify as a 'developing country'.. However, other parties may challenge the decision of a party to make use of provisions available to developing countries. According to paragraph 3 of Article V of the Agreement, based on its development needs, and with the agreement of the parties, a developing country may adopt an offset during a transition period and in accordance with a schedule, set out in its relevant annexes to Appendix I. These offsets shall be applied in a manner that does not discriminate among the other parties and their imposition needs to be clearly described in the notice of intended procurement. In other words, a developing country becoming a party to the Agreement may adopt offsets in civil public procurement if the following requirements are met:

a. the offset is justified by the developing needs of the country in question;

b. the offset is adopted with an agreement of the parties;

c. the offset is adopted during a transition period and in accordance with a schedule, set out in an annex to Appendix I of the Agreement;

d. the offset is applied in a manner that it does not discriminate among the other parties;

e. the imposition of the offset is clearly stated in the notice of intended procurement. (Article V).

However, practically the totality of countries that could be referred to as ‘developing countries’ have not become parties to the GPA since these countries have not been able or willing to commit to market access. Consequently, at present, these countries are free to continue with their offset practices, unless the terms of MDB finance provide otherwise.

In summary, the GPA

- establishes a general prohibition to apply offsets in civil public procurement;
- allows developing countries, when certain requirements are met, to apply offsets during a transitional period and in a limited manner; and
- does not apply to public procurement related to the defence and national security sectors, which, in practice, are the sectors where offsets are most common.

2.3. THE UNCITRAL MODEL LAW ON PUBLIC PROCUREMENT

The purpose of the UNCITRAL Model Law on Public Procurement (2001) is twofold:

1. to serve as a model for states for the evaluation and modernization of their procurement laws and practices, and
2. to support the harmonization of procurement regulation internationally, in order to promote international trade.[6]

The Model Law brings national defence and national security sectors into its general ambit.[7] Pursuant to Article 1 of the Model Law, the Law applies to all public procurement. At the same time, the Model Law recognizes the special interests of states involved in defence and security procurement (e.g. the need to protect classified information and ensure security of supply). Consequently, when justified by national security interests, the Model Law allows states to deviate from the general provisions on transparency in the procurement procedures[8]. In addition, when a state’s national security is concerned, the state may, instead of open tendering, resort to alternative methods of procurement, characterized by their more ´restricted´ nature.[9]

Although offsets are not explicitly mentioned in the Model Law, it contains provisions relevant for offsets. Article 8 of the Model Law regulates the participation in procurement proceedings by suppliers or contractors. Pursuant to Article 8, suppliers or contractors shall be permitted to participate in procurement proceedings without regard to nationality, except where the procuring entity decides to limit participation in procurement proceedings on the basis of nationality on grounds specified in the procurement regulations or other provisions of law of this state. The procuring entity shall establish no requirement aimed at limiting the participation of suppliers or contractors in procurement proceedings, or that discriminates against or among suppliers or contractors or against categories thereof, except when authorized or required to do so by the procurement regulations or other provisions of law of the state.

These discriminations, authorized by the procurement regulation of a state, might be, for instance, the result of pursuing ´socio-economic policies´[10], defined by the Model Law as environmental, social, economic and other policies of the state authorized or required by the procurement regulations or other provisions of law of the state to be taken into account by the procuring entity in the procurement proceedings (Article 2(o)). The procuring entity shall, however, when first soliciting

6 UNCITRAL Guide to Enactment of the UNCITRAL Model Law on Public Procurement (2014), p. 2.

7 ibid., p. 13.

8 ibid., p. 13 –14.

9 ibid., p. 14.

10 ibid., p. 5.

the participation of suppliers or contractors in the procurement proceedings, declare whether the participation of suppliers or contractors in the procurement proceedings is limited and on what grounds, and include in the record of the procurement proceedings a statement of the reasons and circumstances on which it relied (Article 8).

Article 11 of the Model Law on rules concerning evaluation criteria and procedures provides that the evaluation criteria may include:

a. Any criteria that the procurement regulations or other provisions of law of the state authorize or require to be taken into account;

b. A margin of preference for the benefit of domestic suppliers or contractors or for domestically produced goods, or any other preference, if authorized or required by the procurement regulations or other provisions of law of the state. The margin of preference shall be calculated in accordance with the procurement regulations.

The evaluation criteria (and their relative weight) observed by the state shall be set out in the solicitation documents (Article 11(5)).

With regard to the socio-economic policies mentioned above and defined in Article 2(o) of the Model Law, Article 30(5) provides that a procuring entity may engage in single-source procurement when, following public notice and adequate opportunity to comment, procurement from a particular supplier or contractor is necessary in order to implement a socio-economic policy of the state, provided that procurement from no other supplier or contractor is capable of promoting that policy. According to Article 52, a single-source procurement is a procedure preceding the solicitation of a proposal or price quotation from a single supplier or contractor.

In summary, the UNCITRAL Model Law on Public Procurement

- does not rule out the possibility to make use of an offset;
- lays down systemic and procedural requirements for its use, as the evaluation criteria for offset conditions must be in compliance with the procurement legislation or regulations of the procuring state, and must be communicated to the participants at an early stage of the proceedings.

2.4. OFFSETS AND EU LAW

The legal framework of the EU consists of primary law and secondary legislation. The primary law includes the Treaty on the Functioning of the European Union (TFEU). Public procurement is part of the Internal Market and is regulated by secondary legislation constituted by several Directives: The Classical Directive,[11] the Utilities Directive,[12] the Concessions Directive[13], the Defence Procurement Directive [14]as well the Remedies Directive.[15]

The internal market established by the EU is a single market without internal frontiers in which the free movement of goods, persons, services, and capital is ensured (Article 26(2) TFEU) and in which any discrimination on grounds of nationality is prohibited (Article 18 TFEU). Since offset obligations ´tie´ the party awarded by the procurement to economic activity performed within the frontiers of the awarding country or to its benefit, they violate the four freedoms laid down in the TFEU.

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11 Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC

12 Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities in the water, energy, transport, and postal services sectors and repealing Directive 2004/17/EC

13 Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the awards of concession contracts

14 Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC.

15 Directive 2007/66/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directives 89/665/EEC and 92/13/EEC with regard to improving the effectiveness of review procedures concerning the award of public contracts

EU law does not, therefore, generally allow offsets in civil procurement. Although the Classical Directive, the Utilities Directive and the Concessions Directive all allow socio-economic grounds as awarding criteria, these must be applied in a non-discriminatory manner. As stated in Article 18(1) of the Classical Directive:

> *"Contracting authorities shall treat economic operators equally and without discrimination and shall act in a transparent and proportionate manner.*
>
> *The design of the procurement shall not be made with the intention of excluding it from the scope of this Directive or of artificially narrowing competition. Competition shall be considered to be artificially narrowed where the design of the procurement is made with the intention of unduly favouring or disadvantaging certain economic operators."*

Similar provisions are found in Article 36(1) of the Utilities Directive and Article 3(1) of the Concessions Directive.

One of the arguments in the field of public procurement within the EU has been the application of socio-economic aspects. The EU legislator has refrained from imposing any policies in this respect but left it to the contracting authorities, imposing, however, a general obligation to comply with applicable norms, as stated in Article 18(2) of the Classical Directive:

> *"Member States shall take appropriate measures to ensure that in the performance of public contracts economic operators comply with applicable obligations in the fields of environmental, social and labour law established by Union law, national law, collective agreements or by the international environmental, social and labour law provisions listed in Annex X".*

With reference to Article 18(2), Article 71 of the Classical Directive provides for subcontracting. The contracting authority may not impose subcontracting obligations in favour of local SMEs (direct offsets) but may provide for the safeguarding of payment risks of the subcontractors.

In defence procurement, offsets are tolerated better. There are two inroads to offsets in defence procurement, the Article 346 exemption, where applicable, and the Defence Procurement Directive.

Article 346 TFEU establishes a ground for derogation from the principles of the internal market, which has been interpreted by some member states to allow offsets in their defence procurement.

According to Article 346 TFEU:

1. The provisions of the Treaties shall not preclude the application of the following rules:
   ...
   (b) any member state may take such measures as it considers necessary for the protection of essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specially military purposes.
2. The Council may, acting unanimously on a proposal from the Commission, make changes to the list, which it drew up on 15 April 1958, of the products to which the provisions of paragraph 1(b) apply.

However, the derogation established in Article 346 does not necessarily mean that member states are in any case free to resort to offsets or other market disturbing practices in their defence procurement. Article 346 TFEU itself sets limits to its application. Moreover, the ECJ case-law has further defined the correct interpretation and application of the Article.

Article 346 TFEU refers, in paragraph 2, to a list of the products to which the armament exemption applies. However, the exact contents of the list are not entirely clear, since different versions of it have been published over the years.

In order to apply Article 346 TFEU, the member state concerned must have an essential interest of its security at stake. It is also important to note that the Article refers only to arms, munitions and war material, which, in addition, must be specified in the list mentioned before. Moreover, Article 346

TFEU prescribes that the measures taken by member states shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for exclusively military purposes. This provision is relevant in that many items procured for military purposes can be used for both military and civil purposes (dual-use goods).[16]

The ECJ case-law has further restricted the application of Article 346 TFEU. According to this case-law, Article 346 TFEU must be interpreted narrowly and its application is never automatic, but needs to be invoked by the member states on a case-by-case basis. Moreover, the need for the application of Article 346 must be proven by the member state invoking it.[17]

The Defence Directive attempts to reconcile the special interests of national security involved in defence procurement with the principles of the internal market. The economic value of contracts awarded in the context of defence and security procurement is often considerable. At the same time, procuring states have special needs, particularly security of supply and secrecy. Before the Defence Directive, the public procurement of defence material was not conducted under the procurement directives and member states were prone to resort to the defence exemption provided in Article 346 TFEU instead. The Defence Directive originated as a public procurement directive tailored to the special needs of defence procurement and aims to conduct more defence procurement inside the internal market. However, this does not imply that member states may no longer resort to Article 346 TFEU. Article 346 constitutes a ground for derogation from the Treaty obligations as whole and to the Defence Directive. After the Defence Directive, member states might be less likely to resort to Article 346 TFEU. [18]However, using Article 346 TFEU to conduct defence procurement outside the internal market is still possible if the conditions laid down by the Article itself and the ECJ case-law are met. The Defence Directive applies to contracts awarded in the fields of defence and security that exceed the threshold amounts established in Article 8 of the Directive, and are awarded for (Article 2):

a. he supply of military equipment, including any parts, components and/or subassemblies thereof;

b. the supply of sensitive equipment, including any parts, components and/or subassemblies thereof;

c. works, supplies, and services directly related to the equipment referred to in points (a) and (b) for any and of its life cycle;

d. works and services for specially military purposes or sensitive works and sensitive services.

However, Article 13 excludes certain contracts from the scope of the Defence Directive, including, inter alia, contracts for the purposes of intelligence activities, government-to-government sales, and contracts for which the application of the rules of the Directive would oblige a member state to supply information the disclosure of which it considers contrary to the essential interests of its security.

As to the acceptability of offsets, Article 38(2) of the Defence Directive on the suitability of participants provides that the minimum levels of ability required for a specific contract must be related and proportionate to the subject-matter of the contract. Moreover, when awarding the contract, if the contracting authority does not base the award of the contract only on the lowest price, the rest of the selection criteria for determining the best tender must be linked to the subject matter of the contract in question. Therefore, criteria which are not related to the subject matter of the contract shall not be taken into account when assessing the suitability of participants and awarding the contract, as is often the case when procured contracts are "greased" with offset obligations.

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16 See Articles 16 and 17 of the Classical Directive and Articles 25 and 26 of the Utilities Directive regulating mixed procurement or procurement covering several activities involving defence and security aspects.

17 For a detailed analysis of the ECJ case-law on the interpretation of Article 346 TFEU, see Chapter 3 of Martin Trybus, Buying Defence and Security in Europe. The EU Defence and Security Procurement Directive in Context. Cambridge, CUP, 2014

18 It seems that this objective has not been met yet. The 2016 Report from the Commission to the European Parliament and the Council on the implementation of Directive 2009/81/EC on public procurement in the fields of defence and security concludes, at pages 7 and 8, that a very significant share of defence procurement expediture is still made outside the Directive.

The Defence Directive provides in Article 20 that contracting authorities/entities may lay down special conditions relating to the performance of a contract, provided that these are compatible with EU law and are indicated in the contract documentation. The same article specifies that these conditions may, in particular, concern subcontracting.

According to Article 21(4), member states may provide that the contracting authority/entity may ask or be required to ask the successful tenderer to subcontract to third parties a share of the contract, which may not exceed 30% of the value of the contract and shall be proportionate to the object and value of the contract and the nature of the industry sector involved, including the level of competition in that market and the relevant technical capabilities of the industrial base. The subcontractors are generally selected by the successful tenderer, but the contracting authority/entity may prescribe criteria for qualitative selection, which must be non-discriminatory (Article 53). Moreover, as provided for in Article 20, the authorities and entities may lay down special conditions relating to the performance of a contract and concerning, in particular, subcontracting, provided that these are compatible with EU law, i.e. are non-discriminatory and transparent.

The European Commission has adopted a restrictive attitude towards offsets in defence and security procurement. The Directorate General Internal Market and Services has published a Guidance Note [19]on Offsets in the context of the Directive 2009/81/EC, which, while not legally binding, in practice largely sets the stage in the field concerned. According to the Guidance Note, offset requirements, whether they are civil or military, direct or indirect, are restrictive measures which go against the basic principles of the Treaty, because they discriminate against economic operators, goods, and services from other member states and impede the free movement of goods and services. Therefore, contracting authorities/entities may not require or induce, by whatever means, candidates, tenderers or successful tenderers to commit themselves to:

- purchase goods or services from economic operators located in a specific member state;
- award sub-contracts to operators located in a specific member state;
- make investments in a specific member state; or
- generate value on the territory of a specific member state."

According to the Commission, these rules apply to all kind of works, supplies, services, and investments, whether they are military, security-related or civil in nature or purpose, and irrespective of whether they are directly or indirectly related to the subject-matter of the procurement contract in question.

The Guidance Note also recognizes that a member state might elude the application of the provisions of the Directive 2009/81/EC by invoking Article 346 TFEU. Being a derogation from the freedoms established in the Treaty, the Commission considers, basing its findings on the case law of the European Court of Justice, that Article 346 TFEU is limited to exceptional and clearly defined cases, and the measures taken must not go beyond the limits of such cases. Moreover, like any other derogation from fundamental freedoms, Article 346 has to be interpreted strictly, and the burden of proof that the derogation is justified lies with member state which invokes it. According to the Commission, this means that if a member state makes use of an offset, it must be able to demonstrate that these requirements are necessary to protect its essential security interests.

Economic considerations are not accepted as grounds for justifying restrictions to the freedoms guaranteed by the Treaty.

The Guidance Note of the Commission also specifies that if a member state intends to rely on Article 346 TFEU in order to make requirements which infringe the basic freedoms and principles of the Treaty, it must always be able to prove that any such specific requirement is itself indispensable to protect the essential security interest. Therefore, the concrete offset measure would have to be justified separately as necessary for the protection of the essential interests of the purchasing member state. Finally, the Commission reminds that Article 346 (1)(b) itself states that a measure taken by virtue of the Article shall not adversely affect the conditions of competition in the common

19 Directive 2009/81/EC on the award of contracts in the fields of defence and security, Guidance Note, Offsets.

market regarding products which are not intended for specifically military purposes, thus, prohibiting indirect non-military offsets at the national level.

Moreover, a brief mention of the Code of Conduct on Offsets of the European Defence Agency (EDA), adopted on 24 October 2008 is necessary. The Code, which came into force on 1 July 2009, is voluntary, not legally binding, and applies to all compensation practices required as a condition of purchase or resulting from a purchase of defence goods or defence services. The subscribing member state[20] commit to implementing the principles and guidelines of the Code equally to all bidders from subscribing member state and non-subscribing member state, including third countries. An important principle set out in the Code is that offsets, both required and accepted, will not exceed the value of the procurement contract. The Code introduces thereby a 100% cap on offsets. The European Commission emphasizes, however, in its Guidance Note to Offsets that the application of the EDA's Code on offsets does not of itself make offset requirements compatible with EU law and that the Code itself stipulates that its provisions have to be implemented within the framework of EU law.[21] Consequently, according to the Commission, in every award procedure, contracting authorities/entities first have to ensure that all their requirements comply with the provisions of the Treaty and/or the Directive, which are the only legal criteria for the assessment of offset requirements.[22] However, if EU member state resort to Article 346 TFEU to conduct their defence procurement outside the internal market, the EDA Code could fill, to some extent, the regulative vacuum resulting from the non-application of the internal market regime.

In summary, the EU legal framework for public procurement

- does not generally allow offsets in civil procurement (between member states only);
- has been extended to defence and security procurement by virtue of the Defence Directive;
- allows derogations from Treaty obligations in limited situations; and
- is an important part of the world procurement market through the GPA and bilateral agreements, but a protectionist proposal has been made by the Commission.

2.5. DOMESTIC CONTENT RESTRICTIONS

In addition to regulating the use of offsets directly or indirectly, individual states and trade blocs such as the EU use trade policy legislation that has an impact on bidders external to these territories. The legitimacy of these measures must be examined in the light of international agreements of the WTO system, in public procurement through the GPA. Many countries, and those resorting to offsets, are not, however, members to the GPA. As protectionist tendencies may be growing, these restrictions may have an increasing importance with offsets as well. A brief account of domestic content restrictions in the EU and the United States follows.

The Utilities Directive of the EU regulating the procurement by entities operating in water, energy, transport and postal service sectors establishes a ´domestic content restriction´. The word 'domestic' is understood as referring to the internal market, in other words, the totality of the member state and the European Economic Area. The Utilities Directive prescribes in Article 85(2) that any tender submitted for the award of a supply contract may be rejected where the proportion of the products originating in third countries, as determined in accordance with Regulation (EU) No 952/2013 of the European Parliament and of the Council (1), exceeds 50% of the total value of the products constituting the tender. This provision in effect creates a kind of a direct offset requirement at the EU level. Any discrimination among the providers established inside the internal market, however, is prohibited. The procuring entity cannot require the products to be of national origin.

The domestic content provision in the Utilities Directive is exceptional but reflects the policy the Commission would like to see the EU to adopt in respect of third-country access outside a treaty

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20 According to the European Defence Agency's press release (1 July 2009) titled Bringing Transparency into the European Defence Equipment Market: Code of Conduct on Offsets Comes into Force, the Code will be applied to offset arrangements signed by all EDA participating member states (except Romania) and Norway.

21 Directive 2009/81/EC on the award of contracts in the fields of defence and security, Guidance Note, Offsets, paragraph 28.

22 ibid.

framework (GPA, bilateral agreements) if the third countries in question would not grant reciprocity to the EU bidders. It is noteworthy that the proposal[23] of the Commission would recognize third-country access as a general principle provided that the requirements are met. National authorities would no longer have discretion as to the admissibility of third-country bidders.

The United States domestic content restrictions, broadly understood, can be defined as "provisions which require that items purchased using specific funds appropriated by Congress be produced or manufactured in the United States".[24] Domestic content restrictions are, in practice, often equivalent to offset requirements, since foreign operators, in order to comply with such restrictions, need to establish themselves within the territory of the state applying such restrictions or to collaborate with domestic providers. The U.S. federal law currently has four major domestic regimes, among other domestic content restrictions, applying in specific contexts:

1. The Buy American Act of 1933. The Act establishes a price preference for domestic end products and construction materials. The provisions of the Federal Acquisition Regulation (FAR) implementing the Buy American Act establishes that when a domestic offer is not the low offer, a certain percentage of the low offer's price (inclusive of duty) has to be added to that offer before determining the best offer.
2. The Trade Agreement Act of 1979 permits the waiver of the Buy American Act and has resulted in "eligible products" from "designated countries" receiving equal consideration with domestic offers when certain federal agencies procure certain goods or services whose value exceeds certain monetary thresholds.
3. The Berry Amendment and its former "specialty metals" provision require that certain products purchased by the Department of Defense (DOD) be entirely grown, reprocessed, reused, or produced in the United States; and that any "specialty metals" contained therein and purchased by DOD be melted or produced in the United States.
4. The Buy America Act is the name commonly given to domestic content restrictions imposed on states, localities, and other non-federal entities as a condition of receiving specific grant funds administered by the Department of Transportation (DOT) and certain other federal agencies.

Please see Annex I for information on additional specific country guidelines.

23 Amended proposal for a Regulation of the European Parliament and of the Council on the access of third- country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries, Brussels 29.1.2016, COM (2016) 34 final.

24 See Congressional Research Service (RSR) Report R43354, Domestic Content Restrictions: The Buy American Act and Complementary Provisions of Federal Law, by Kate M. Manuel et al. Washington, D.C., 12 September 2016.

CHAPTER 3: HOW TO CONCLUDE AN OFFSET CONTRACT

3.1. OVERVIEW

This chapter takes a rather practical look at offsets and provides recommendations for the successful conclusion of an offset contract. Offset action obligations arising from the offset contract have to be carried out at the same time as the sales agreement.

An offset contract is initiated and controlled by the authorities in the purchasing country. It requires the seller to propose and implement offset projects to create offset credits.

These offset projects generate offset credits which must balance the offset obligations. With the exception of direct offsets, the time that elapses between notification of the offset amounts and approval of the amount of offset credits as well as the involvement of various external or internal entities such as profit centers (business unit, local unit, sector, or company), lead to complex situations which must be governed carefully.

The entanglement between economic and extra-economic development-related considerations leads offsets to contribute to the spread of corporate social responsibility (CSR): separate contracts are used to conduct an overall operation which exceeds the sum of its parts. Thus, the true economics of the contract actually lie outside the contract.

3.2. STEPS TO CONCLUDING AN OFFSET CONTRACT WITH YOUR CUSTOMER AND OFFSET ADMINISTRATION (IF ANY)

3.2.1. IDENTIFICATION OF OFFSET REQUIREMENTS IN THE BID SPECIFICATION

In some countries, offsets are clearly required in the bid specification but in other countries, offset requirements are scattered throughout the bid specification and the first step is to identify whether or not the Request for Quote (RFQ) includes an offset requirement. This will be done using the definitions set out in Chapter 1, above.

3.2.2. SEPARATION OF THE OFFSET REQUIREMENTS FROM THE MAIN CONTRACT REQUIREMENTS

If the RFQ does not include an offset requirement, ask your customer to create a special specification concerning offset.

> Recommendation: The main contract and offset contract are different and need to be treated separately.

The main contract

Government procurement contracts are awarded by government agencies, ministries, or state-owned companies (SOC) and involve infrastructure or high technology assets, goods or services via an international tendering process to a foreign company.

It is a bilateral contract: equipment or services against money.

The offset contract

Agreement between the foreign company and the national offset authority (rarely with the customer in charge of the main contract), which is always part of the government.

The offset contract sets the value of the offset obligation to be met by the foreign company in line with the proportions set in the applicable offset legislation. This value – a percentage of the main contract—corresponds to the amount of local added value to be created.

As mentioned in Chapter 1, this percentage can sometimes be reached by combining direct and indirect offsets to reach the total value of the obligation.

It is a unilateral contract: creation of added value against signature of the main contract. Advantages to having two different contracts are:

- compliance with the requirements of most credit-insurance agencies;
- greater flexibility in the performance of the contractual provisions, because goods and delivery dates are different;
- he possibility of transferring the offset obligations to a third party ensures that the main contract obligations can be kept confidential; and
- above all, the contracting parties may modulate, according to their respective interests, the relationships existing between the two sets of obligations (main and offset).

3.2.3. IDENTIFICATION OF THE KIND OF OFFSET REQUIRED BY THE COUNTRY

Depending the kind of offset required, the offset contract will differ.

The direct or semi-direct offset contract

This is an agreement signed, in execution of the offset agreement, between the main contractor and the local subcontractor, which will benefit from the offset obligations. The object of this agreement is directly related to the main contract.

> Recommendation: Decide carefully who will be responsible for fulfilling the direct or semi- direct offset obligations: yourself (main contractor involved) or the local subcontractor?

The interest of the purchasing country is always to have the main contractor responsible. The interest of the main contractor is always to have the local subcontractor responsible.

> Recommendation: Never forget that the performance of the main contract depends on the performance of the direct or semi-direct offset obligations.

The indirect offset contract

This is an agreement signed, also in execution of the offset agreement, between the main contractor and a local subcontractor or a non-governmental organization or with any kind of non-local company. The object of this contract is not related to the main agreement at all, but dedicated only to create local added value.

> Recommendation: Project and partner will be selected to bring a maximum of offset credits at the lowest cost.

3.2.4. MAIN CLAUSES TO INCLUDE IN AN OFFSET CONTRACT WITH YOUR CUSTOMER OR OFFSET ADMINISTRATION

The involvement of the state as a contracting party to an agreement always raises the possibility of unilateral change or premature termination by virtue of the state's sovereign legislative and judicial power.

Against this backdrop, lawyers have generally sought stability guarantees as protection from the unilateral exercises of state power to change the terms of the contract by legislation or administrative discretion.

Condition precedent clause

A term in a contract outlining an event that must happen before the contract can come into force. In the main agreement, the event will be the acceptance of the offset obligations requested or the signing of the offset agreement.

> Recommendation: Avoid the following clause in an offset contract:

"This agreement shall come into force on the date on which the related offset contract comes into force" and replace it with:

"This agreement shall come into force on the date on which the related government procurement comes into force".

Stabilization clause

The stabilization clause is a contractual provision developed in response to unilateral change or premature termination by virtue of the state's sovereign legislative and judicial power.

It attempts to insulate contracts from changes in the legal environment surrounding the contract.

> Recommendation: Include a stabilization clause in your offset contract.

Intangible clause

This stipulates that contracts will not be modified or abrogated except by the mutual consent of the contracting parties. It protects the private party from the executive power of the state.

This clause can be very effective against nationalization (a private company becoming public).

> Recommendation: Include in your offset contract the following clause: "This contract shall not be annulled, amended or modified in any respect, except by the mutual consent in writing of the parties hereto."

Economic stabilization clause

This stipulates that the host state will not enact any legislation or take any administrative measures which have the effect of aggravating the costs of the project.

> Recommendation: Include this clause in your offset contract.

Choice of law clause

This clause stipulates which law will govern any dispute arising under the contract.

There are three possibilities.

The chosen law may be (i) the national law of the host country, (ii) the law of another country, or (iii) the custom and practice of international trade, called lex mercatoria.

> Recommendation: In most cases, the national law of the host country regulates the offset contract. Be careful to understand the national law which is proposed in the local language.

3.2.5. THE KEY FEATURES TO CREATE LOCAL ECONOMIC ADDED VALUE (INDIRECT OFFSET)

The offset obligor has to respect the following rules to create local added value:

Causality

Within the framework of an offset contract, offset credit releasing the foreign exporter from part of its obligations can be obtained only if it is the consequence of direct action by the foreign exporter, e.g. assistance to a local company or entity in the form of purchases, investments, etc. in the purchasing country.

> Recommendation: Check the causality with the partner you will choose to solve your indirect offset before going ahead.

Prior agreement approval

This is essential in all countries - a planned purchase or some other offset option must be declared to the local authorities before it takes place.

> Recommendation: Never use an ongoing project to fulfill your obligation.

Level of Technology

The technology must be at least at the same level as the system that the counterparty sells to its customer.

> Recommendation: Don't hesitate to propose an equivalent technology or service connected to main contract (training for example).

Additionality of the economic benefit created

An offset project proposed by a foreign exporter must either generate an increase in the value of an existing project or constitute a new project.

> Recommendation: The project must be new or additional.

3.3. FOUR KEY POINTS TO MANAGE CUSTOMERS EFFECTIVELY IN AN OFFSETS ENVIRONMENT

1. Understand customer landscape and requirements
   - Your customer (offset authorities or main customer) have long-term relations with local industry, academia, end-users and government. You need to understand who is who and the kind of relations they have, as well as the culture of the country.
2. Establish a long-term relationship
   - Develop a long-term relationship through meetings and exchanges.
3. Deliver sustainability
   - Sustainability is fundamental, this is one of the most important factors for success.
4. Be open and transparent
   - An offset project needs to be fair and profitable for both parties.

3.4. HOW TO INCREASE THE LIKELIHOOD OF A QUICK APPROVAL FROM THE ADMINISTRATION

1. 1Clearly translate the objectives, benefits and deliverables of the offset project(s).
2. Understand the offsets management approval process and the different phases.
3. Identify the key officials and persons who are responsible for approval at the various stages and what level of responsibility and authority they have.
4. Build a rapport with the stakeholders to get their buy-in and approval regarding the importance and benefits of the project.
5. dentify the final decision-maker in the process.
6. Dissect the guidelines and ensure that all the criteria are fulfilled and if not, why and what can be done to mitigate the risk of not being able to fulfil the requirements.
7. Demonstrate proposed modification and corresponding economic value clearly.
8. Provide a technical evaluation of the proposed project.
9. Do not look for a win-lose solution.
10. Be flexible in your approach and provide room for amendment.

3.5. THE ROLES OF DIFFERENT STAKEHOLDERS

Strategic institutions can play key roles in supporting efficiency and enabling progress in the negotiations and execution of offsets.

The government agencies of a public party play an essential role at the beginning of the negotiations. Initially, the country policies regarding offsets and locally applicable framework and guidelines shall be properly disclosed to the interested parties. This allows private parties to understand the potential extent of their obligations, increasing potential commercial interest.

Well-defined policies can also help government agencies set out strategic plans for offsets to underpin the successful development of a state's technological and industrial base.

Likewise, creating an environment that celebrates and supports offset contracts may encourage national companies to engage in strategic offsets. Possible mechanisms include supporting national company parties with investment bank advice, as for example the British Offset Office supports companies in the United Kingdom with advisory services regarding offset issues.

Risks to the effectiveness of offset contracts may arise when the receiving country lacks proper know - how to absorb the technology granted as offset compensation (as mentioned on section 5.4).

To enhance the performance of the offset obligation, the providing party may want to develop local partnerships in the receiving country. As the offset compensation usually involves high-skilled jobs, local partnerships are particularly important when the public party is a developing country.

The expert interaction between the private party and local companies allows better internalization of the foreign compensation – for example, by training highly skilled human resources -- and also protects the supplier from fully transferring a technological advantage without further supervision or restriction of its use in country.

In this scenario, international and local trade associations may also play a key role by linking the stakeholders with proper partners. In some cases, the binding role performed by the trade associations may allow the private party to properly transfer a compensatory obligation to a third party, when the contract contemplates this provision.

Note also that policies governing the relationship between trade associations and government agencies can be beneficial to the local industries that will benefit from the compensation, such as technology transfer, improving the local economy and the development of the domestic industrial base.

Development banks may also play an important role by assisting interested parties in obtaining information about the public contractor and also providing financial guarantees to protect both parties against economic hazards once the agreement is signed. These institutions play a strategic role, especially in countries that might not have access to credit facilities, based on the country's history of indebtedness.

Most development banks grant access to economic research publications, statistics, and reports that can be useful for companies interested in investing in the offsets market. The combination of information and financial engagement allow these banks to support offset negotiations, consequently reducing indebtedness risks.

3.6. HOW TO MANAGE AN OFFSET OBLIGATION INTERNALLY

The following questions and answers should be asked inside the company before accepting an international contract that includes offset:

3.6.1. DO WE NEED TO OFFER AN OFFSET PROGRAM?

- Is my company inclined to accept an offset obligation?
- How is the competition handling countertrade?
- Will I remain competitive if I offer countertrade?
- Do I have the resources?
- Suppose I need some help - would I be able to get it?

3.6.2. DO WE USE BROKERS / ASSOCIATES IN THE COUNTRY?

- Know the country's decision-makers?
- Have a grasp of the political environment?
- Understand the cultural nuances?

- Familiar with the manufacturing community?
- Know the guidelines during program or project implementation?

3.6.3. WHAT ARE THE ADVANTAGES OF THE PROPOSED COUNTERTRADE LONG-TERM ECONOMIC GROWTH?

- International manufacturing partnerships?
- Increased competitiveness?
- Long-term effect on employment?
- Knock-on effect on country's economy?
- Stronger manufacturing base?
- Technological growth resulting from co-operation?
- Access to the world market?
- Industrial growth resulting from investment?
- Support for national priorities?

3.6.4. DO WE HAVE EXPERIENCE FROM PREVIOUS COUNTERTRADE PROGRAMS?

- Statement of experience?
- Number of programs successfully completed?
- Countries involved?
- Types of program developed?
- Participating suppliers and partners?

3.6.5. DO WE BID FOR DIRECT COUNTERTRADE?

- Co-production and manufacture under license?
- Training, technical assistance, qualification and certification process?
- Other opportunities for sub-contracting / procurement?
- Co-development / common design?
- Maintenance, repairs and servicing?

3.6.6. DO WE BID FOR INDIRECT OFFSETS?

- Joint ventures and strategic alliances?
- Investment and providing funding?
- Collaboration or technology transfer?
- Technical assistance or training?
- Purchases?
- Promoting exports?
- Research and development?
- Investment and collaboration in education?
- Studies and surveys?
- Third-party projects?

3.6.7. HAVE WE IDENTIFIED ALL POSSIBLE LARGE-SCALE PROJECTS?

- Projects that could cover all or most types of countertrade?
- Projects that the customer sees as priority?
- Projects that address priorities or national objectives?
- Creating a manufacturing unit in the country?
- Developing a design system jointly?
- Producing and installing components in the country?

- Investing in a national energy program?
- Providing electricity infrastructure?
- Investing in a significant joint venture?

CHAPTER 4: PLANNING FOR LEGAL RISKS

4.1. OVERVIEW

Whilst making offset agreements can bring about tremendous specific advantages, the contract manager will need to be aware of certain legal risks which could bring down not only the beneficial arrangement but also cause financial, reputational and socio-political harm to the company. Chapter 4 offers some pointers as to the attendant risks and measures you can take to ameliorate and better manage those risks. Other than this guide, which focuses on offsets, you may also wish to have reference to ISO 31000: Risk management - Principles and Guidelines, IEC/FDIS 31010 Risk Management–Risk Assessment Techniques and other national standards and guidelines more generally.

This guide will largely concentrate on common legal risks in offsets and the ways to control them. It does not purport to advise you on how to carry out a risk assessment or how to identify risks specific to your business and economic interests. It should also be noted that risk management techniques are a controversial subject – there are no right answers. This guide merely offers up some suggested techniques as they relate to legal risks.

4.2. THE RISKS AND MANAGING THEM

Indeed, a regulatory risk is actually the failure to establish and implement a risk management plan when engaging in offsets. That may be required of companies seeking a licence to operate in particular sectors – for example, in defence and security, transport, energy etc.

Risk management planning is not without controversy. It is not proposed to set out a checklist here. A sound risk management should be principles-led. There are also debates as to whether risk management should be integrated into the organisation's processes and systems – on the contrary there are proponents for a risk listing approach, namely, that the risk manager suggests methods for particular steps in particular processes.

There are four types of legal risks, generally.

4.2.1. REGULATORY RISKS

In Chapter 2, we have seen how different countries have different legal and regulatory provisions for the conduct of offset. The risk of breaching regulatory and administrative offences and requirements can be quite considerable. Penalties, of course, vary from country to country but they can range from small fines to imprisonment and asset confiscation. There are certain regulatory risks to bear in mind:

Prohibitions and corporate compliance

It is well known that the EU has banned offsets, whether direct or indirect, save for a narrow exception in security and defence. The U.S. too has largely taken an anti-offset position. Although that has not stopped EU or U.S. companies from engaging in offset transactions, it does not mean that there is no risk of participating in a "banned" activity. It is thus important to ask the questions:

- Does the applicable law prohibit me from entering into an offset agreement with the individuals concerned?
- Is there a ban on offsets in the type of sector?
- Is the ban applicable to me? Do I or my organisation come within the remit of that country's prohibitions?
- Is the structure of my offset agreement the type of arrangement banned?
- How clear are the applicable rules? If they are not, is good local legal advice available?

It is important to remember that because offsets are not structured along conventional monetary terms, they can create compliance challenges for the corporation when it comes to statutory financial reporting and audits. From a reporting standpoint, it is necessary to have sufficient clarity as to what aspects (e.g. any standby letters of credit, performance bonds, guarantees, etc.) of the offset should be provided for in accounting statements. Membership of reputable offset industry organizations such as ECCO can help discover the best industry practices to aid making accurate and realistic cost projections so as to avoid overruns, non-performance and loss.

Likewise, there is also the risk of complying with the applicable competition law regime in the market. The nature of offsets may give rise to a situation of dominance for the party in the market. That party must thus be careful not to abuse that dominance if it indeed does exist.

The lack of explicit information in some offsets may also give rise to suspicions concerning money laundering and/or terrorist financing activities. Again, a reputable offset trader would ensure that there is proper transparency and awareness of these risks in the corporation and that applicable money laundering and terrorist financing regulations are fully complied with.

Bribery and corruption

The subject of bribery and corruption is high on the agenda of ICC and ECCO. Suffice it to say that different countries have different rules relating to the definition and scope of bribery/corruption.

Indirect offsets are clearly more likely to attract an increased risk of corruption. Organizations have less control of the process in indirect offsets, which in turn can create gaps where opportunities for corruption can creep through. Indirect offsets, more so than direct offsets, may require the involvement of third parties to perform the agreement who do not come within the domain of control of the organizations in question. The reliance on local consultants who may have too proximate a relationship with government officials in offsets more generally can also present challenges for managing the risk of corruption.

An important facet to the risk planning exercise is to take seriously the “red flags”. One way of considering the red flags might be by asking these questions:

- Does the offset delivery requirement exceed 100% of the supply contract value? Can that weighting be justified?
- Do the prescribed offset valuation mechanisms give you confidence? Are they clear and explicit and consistent with good valuation techniques in the sector?
- What is the corruption profile of the country, region or organisations? What do specialist indices such as those produced by Transparency International say about the country or area in question?
- What corruption legislation is in place in the country/area in question?
- What is the attitude of your counterparty to bribery and corruption? Will they agree to an anti-corruption clause?
- Is your counterparty prepared to let you have audit access to their records and accounts?
- Are you content with their books and recordkeeping procedures?
- Do they have special accreditations such as Authorised Economic Operator status issued by customs authorities?
- Are they part of an unclear corporate network where you cannot easily work out who the beneficial owners, directors, financers etc. are?
- Do they use shell companies, trusts, company service providers etc?
- Do they use offshore facilities or are they proposing to use offshore facilities for the purposes of their agreement with you?
- Do they have sufficient experience in the sector and/or agreement in question? Do they have a good track record in offset and countertrade transactions?
- Is there pressure or suggestion from the government or authorities to use selected individuals or agencies? Are they suggesting or requiring you to use the services of a third party, just before the contract is awarded or soon after the contract had been awarded?
- Do the third parties involved, especially in the indirect offset, have significant relationships with government officials? Is there media reports suggesting impropriety?
- Are they asking for questionable fees or payments for questionable services provided by third parties?

- Are they suggesting that payments and currency transactions be made to multiple and different accounts held by different individuals or in different jurisdictions?
- During negotiations or soon after award, are they suggesting the addition of additional participants?

Some of these red flags are also applicable to reducing the risks of being ensnared in money laundering and/or terrorist financing activities.

Lack of authority

Most legal systems would only enforce contracts against the organisation if the individuals making the contract on their behalf have the proper authority to do so. Although many countries' laws would also enforce contracts against an organisation if the person making the contract purportedly on their behalf had apparent or ostensible authority to do so, proving apparent authority is often challenging. The individual concerned may no longer be traceable, for instance. Moreover, a tribunal will require evidence of what was communicated or represented by the organisation in question.

In offsets, as the agreement often involves large values and equally large organisations, it may be thought that the risk of a lack of authority might be less present. However, the issue of lack of authority can sometimes be quite nuanced and murky. For example, when a CEO of a company acts outside his or her powers as an officer of the company by paying a bribe for the contract, or when a government official exceeds his or her power in signing the offset agreement, or when the director of a sovereign wealth fund seeks to bind their government to an offset deal, or when only one director out of several directors has signed the agreement, questions of authority would arise. Issues of foreign law could also arise – for example, under the law applicable to X, the individual concerned may have no authority to bind X, but under the applicable law of the offset agreement, that same individual does have the authority to bind X.

It is always prudent to have authority properly confirmed in the course of negotiations. It is also important to note that not all legal representatives are legally competent to make contracts for their principals.

Another matter for checking is the name/s of the contracting parties – failure to use the legal name of the company in making the contract may be relied on subsequently in a dispute that the person making the contract was not actually doing so on behalf of the company, but in their personal capacity.

The same principles apply to authorisations – many developing countries are especially bureaucratic and failure to obtain the relevant authorisations could cause a huge stumbling block. In the case of indirect offset, those authorisations would extend to the collateral investment contract in the local industry. Unfortunately, the risks of bribery or "coffee money" are increased if authorisations, however minor, have not been properly obtained, given the pressure to preserve the commercial deal.

Export-import controls

There are often strict laws about the import and export of goods conventionally the subject of an offset agreement (such as weapons, defence technology etc.). Those restrictions may apply to final export/import, temporary movement, transit, inward processing, outward processing and even storage. There may also be restrictions on the technical data, information or specification related to those goods or articles.

Understanding the export-import regulatory environment is thus vitally important to the successful execution of the offset.

Seeking appropriate licensing well in advance can help. Continuous positive engagement with government and customs authorities not only helps lubricate the process, but improves the reputation and moral hazard of the company in question in the eyes of the authorities, making it less difficult in future transactions. Where appropriate and applicable, securing accreditation as an authorised economic operator (AEO) can offer the organisation the benefit of simplified customs procedures.

It would also be commercially prudent to factor in the administrative costs involved including those of using brokers and agents to help with the movement of goods. Contract management should ensure is necessary to build sufficient cushion into the time for delivery, given that the movement of controlled goods and articles is subject to more intrusive controls and may take longer than expected. A renegotiation clause in the event of delays would also be useful if no contractual allowance or contingency has been made for delays and extra official fees.

Quantitative restrictions may also be suddenly and unexpectedly imposed on the goods – such as quota restrictions, embargoes and limits on the values to be imported. It goes without saying that maintaining a clear line of communication with the counterparty (importer) and the importing country's authorities is needful. Other risk amelioration measures can include export insurance, performance bonds, sureties, deferred performance agreements, renegotiation clauses, etc.

4.2.2. CONTRACT AND OPERATIONAL RISKS

Multiplicity of contracts

Offsets necessarily involve a multiplicity of contractual relationships – that is more acutely so in the case of indirect offsets. In a conventional international sale, there is usually one sale contract. In offsets, there are typically two contracts at the least. One is the sale contract and the other, the local "investment" agreement. The problem in one contract may well have an impact on the other. The risk of failure thus increases. Also, although some suppliers would probably not be too concerned about the local investment contract (the offset obligation) (since that is often perceived as a necessary evil or part of the quid pro quo for the main deal), the failure of the local investment contract can cause significant reputation harm to the supplier and more generally to the public perception of offset. Also, the challenges involved in performing the offset can put the main contract itself at risk. Indeed, many countries do not have the appropriate human and economic resources, legal institutions and physical assets to enable the successful performance of the offset obligation locally. Finding a competent and reliable local partner is key.

Performance and Price Issues

Performance risk, of course, cuts both ways. Buyers and the recipient country are likely to impose penalty or liquidated damages clauses on suppliers who fail to meet their offset obligations.

Suppliers, on the other hand, may not see the full value of what they were promised or serious breaches of their intellectual property rights. The lack of transparency which sometimes bedevils the offset industry can make it difficult to prove in court what was promised.

Naturally, the trader would be concerned about prompt payment for the main contract. Similar concerns may be raised about the timing of other obligations in the contract. Performance guarantees and letters of credit can go some way to reducing the risk of non-payment or late payment. As to the performance of the offset obligation, it is sometimes useful to incorporate a mutual cooperation clause in the contract. Moreover, it usually is helpful to provide for specific contingencies such as unforeseeable events, disagreements as to performance, and notices and communications. As to the last element, traders should not under-emphasise the important role played by a prescribed notice.

An appropriate notice helps prevent disputes and enables the performing party to take the necessary actions on its part to ensure that the contract is properly discharged.

Pricing and valuation are two sides of the same coin in offsets. The trader would be aware that there is no true "market value or price" given the bespoke nature of the offset arrangement. As regards indirect offsets, they indeed have little relation to the product/s being purchased and can include value-add in any other industry or high-technology field. Indirect offset projects may take the form of investments, transfer of technology, licencing, export assistance, etc. It is not easy to establish a clear and direct equivalence between what is being sold and what constitutes "payment". The substance of the contract must go beyond what is acceptable to the parties, at a generic level. There must be properly recognised standards for measuring comparability and equivalence in value taking into consideration the time of performance. For example, at the time the offset obligation is to be performed, the cost and physical environment may have changed considerably. It should be a matter, of course, that clauses in the offset agreements be introduced to make explicit how valuation is to be constructed. Reference to industry standards can help with fleshing out those clauses.

Ability to pay or creditworthiness can be an issue, especially where in some instances of offsets, conventional credit analysis cannot be easily performed on the counterparty and/or relevant third parties. Using a trusted payment tool such as a letter of credit or performance guarantee can help manage this risk better. However, the value of the letter of credit or performance guarantee is only as good as the standing of the issuer – in some cases, the issuer may simply be another government agency or institution. Where that is the case, offset traders should be careful, since sovereignty immunity defences may be used. Understanding how the applicable law to the offset relationship/s deals with sovereignty immunity and related issues would be useful.

Impossibility and Unforeseeable Events

The offset contract, as are commercial contracts, is subject to unexpected changes in circumstances which may render performance hugely more difficult and even, impossible. A clause in the contract drafted sufficiently clearly and capaciously can assist in resolving where the risks should fall in the event of impossibility or hardship. These so-called force majeure (and/or hardship) clauses may also provide for any extension to the contract, a revaluation of the relevant costs, a process of renegotiation, or indeed, any other appropriate measure to preserve parts of the contractual relationship. Often there is also a requirement in the clause in question calling for some third party determination as to whether a particular event or incident is sufficiently serious to warrant the triggering of the clause. In the case of offsets, it should be noted that governmental or administrative interventions are not as a matter of course treated as "force majeure". So, if the counterparty failed to obtain the relevant licensing or approvals for the project, that does not count as an event which could bring an end of the contract by law. As to whether such an event falls within the ambit of the hardship

or force majeure clause, that depends largely on the drafting of the clause and the relevant applicable law of the contract. Choosing a sound applicable law to govern your contract is thus crucial.

It is of course also prudent to consider commercial insurance or export credit guarantees and export insurance in this regard, bearing in mind though that in the offset industry insurance may need to be tailor-made to suit your unique trading relationship and may be difficult to secure.

Security risks

Most offset agreements will largely be performed by means of electronic communications, as with most modern commercial transactions. Chain obligations, digitisation and electronic communications help facilitate fast and safe transactions. However, cybersecurity risks have emerged in recent times as a significant harm to successful business transactions. Offsets are no different given the involvement of multiple computer networks – from the supplier's systems to the buyer's systems and the multiplicity of government agencies' systems. The risk of a cyberattack cannot be downplayed – having strong encrypted systems, software and hardware protection, virus and data security systems and properly trained personnel will help better control this risk.

4.2.3. LITIGATION RISKS

Litigation, whether it takes place in a foreign country or the trader's home country, is likely to be costly and inconvenient. Litigation also can potentially have a damaging effect on the corporation's reputation as well as public and investor relations.

Arbitration may be an efficient and economical way of resolving disputes, though arbitration can at times be as costly and damaging to the corporate reputation as litigation. It is important to note that in transnational litigation and arbitration, action instituted in one country may well lead to action in another, thereby increasing the cost and negative exposure of the company.

Some offset traders would carry out a continuous litigation risk assessment over the course of the offset project. They see it as appropriate to schedule regular legal team meetings to discuss the risk areas and to measure the risk accordingly. A risks log with an action plan may be used for that purposes.

It is also useful to keep the public relations team in the loop and a PR response plan should be in place for easy despatch. It is platitudinous to suggest that a proper record keeping system needs to be in place for every offset project.

Monitoring movements of corporate assets for the purposes of satisfaction of the debt (and, indeed, tribunal award) may also be necessary, especially, in large offset transactions. Having good and reliable professionals at hand will help locate any assets hidden away by the defendant to avoid payment.

4.2.4. STRUCTURAL RISKS

These risks relate to unforeseeable changes to the macro level environment – these could be physical or geographical changes (such as an earthquake, hurricane etc.), or socio-political changes (such as a radical change in government and thus government policy which may lead to seizure of assets etc.), or economic changes (such as a financial crisis, depression etc.) or corporate changes (such as a takeover, merger, insolvency etc.). These risks are clearly difficult to control or prevent given their magnitude.

A useful method for risk planning is to carry out scenario testing – that entails using available data and examples and case studies to map the impact of alternative economic, political or physical events on the offset relationship. Some companies also rely on strategic forecasting to undertake scenario testing.

Another method of diffusing the problem is to provide for staggered performance of the offset contract, especially it is a long-term arrangement. Performance by installment of course does not work for all offsets – however, where appropriate, it could help to reduce the risk of losing all of the investment in one go.

Diversification is sometimes said to be a means of controlling political risks – in the case of indirect offsets, the trader may choose to invest in different sectors in the buyer's country to avoid structural risks having an impact on one particular sector. For example, if the investment is solely made in the cotton industry in the buyer's country, any structural disruption to the local cotton industry will have a highly negative impact on the trader.

Of course, it must go without saying that appropriate insurance cover will be able to ensure that the risk of loss is spread to the underwriters and their reinsurers. For offsets, the availability of appropriate insurance cover may at times be challenging given that often there is a lack of transparency and information in the nature of the offset relationship and insurance providers are loath to take on such risks without full and open disclosure of information.

CHAPTER 5: DISPUTE PREVENTION AND MANAGING THE CONTRACTUAL RELATIONSHIP

5.1. GOOD FAITH DURING DUE DILIGENCE PHASE

The due diligence phase is essential for a negotiation built on a solid and realistic foundation. In this regard, the chances of success of an offset contract increases in proportion to the solidity of the studies carried out during this phase.

Due to its importance, the duty of good faith, which is an implicit duty, requires the parties' careful attention from the beginning of the pre-contractual phase.

Unfortunately, offset contracts have been linked to fraud and corruption: One party offers goods to a specific agent with the goal of obtaining more favorable terms in a negotiation than its competitors. It could be imagined that offsets might start to influence a decision on a particular acquisition rather than the quality of the main product or service offered.

Corruption is not only limited to the main parties of the contract, but may also occur through offset brokers and intermediaries, who offer benefits to officials to secure improper advantage for a main supplier company, or to create demand for offsets in defence contracting. This practice must be avoided at all costs, since much of the resistance of some countries to this type of contract comes from this risk of bribery or corruption. Moreover, several international organizations have carried out studies on this subject.[25]

It is important for private parties to establish solid due diligence procedures in order to identify signs of corruption ("red flags") and to act appropriately if encountering them, including:

- history of corruption in the territory or inadequate control mechanisms;
- adviser with lack of experience in the sector and/or territory, no residence in the territory or no significant business presence in the territory;
- payments made to accounts/persons not connected to the contract; and
- use of holding companies or blind trusts without reasonable commercial justification.

With the aim of identifying and investigating these red flags, it is recommended that the private party assign a department distinct from the one who is conducting the negotiations (from the commercial point of view), for the performance of the due diligence, or even hire an independent law firm or an investigative company. The private party could also consider being assisted by on-the-ground investigators to explore the red flags, during the due diligence phase.

It is recommended that the private party establish procedures to answer questions such as:

- What is the reputation of the people involved?
- Who has authority in decisions on the main and offset contracts?
- Is there a recognizable network of relevant people who are connected with each other?
- How does the money flow throughout the offset deal?

Moreover, it is important that subcontractors and intermediaries have a contractual obligation to disclose all information in the context of the offset, especially any that may involve corruption.

At this point, industry associations also have an important role to play, to assist and guide their members in appropriate practices in offset due diligence, and to encourage governments to increase transparency. For example, they might consider providing a checklist that government officials could use, specifying transparency, reporting and audit requirements.

ICC is a pioneer in building companies' capacity to assume their anti-corruption, integrity and compliance obligations when conducting business transactions. Only in a transparent and corruption-free system can companies compete on a level playing field. ICC issued its ICC Rules on Combating

25 Highlighting the Defense and Security Programme of the Transparency International UK, who has made the one named "Due diligence and corruption risk in defence industry offset programmes". Available in: <http://ti- defence.org/wp-content/uploads/2016/03/2012-02_DueDiligenceAndCorruptionRiskInOffsets.pdf>. Accessed in: 13/10/2017.

Corruption[1] in 1977 to help companies comply with the U.S. Foreign Corrupt Practices Act, and since then ICC has developed a full-fledged suite of tools to support companies – in particular SMEs - in doing business with transparency and integrity. ICC's tools, used by companies worldwide, include RESIST, ICC Anti-corruption Third Party Due Diligence for SMEs[2] and ICC's just-released ICC Guidelines on Conflicts of Interest[3], a key issue for business and governments alike.

In addition to the issue of corruption, much discussed in the matter of offset contracts, is the due diligence phase during which it is also extremely important to prepare the parties to assume the responsibilities that will be established in the contract.

At this point, it is important to carry out a thorough and accurate evaluation of the project.

Due to the duty of good faith, the parties may not omit any aspect that is relevant in this assessment. The government cannot fail to provide the required information and the private party, in turn, cannot omit any economic or operational issues that might impact the implementation of the offset contracts.

Consequently, is essential that the parties observe the duty of good faith during the due diligence phase, providing the necessary information and establishing a clear procedure to identify possible issues and correct them.

5.2. DECIDING ON THE MOST APPROPRIATE PROJECT DELIVERY METHOD

A project delivery method is a system used by the contractor – or the owner – for organizing and financing design, construction, operations, and maintenance of services for a structure or facility by entering into legal agreements with one or more entities or parties.

The spectrum of project delivery methods varies from those where the owners keep full control to where they have minimal involvement, relying on a turnkey contractor to coordinate all aspects of the project.

There is not a right or a wrong method, but an appropriate choice will drive project cost, quality, long-term maintenance and project completion date. The most typical methods are:

a. Traditional Model (Design-Bid-Build - DBB)

The oldest of all, the traditional method, assumes that the buyer develops all the specifications of the project in detail and then hires the other party to simply run the finished and delimited project. Generally, there is no room for negotiation on contracting conditions and the contractor receives payments based on the progress of project execution. The major problem arising under this model is that often the buyer develops a project with errors, which are identified only later by the party that will perform the project. As there is no room for negotiation, these problems only appear during the execution of the project, which tends to lead parties to conflict or, at a minimum, increases the costs because of the changes that may be necessary.

b. Collaborative Model (Design-and-Build)

In collaborative models, there is room for communication between the parties, so that some risks of offset contract execution may be avoided or, at least, minimally shared, which favours the spirit of partnership rather than litigation. Perhaps the most well-known collaborative project delivery approach, the Design-and-Build, involves a design consultant joining forces with the main contractor.

c. ntegrative Model (Integrated Project Delivery)

The integrative model is an approach with more risk-sharing features. Under this method, owner, design consultant and contractor work as a team from the beginning of the project in order to develop, define, and deliver it. It attempts to exploit the most valuable skills of each party at every step of project planning. This method is well indicated because the features of the offset contracts can be precisely defined, as far as the spirit of partnership between the parties prevails, avoiding disputes.

d. Partnership Model, i. e. Public-Private Partnership

The partnership model goes beyond the integrative one and transfers to the contractor the design, construction and operation as well as the financing and the risks of the project. Later, the contractor is responsible for the operation and maintenance in a long, fixed, term. Remuneration may take place through user charges or flat payments subject to reduction in the case of poor performance.

The choice of project delivery method is not simple and should aim to satisfy the parties' interest in undertaking a suitable and qualified project that can be executed in the predicted conditions, while fostering a collaborative spirit between the parties.

Offset contracts are often complex, involving multiple sectors, so it becomes even more important to establish a reliable channel for dialogue between the parties to predict and negotiate potential future disputes, as well as to determine a realistic allocation of risks.

5.3. REALISTIC RISK ALLOCATION

Offset contracts may be subject to unforeseen, unusual and excessively onerous conditions, which could harm the performance of the contract. In order to prevent potential disputes, it is very important that the parties carry out a realistic risk allocation, before signing the offset contract.

An efficient risk allocation method is one of the keys to deliver great value for money (VFM) to the offset project. The parties should bear in mind that it is extremely important to establish communication during the negotiation phase to predict the potential risks that may arise for both parties.

Considering the general features of offset contracts, it is possible to list some key risks that should be allocated between the parties:

a. Completion risk

Risk of the project cost of completion increasing as compared to that anticipated at the contract closing. This risk may also involve liability for liquidated damages for late completion (defining "completion" is clearly important).

b. Revenue risk

The offset project is unlikely to generate revenue by itself. The performance of the main contract is essential for the profitability of the offset. The risk of revenue is certainly a factor that must be taken into account, as this is not a primary objective of the offset contract.

c. Force majeure and change of law

It is necessary to define force majeure and change of law provisions, specifying who will bear possible damages. Parties may wish to consider using the "ICC Force Majeure Clause 2003"[26], which is intended to apply to any contract which incorporates it either expressly or by reference.

d. Environmental risk

Environmental and social laws and regulations may impose liabilities and constraints on an offset project. The costs related to this issue may be high, so it should be allocated contractually between parties.

e. Currency exchange risk

Offset projects are often sourced from foreign companies, in foreign currencies, notwithstanding the revenues (from the main agreement) usually denominated in local currency. Where the exchange rate between the currency of revenue and the currency of debt diverge, the cost of the project can increase. Thus, it is important to establish whether or not the revenue will be adjusted to compensate for any relevant change in exchange rate or devaluation.

26 See International Chamber of Commerce. ICC Force Majeure Clause 2003/ICC Hardship Clause 2003. Feb. 2003. Available at: <https://iccwbo.org/publication/icc-force-majeure-clause-2003icc-hardship-clause-2003>. Accessed: 9/10/2018.

Regardless of the key risks listed above, it is relevant to define a risk allocation method for all the other non-listed possibilities. The concept of risk allocation in most major government procurement contracts is based on the premise that risks should be allocated to the party best able to manage them. This principle contributes to improving the efficiency of the risk allocation, reduces costs of the project and increases VFM. Allocating all the risks to the private sector sometimes seems easier, but comes at a price. Therefore, transferring risks that the public party is more capable to manage will certainly reduce the VFM.

Some questions should be considered to maximize VFM in risk allocation:[27]

- Which party is best able to control or manage the occurrence of the risk?
- Which party is best able to control or manage the impact of the risk?
- For a particular risk, which party has a greater incentive to develop risk mitigation strategies, either to control the occurrence of the risk or its impact?
- For risks that are typically allocated to the public party, might there be innovative opportunities to reduce the costs of the project by allocating (even if only partially) the risk to the private party?
- What would be the best risk allocation to reduce the total cost of the project?
- Which risk allocation incentivizes preventative risk management, as opposed to reactive risk management?

On the one hand, the buyer must carry out serious studies to identify its real demands and goals. At this point, it is fundamental that the purchasing government has the ability to enable the realization of the offset contracts.

For example, it would be pointless to establish an obligation for the exporter to transfer technology in a given sector where the country lacks and is unable to produce in the short term a qualified labour force to absorb it. Thus, it is much better when the offset is used for sectors where there is already some degree of development that is intended to be improved, reducing the difference in the level of expertise between the national context and the context of the private parties' country. It is essential that the products, services and/or technologies received manifest real benefits for the local economy.

Aug. 2015. International Institute for Sustainable Development.

In any case, the parties should establish the offset's features and conditions, including the type of offset that will be adopted (direct, semi-direct or indirect), the modality, the object and the deadlines. After precisely establishing such conditions, the careful preparation of the contractual instruments becomes essential for the correct allocation of risks.

In Chapter 3, important issues related to the contractual instruments were covered, as well as the question of the link between an offset contract and the main contract. The impact of the obligations arising from the offset in the main contract should be precisely established.

From the point of view of the private party, it is advantageous to establish that the fulfilment of the main contract's obligations is a condition for compensatory obligations' enforcement. Thus, if the main contract is terminated, the offset obligations cease to exist. Similarly, for the private party it is not advantageous to establish that the obligations of the main contract are affected by problems in the execution of the offset contract.

From the public party's point of view, it is advantageous to establish that the main contract is not effective until the compensation agreement has been concluded. In this way, it is important that the parties establish a dialogue to reach a consensus in the negotiation phase, which will certainly avoid future disputes.

In this regard, the offset contract should clearly set out how non-fulfilment of any of its obligations could interfere with the main contract. In the same way, it is recommended that the main contract establish whether and how its non-performance may lead to the suspension of the offset contract.

27 HOVY, Pauline. Risk Allocation in Public-Private Partnerships: maximizing value for money. Discussion Paper.

The main and offset contracts, while separate instruments, will often be economically connected and should not be treated as isolated from one another, to avoid the risk of unrealistic risk allocation and related litigation.

In conclusion, it is extremely important that the negotiations lead to a realistic risk allocation, as it is essential that the risks are effectively foreseen and expressly shared, to avoid future disputes. It is important that the parties consider each other as partners and allies, and avoid negotiations on the basis of a "win-lose", insofar as trust-based and loyalty-based behaviours tend to establish long-term relationships which can bring benefits to both parties.

When the parties take the duties of good faith, loyalty and trust seriously, the relationship between them becomes "win-win". The buyer, observing such duties, inspires in the other party a real desire to fulfil its obligations satisfactorily. The private party, in turn, by compromising in this way, increases its chances of a long-term relationship.

5.4. INCENTIVES TO ENCOURAGE COOPERATION (TAKING INTO ACCOUNT CULTURAL ISSUES)

Given that offset contracts intensify the relationship between the parties, insofar as they go beyond what is set out in the procurement contract, it is important that both parties consider the possibility of establishing incentives to encourage cooperation.

The incentives to be offered by a party relate to the type of transaction. The main types of transactions are co-production, credit assistance, licensed production, subcontracting, technology transfer, and training. The incentives will depend in part on the legislation and culture of each country.

As offsets are very complex and detailed transactions, incentives related to the time that a party takes to perform its obligations under the offset agreement can be effective. For example, if the time period for the execution of an offset is five years, and there is a time sheet stating that in the first year 25% of the obligation is to be delivered, a bonus may be appropriate if the 25% target is met. Such a mechanism may also imply penalties for non-performance of the 25% target.

Tax benefits are also very important when choosing the foreign country to which to offer the offset. If the taxes are too high in a certain country, it can be very expensive for a party to sub-contract, or to provide training and invest in the obligation, and thus, the country becomes less attractive for offset proposals.

Another example of an incentive is the increase of the FDI threshold for investment in local companies. This type of incentive is particularly important in the types of transactions that involve the requirement of local production of part of the products. The foreign manufacturer will be much more willing to share information and resources with companies with which they have signed commercial agreements. Note though that in many countries, there are serious restrictions on FDI, which may ultimately inhibit foreign cooperation.

Appropriate incentives tailored to the relevant country bring benefits to all parties.

On the one hand, the company is genuinely encouraged to collaborate effectively in the implementation of offset contracts, as the fulfilment of the obligations agreed upon will bring it additional benefits.

On the other hand, effective cooperation on the part of the company causes the local economy to develop in one way or another, which will consequently guarantee economic and even political benefits to the government.

5.5. PARTNERING AND ALLIANCING

Because of their complexity and high value-added projects, offset contracts must be planned to create a harmonious environment between the parties. The establishment of a partnership between the contracting parties will have several benefits, such as:

- prompt development of products and/or services;
- specialized assessment of technology and subsequent impact on the market;
- optimization of the business model of the enterprise;
- establishment of cooperation with companies with expertise, which, in turn, reduces transaction costs; and
- greater openness to funding entities and specialists in this type of contracting.

Nevertheless, the establishment of a long-term partnership with a company or institution that is later disengaged from the project exposes the innocent party to serious risks, primarily the disengaged company's lack of compliance with its obligations, potentially causing irreparable damage to the remaining party.

A third contract (besides the main and the offset), as mentioned in section 5.3, whose purpose is to regulate the commitment of the parties to the maintenance of a good working relationship between them, may be a good way to ensure the long-term relationship. However, it is possible that the offset contract itself will contain either general provisions or specific provisions that will expressly provide for the parties' obligations concerning the relationship.

In other words, the contract must be designed in such a way as not only to be a legal shield, made to protect the parties against possible opportunistic conduct by the opposing party, but also as a contract focused on maximizing the benefits of the project. Here it is important to remember that the success of the enterprise in dynamic outsourcing such as offsets depends on both: (i) what was agreed upon by the parties, and (ii) how the parties will behave during the execution of the contract.

One way to ensure effective alliance formation is to alter the parties' view of the offset contract as a mere bundle of obligations to a business opportunity. In this context, it is necessary to encourage the

interest of the parties by predicting benefits and bonuses in case the object of the offset brings results beyond those expected.

As an example, where the object of the offset contract is the implementation and operation of a technological centre for the development of a certain product, and technological innovation is achieved as a result, the benefits from it should also transfer to the companies that built the centre. Thus, the companies involved will have the incentive to encourage the offset goal to effectively fulfil its role. If the offset is contemplated as a simple obligation, the parties will be satisfied with the delivery of the project.

Another way to establish a good relationship between the parties and to encourage efficiency gains is by entering into an alliance agreement with open-book accounting, sharing all uninsurable risks and establishing an initial target cost for all involved, which would be compared to the final cost and the excesses divided between the contractors.

5.6. STEP NEGOTIATIONS AS A MEANS TO RESOLVING POTENTIAL ISSUES

An often disregarded issue linked to the design of a precise, objective and well-defined contract, is the establishment of step negotiations for the negotiation rounds, following a precise calendar.

Many disputes and issues that arise during the execution of a contract are due to the lack of communication between the parties at the time of the contract formulation. If the parties negotiate the terms of the execution of the object during the pre-contractual phase, experience shows that questions about the interpretation of the clauses are resolved even before any dispute arises.

Thus, where a problem arises concerning a specific clause, even if the technical representatives responsible for the execution of the contract cannot achieve consensus, it is possible to engage the parties' major representatives to discuss the issues. Therefore, it is important to provide the senior executives with the information they need to complete the negotiations, as their participation will not be productive unless they understand the particularities of the project.

Provided with the necessary information, it is likely that senior executives will decide and negotiate in a more practical way, since they are outside the context of possible personal conflicts inherent to the daily basis of the implementation of the other contractual arrangements.

There is also the possibility for the parties to establish a project council, which will be explained further in Section 5.8.

Establishing step negotiations can be very helpful in designing the optimal contract. In order to do so, four steps should be followed.

The first one concerns the establishment of a negotiation plan by each of the parties, including the strategies of each, their position and their aims in signing the contract. This will help to distinguish between what is a fundamental objective and what is a secondary aim.

The second step is to conduct the negotiations in order to seek, at all times, the implementation of the negotiation plan.

Thirdly, the parties should always seek to adjust their negotiation strategies to achieve the desired ends. If a strategy originally formulated is unfruitful, it is necessary to seek new strategies.

Finally, negotiations must be documented in all its terms. The discussion and interpretation of the negotiations is extremely important for the purpose of resolving a dispute arising during the performance of the contract. The written document is of assistance at this stage, and the parties must have easy access to it, in order to know what interpretation was given and to avoid opportunistic practices by either party.

In summary, negotiations when drafting the offset contract are as important as the actual implementation. Both the establishment of a work plan for the execution of the offset contract and the establishment of a schedule to the pre-contractual phase are very important to help avoid problems of interpretation of the contract.

5.7. INFORMATION SHARING AND TRANSPARENCY

5.7.1. INFORMATION SHARING

Information sharing between the parties is very important to the success of the project, helping to establish realistic expectations of goals and objectives, and thus encouraging commitment between the parties, increasing the chance of success of the project.

For example, the private party has the duty to inform the government about all costs likely to be caused by the inclusion of new obligations in the offset contract and, in turn, the public party should report on any preliminary studies about the object of the offset.

Other important subjects to share include best practices in anti-corruption measures, due diligence with third parties, sharing of know-how and training of employees, as well as demographic, geographic and other factors that may influence the construction / delivery of the project.

The asymmetry of information that is present at the initial stages of the process must, eventually, cease to exist. The more openly the parties discuss their problems, concerns and needs, the greater the opportunities for cooperation, problem solving, and success in the venture for both parties.

5.7.2. TRANSPARENCY

The offset agreement shall be designed in the most transparent way for the contracting parties, and other players involved, such as subcontractors and investors. To this end, the contract should be drafted, and all legal procedures satisfied, in such a way as to remove any doubts regarding the integrity of the operation.

The complexity of offset contracts can give the impression of a lack of transparency. It will be up to the parties involved to demystify the process, promoting an environment of transparency and integrity in which the parties will assume their contractual obligations.

In addition, transparent practices contribute to good corporate governance, development of public accountability, and a robust response to any questions about the use of public money. Moreover, the probability of corrupt practices is significantly reduced if these measures are undertaken.

As a means of guaranteeing transparent obligations, those responsible for contract preparation must have technical knowledge of the matter, have a good reputation, have a strict code of conduct, and disclose of conflicts of interest, especially about the beneficiaries of the offset contract.

In addition, it may also be useful to submit a contract to audit by an independent firm able to validate its integrity regarding the procedure by which it was prepared and its substance.

The existence of a compliance program or code of conduct for the contracting companies is an appropriate way for the parties to demonstrate their good faith during the procedure. Equally, establishing a due diligence method for hiring third parties is another advisable way to guarantee transparency in hiring.

5.8. DESIGNATING A "PROJECT COUNCIL"

As mentioned, the goal of an offset contract is to create a harmonious environment between the parties. Nonetheless, the players must keep in mind that eventual problems will arise, particularly because the contracting parties are not, usually, from the same cultural background.

The parties should consider choosing impartial people to decide whether any such issues can be resolved, and to contribute to the harmonious environment between the parties. This is the basic idea of a project council.

The purpose of a project council will never be to benefit or protect the interest of one of the parties, but to resolve potential conflicts that arise, considering the best way to execute what has actually been agreed upon by the parties. The main goal is to ensure the effectiveness of the offset for all parties, to assist in bureaucratic and legal matters, and to prevent cultural issues that can arise between the parties.

There are a number of structures a project council may use, often including business people and lawyers appointed by each of the parties, and typically having a presiding member. The members must have expertise in the contractual matter, to be able to assist in the drafting, pre-contractual phase, and execution of the offset, as well as to provide guidance to the parties on cultural and substantive issues.

The role of the project council is to help prevent problems, and resolve any such problems quickly. The project council are often remunerated by means of a fee contract, to be agreed upon by the members and the parties, separate from the offset.

CHAPTER 6: ICC AND ECCO RESOURCES

ICC

The International Chamber of Commerce (ICC) is the world's largest business organization with a network of over 6 million members in more than 100 countries. It works to promote international trade, responsible business conduct and a global approach to regulation through a unique mix of advocacy and standard-setting activities – together with market-leading dispute resolution services. ICC members include many of the world's largest companies, SMEs, business associations and local chambers of commerce.

Information on ICC's activities, services, model contracts, tools, and publications is available at www.iccwbo.org

ECCO

The European Club for Countertrade and Offset (ECCO) is worldwide non-profit

association with over 60 members from 12 countries both in and outside of Europe, and a network of over 1000 stakeholders.

It serves as a resource centre specialized in offset and countertrade activities, with unique expertise

in offset provided thanks to the involvement of prestigious leading companies in the energy, transport, security and defence sectors as well as offset stakeholders in the areas of operations, compliance and social responsibility.

Objectives and activities

ECCO provides an international platform to share information and best practices in the field of offset and countertrade activities. Its activities are based on three pillars.

- Business community

ECCO holds biannual symposia to bring members and non-members together to discuss offsets and exchange information on global practices.

- Expert interaction

ECCO through its workshops and committees provides a trusted platform for information and discussion on offset and associated issues such as government procurement, international trade, and economic and industrial development.

- Training + education

ECCO is a founding member of the Countertrade and Offset Academy, which offers to both members and non-members the only complete advanced training programme in offsets available globally. The Academy's mission is to develop and promote the professionalization of offset management worldwide, and was founded in partnership with ESSEC and IHS.

ECCO also publishes guidance to support learning about offsets, beginning with the 2014 book, "100 Compensation Terms Commonly Used in International Government Procurement Contracts."

Information about ECCO's activities is available at: http://www.ecco-offset.eu/ as well as on LinkedIn and via videos on YouTube.

ANNEX I

Countries where offsets are applicable

Readers should seek further clarification from the implementing authorities of the countries concerned.

Algeria: No legislation, but frequently demands that industrial participation projects accompany both civil and defence contracts.

Angola: Local content regulations are spread across various laws and decrees passed between 2003 and 2009.

Argentina: Liaise with COMDEF and CITEDEF.

Australia: See the Australian Jobs Act dated 25 June 2013 and Global Supply Chain (GSC) programme established under the AIC - Australian Industry Capability - in 2009.

Austria: Contact Offset Department – BMWA.

Azerbaijan: Offset required without any legislation.

Belgium: Royal decree 612/1997 modified 6/12/2001.

Bolivia: Informal and reactive industrial participation.

Brazil: Order 764/MD – MoD Policy Directive on Offsets, Dec 27th 2002 - Order n°. 899/MoD, 19 Jul 2005 - Order nº 1.395/GC4 – Air Force Regulation DCA 360-1 - Order nº 1.396/GC4 – Order nº 1.397/GC4 – Guidelines for the Negotiation of Commercial, Industrial and Technological Cooperation (“Offset”) Agreements, Dec 13th, 2005. (Air Force Regulation ICA 360-1) - Normative Order nr.586/ MoD, 24 Apr 2006 – Joint-Order n° 1068, 21 Jul 2008 – Decree nr. 6.703, 18 - Decree 7.546 of 2011 - Law 12.598 of March 2012 and decree 7970 March 28, 2013 which regulates the provisions of Law No. 12,598. 7970.

Brunei: No formal legislation, see RBTS.

Bulgaria: See decree n° 180 on 22 August 2013.

Burma: Mainly bilateral barter agreements.

Canada: See IRB/ITB policy.

China: China does not have an official offset or industrial participation policy, but has dallied with IP in a number of different sectors with varied success.

Colombia: Policy Document 3522 - June 2008 and Directive No. 26 dated August 2011.

Croatia: Law on offset regulation in September 2004 under Article 21.

Cuba: Use countertrade and creative trade finance techniques.

Czech Rep: Government Resolution No. 594, dated August 15th, 2012-Offsets only if justified under Article 346 TFEU.

Denmark: Procurement of Defence Equipment Nb 992 of 4 October 2006 amended by “Circular on Industrial Co-operation in connection with Procurement of Defence Equipment No 88 of 27 October

2010, modified by new guidelines (not regulations) for industrial co-operation entered into force on 1 July 2014.

Egypt: The countertrade rules were published 1992 - The rules are laid down by the MFTI - A Form EX must be submitted by the exporter.

Estonia: Offsets required for defence procurements only when justified under Article 346 TFEU.

Finland: Offsets required for defence procurements only when justified under Article 346 TFEU.

Greece: Defence Directive 2009/81/EC has been transposed into Law 3978/2011 and Law No. 4284 became effective 10 September 2014, regulating old Offset Benefit Contracts.

Hungary: Decree 228/2004 modified now lists under clause 74/B offset permitted such as international agreements, bilateral R&D programs, government-to- government agreements, and procurements under Article 346 TFEU.

India: For defense, DPP 2005; DPP 2006; DPP2007, DPP2008, DPP2009;

2010,2011 and DPP 2013 Amended 5 August 2015. Countertrade Policy Implemented by State Trading Corporations (STCs) for Civil Sector Procurements.

Indonesia: KKIP is the management authority for industrial participation in the defence and security sector. Government regulation No 74/2014 defines local content - On the civil side, Indonesia relies on countertrade guidelines enacted in 1982.

Iran: Technology transfer is a prerequisite for contractors.

Israel: In December 2011 Israel was granted 15 years to phase out its civil offset programme and domestic content requirements – See Mandatory Industrial Cooperation regulation, last amended in 2007.

Italy: Offsets required for defence procurements only when justified under Article 346 TFEU

Japan: Acquisition, Technology and Logistics Agency to manage international trade in weapons and military equipment - On the civil side discussions involve the relevant ministry.

Jordan: The agency with responsibility for offset is the King Abdullah II Design & Development Bureau (KADDB), which reports directly to the Royal Palace.

Kenya: Kenyan government has introduced regulations which aim to protect the local construction industry.

Korea (South): The legal basis for the offset policy is provided in:

- The Defence Acquisition Program Act (Article 26);
- The Enforcement Decree of DAP Act (Article 26);
- The Defence Acquisition Program Management Regulations;
- The Offset Programme Guidelines.
- DAPA Guidelines #2008-1 (Revised as of 24 January 2008) DAPA Guidelines #2009-18 (Revised as of 5 February 2009)
  DAPA Guidelines #2009-59 (Revised as of 2Standard 5 September 2009) DAPA Guidelines #2011-3 (Revised as of 23 February 2011)
  DAPA Guidelines #2011-24 (Revised as of 2 August 2011)
  DAPA Guidelines #2012-1 (Revised as of 2 January 2012)
  DAPA Standard Operating Procedure #68 (Revised as of 26 October 2012) DAPA Standard Operating Procedure #124 (Revised as of 15 April 2013) DAPA Standard Operating Procedure #204 (Revised as of 26 February 2014)
- An enforcement decree of the Defence Acquisition Program Act was issued 02 Nov, 2010. Article 26 addresses the threshold and export linkages.
- The Defence Acquisition Program Act became enforceable 23 Mar, 2013. Article 20 concerns offsets and outlines the conditions for applying the policy. Article 21 addresses R&D and technology transfer.
- The regulation on the Defence Acquisition Program Act became enforceable 22 July, 2014. It addresses many issues including the Offset Memorandum of Agreement, the Offset Council, how methodology is decided, the release of RfPs, offset implementation, and the selection of Korean Industry Participants.

Luxembourg: The Grand Duchy of Luxembourg requires offset on an occasional basis for larger defence procurements. These are usually to support NATO requirements. The Ministry of Economy and Foreign Trade has established an offset division. Requirements are detailed in the RfP.

Malaysia: The Industrial Collaboration Program (ICP) consists of activities that are designed to add value to government procurement. The policy was last revised in December 2014 when it replaced the offset policy published by Ministry of Finance (MoF) in March 2011 and the offset policy published by Ministry of Defence (MinDEF) in 2005.

Morocco: Public procurement is governed by Decree 2-06-388 dated 5 February 2007. Morocco is increasingly inserting industrial participation clauses into international tenders for both military and civil purchases. There is no formal policy as such and no threshold, but points will be allocated for industrial participation as part of the bid qualification criteria. Bidders are to take the initiative in the formulation of their offers.

Netherlands: Procurements are considered individually to determine whether there is justification for industrial benefits under Article 346 TFEU.

Norway: There is a 100% offset obligation related to foreign defence acquisitions for all contracts above 50 million NOK. The obligor has to present a credible plan to fulfil the offset obligations and a substantial part of the obligor's commitment must be covered by binding contracts with Norwegian industry before the Norwegian Armed Forces will enter into a procurement contract with the supplier.

Oman: Royal Decree No. 9 of February 2014 established the Omani Authority for Partnership for Development (OAPFD)

Pakistan: The Defence Export Production Organization (DEPO) is making serious efforts to work with foreign partners to take advantage of offset opportunities in the defence sector. Pakistan has entered into partnership and outsourcing programmes with several countries, particularly China.

Peru: Authority for the policy is provided by Directive No. 08-2010 MINDEF / SG / VRD. Guidelines were issued by the MoD under General Directive No. 010, dated May 18, 2011. A dedicated offset department opened in 2015 within the procurement division.

Philippines: The Philippines relies for its countertrade and offset guidelines in Executive Order No. 120, a Presidential Order established August 19th, 1993.

- Circular N°. 7, dated 21st December 2007, titled "Amended Guidelines in the Implementation of Countertrade for Dept. of National Defence (DND) Procurement Contracts" regularised the anomaly created by the previous circular, N° 19 of 2006. 'Best efforts' is now properly mandated. It is often relied on by the AFP to avoid engaging with the process. Circular CT-2012-001 amends the multipliers.

Poland: An Offset Act approved in June 2014 and enacted 30th July 2014 lays down the rights and obligations of parties to defence contracts procured under Article 346 TFEU. Article 346 permits offsets when the procurement is deemed necessary for the protection of essential national security interests.

Qatar: Qatar has no formal defence offset policy and has not seen major arms purchases. It does, however, see offset benefits as a key discriminator in the procurement process and the country is asking for benefits for both civil and defence acquisitions, including oil and gas concessions.

Romania: The offset management authority is the 'Office for Offsetting Special Technique Procurements' (ACATS). Emergency Government Ordinance No.

189/2002, regarding the offset operations related to procurement contracts for defence, public order and national security needs, published in the Official Gazette 942 / 23.12.2002.

- Law No. 354/2003 for approval of the Emergency Government Ordinance No. 189/2002 with its modifications and completions, published in the Official Gazette 519/ 18.07.2003.
- Law No. 146/2004 for modification of the Emergency Government Ordinance No. 189/2002, published in the Official Gazette 425 / 12.05.2004.

- Government Ordinance No. 30/2005 for modification and completion of the Emergency Government Ordinance No. 189/2002, published in the Official Gazette 640 / 20.07.2005.
- Law No. 19/2006 for approval of the Government Ordinance No. 30/2005 for modification and completion of the Emergency Government Ordinance No. 189/2002 with its modifications and completions, published in the Official Gazette 38 / 16.01.2006.
- Government Decision No. 1814/2005 regarding the organization and functioning of the Agency, published in the Official Gazette 16 / 09.01.2006.
- Government Decision No. 459/2006 regarding the procedural norms for applying the law, published in the Official Gazette 344 / 17.04.2006.
- Government Decision No. 955/2006 of July 26, 2006.
- Government Emergency Ordinance #7/2010, March 2010 (re pre-offsets)

Russia: Legislation passed under Federal Law No-44 on April 5th, 2013, which came into force in 2014, provides a comprehensive approach to the procurement process, including planning, forming, executing and monitoring.

Saudi Arabia: The Economic Offset Committee (EOC) was established in 1984 and facilitates joint ventures. The committee is chaired by a member of the royal family and its members also consist of representatives of the ministries of Finance, Industry, Planning and Commerce, individuals representing the private sector, and the Managing Director of the Saudi Basic Industries Corporation (SABIC).

Singapore: The formal policy states that the Defence Science & Technology Agency (DSTA) has no requirement for any offsets as part of a tender.

South Africa: The South African government has set out new strategies for its offset policies. The Industrial Policy Action Plan (IPAP) affects both civil and defence industrial participation. The new strategies will be developed in conjunction withsector desks, and will either become part of the general National Industrial Participation (NIP) guidelines or will be included as annexures to tender documents.

Spain: The MoD is responsible for defence policy and the Industrial Cooperation Directorate (DICOIN) of Isdefe-Gerencia de Cooperación Industrial (Isdefe) administers it. There is no formal policy concerning industrial participation at this time.

Sri Lanka: The Board of Investment and the Bureau of Infrastructure Investment encourage the use of compensation structures, yet countertrade and offset do not feature highly in Sri Lankan trade procedures. There is no clear government policy on countertrade, but some bilateral activity does take place.

Switzerland: Armasuisse established an offset agency in Berne on 1st January 2010 in partnership with the trade associations Swissmem and GRPM. The arrangement is a Public Private Partnership (PPP) by the Department of Defence, Civil Protection and Sport (DDPS), to which Armasuisse reports. The ministry retains overall control.

Taiwan: The Ministry of Economic Affairs (MOEA) set up an Industrial Cooperation Steering Committee with both the Vice Minister of the Ministry of National Defence (MND) and MOEA designated as the co-chairmen. The Industrial Cooperation Programme Office (ICPO) is under the jurisdiction of the IDB and functions as the contractor's window.

- 1993: Industrial Cooperation Program enacted in compliance with Executive Yuan's Economic Stimulus Plan.
- 2001: "Guidelines for Organization of ICP" issued February 2001 by Executive Yuan.
- 2002: National Defence Act applies offsets to defence needs.
- 2004: WTO entry results in major ICP changes with civil offsets faded out.
- 2008: Government Procurement Agreement on Defence Offsets.

- 2009: “Organization Framework and Operation Process for Improving Industrial Cooperation Program” issued by Executive Yuan.
- 2010: New “directions” issued for planning and utilization of ICP Projects.

Turkey: The authority responsible for management of the military industrial participation and offset policy is the Undersecretariat for Defence Industries (SSM). SSM is a civilian procurement agency affiliated to the Ministry of National Defence (MND). Law No: 3238 of 1985 established SSM and authorised it to coordinate export and offset trade issues relating to defence industry products. The first offset handbook was published in July 1991. Offset directives were subsequently published in 2000, 2003, and 2007. With the directive issued in April 2011, SSM is on its fifth policy revision.

Concerning civil offsets, the Regulation on the Purchase of Goods and Services, based on Article 3

(u) of Law No: 4734, was issued by the Ministry of Science Industry and Technology and gazetted February 15th, 2015. The regulation is based on an exemption clause stipulating that goods and services purchased under industrial participation programs are not subject to that law. Several ministries could, then, establish very different industrial participation/offset models provided they comply with the basic requirements of Law 4734.

UAE: The UAE Offsets Group was established in 1992 and became the Offset Programme Bureau (OPB) in May 2007. The OPB became the Tawazun Economic Council (TEC) in June 2012.

Ukraine: An Offset Committee has been established to coordinate activities relating to offset contracts. The chairman is a senior MEDC deputy minister. Nine other members are drawn from ministries that include Internal Affairs, Finance, Defence, and the Security Service. Procedures for the signing of compensation deals in both the military and civil sectors were approved by parliament in the State Defence Procurement Order of April 20th 2011 and adopted by the cabinet as Resolution 432.

The offset commission was set up by a resolution issued Jan 12 2012. Also, legislative amendments to regulate commodity barter transactions were passed in March 2009.

United Kingdom: The United Kingdom has introduced an ‘industrial engagement’ policy designed to overcome the barriers on offsets imposed by EU defence directive 2009/81/EC. The policy is implemented on behalf of the MoD by the UK Trade and Investment (UKTI) Defence and Security Organisation’s (DSO) Industrial Engagement Unit.

UNITED STATES (INCL: FEINGOLD / BERRY / JONES / BUY AMERICAN ACT / 10 U.S. CODE § 2532 / FMS 78: THE FEINGOLD AMENDMENT:

The Feingold Amendment prohibits U.S. companies from offering cash incentives to subcontractors if they move production offshore in the conduct of offset obligations in foreign countries.

The Feingold Amendment was passed in 1994 as an amendment to the Arms Control Act. It is designed specifically to restrict a particular kind of offset activity by U.S. firms. The law prohibits

U.S. obligors earning offset credits by paying U.S. companies to buy foreign goods.

THE BERRY AMENDMENT:

The Berry Amendment applies to U.S. sourcing of food, clothing and textiles.

The Berry Amendment (10 U.S.C. § 2533a) requires the Department of Defense (DOD) to give preference in procurement to domestically produced, manufactured, or home-grown products, most notably food, clothing, fabrics, and specialty metals.

The Defense Federal Acquisition Regulation Supplement (DFARS) was amended to include exceptions for the acquisition of food, specialty metals, and hand or measuring tools when needed to support contingency operations or when the use of other-than-competitive procedures is based on an unusual and compelling urgency. The specialty metals provision was added in 1973. This provision requires that specialty metals incorporated in products delivered under DOD contracts to be melted in the United States or a "qualifying country". Specialty metals include certain steel, titanium, zirconium and other metal alloys that are important to the DOD.

Congress revised the Berry Amendment in the Fiscal Year 2007 and Fiscal Year 2008 National Defense Authorization Acts. The revised statute, 10 U.S.C. § 2533b, now includes exemptions for certain Commercial-Off-The-Shelf (COTS) items.

There is also an exception for small amounts of non-domestic metal (excluding high-performance magnets), a market basket approach to measuring the amount of domestic metal content in articles delivered to DOD, and a national security waiver to prevent the delay in delivery of critically needed systems to troops in combat.

A blanket exemption for fasteners was removed by Congress, now requiring that at least 50% of commercial fastener specialty metal content be domestic. Congress required that all waivers or Domestic Non-Availability Determinations (DNADs) be reviewed and revised to comply with the amended law.

SMALL BUSINESS SET ASIDES

- Small Business set asides are under Federal Acquisition Regulations Part 19 and are contract goals established under law for the U.S. government to direct 23%of all contracts to certified Small Businesses (certified by U.S. Small Business Administration), including percentage targets for Native American-owned, Veteran-owned, Minority/Disadvantaged, Women-owned or Handicapped-owned. This all implies that only U.S. contractors can be used.
- 10 U.S.C. § Section 2534 generally pertains to the shipbuilding industry. All U.S. flagged ships must receive major maintenance and repair in U.S. ports. All U.S. Naval Vessels must be built in the U.S. at U.S. shipyards. Anchor chain, propellers and other "critical" items in the construction of ships must also be procured from U.S. sources.

THE JONES ACT

The Merchant Marine Act of 1920, often referred to as the "Jones Act", governing the workers compensation rights of sailors and the use of foreign vessels in domestic trade.

The Act requires that all goods shipped between the East and West Coasts, the Great Lakes, and the non-contiguous states and territories must be:

- Carried on vessels built and documented (flagged) in the U.S.;
- Crewed by Americans; and,
- Owned and operated by American citizens.

THE BUY AMERICAN ACT

The Buy American Act is not to be confused with the very similarly named Buy America Act. The latter applies only to mass-transit-related procurements valued over US$100,000 and funded at least in part by federal grants. The Buy American Act's U.S. content requirement under Title 41, Section 10a is a broad requirement, often waived by the DOD, that all major purchases must be 50%U.S. content by value.

The Buy American Act, (41 U.S.C. § 10a-10d), applies to procurements of supplies and construction materials for the United States government. It is implemented by the Federal Acquisition Regulation (FAR, Part 25.)

The Buy American provisions of the Recovery Act, (Section 1605 of Pub. L. 111-5), require that all iron, steel and manufactured goods used in projects funded by the Recovery Act for the construction, alteration, maintenance or repair of a public building or public work be produced in the United States, with some exceptions.

“Domestic construction material” means:

An end product manufactured in the United States, if—

(i) The cost of its components mined, produced, or manufactured in the United States exceeds 50% of the cost of all its components. Components of foreign origin of the same class or kind as those that the agency determines are not mined, produced, or manufactured in sufficient and reasonably available commercial quantities of a satisfactory quality are treated as domestic. Scrap generated, collected, and prepared for processing in the United States is considered domestic; or

(ii) The end product is a COTS item.

OTHER BUY AMERICAN PROVISIONS IN U.S. LEGISLATION: BUY AMERICAN PROVISIONS HAVE ALSO BEEN INSERTED IN THE FOLLOWING LAWS:

1. The 2009 American Recovery and Reinvestment Act (ARRA) prohibited the use of recovery funds for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the iron, steel, and manufactured goods used in the project are produced in the U.S. The monies for these recovery projects have mostly been allocated and projects are already well under way. The bilateral agreement between Canada and the United States provided some relief, but only for those projects funded by recovery monies and identified under the agreement.
2. The longstanding Buy American domestic content provisions under the Federal Aviation Administration (FAA) require all steel and manufacturing products to be produced in the U.S. When procuring a facility or equipment under the Airport and Airway Improvement Act of 1982, the cost of components and subcomponents produced in the United States must be more than 60% of the cost of all components and the final assembly of the facility or equipment must occur in the United States.

The Federal Highway Administration (FHWA) requires that the steel, iron, and manufactured goods used in its procurement process be produced in the United States. Buy American provisions are applied to transit-related procurements valued over US$100,000, for which funding includes grants administered by the FTA or the FHWA. Some important waiver applications have been adopted since the original introduction, including a 1983 rulemaking which determined that Buy American did not apply to raw materials and waived its application to manufactured goods when certain conditions applied.

1. The Federal Railroad Administration (FRA) Buy American chapters also require that the steel, iron, and manufactured goods be produced in the United States under its High Speed Rail Program.

Uzbekistan: Countertrade practices in Uzbekistan are regulated by a series of decrees issued by the Cabinet.

Venezuela: Venezuela’s armed forces have been obliging foreign contractors to engage in industrial participation programmes designed primarily to develop the domestic defence sector. It is almost essential to provide industrial participation in order to win a defence contract. There is no formal procedure but the armed forces are asked to ensure industrial participation is applied to all major procurements. The threshold is applied arbitrarily.

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