Tawazun Economic Program

Guidelines

2015/2016 Edition
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1 INSTRUCTIONS FOR USING GUIDELINES

1.1 PURPOSE OF GUIDELINES

The purpose of the Tawazun Economic Program Guideline is to set out the methods by which contractors can generate Credits in order to fulfill their Tawazun Economic Program Obligations. Further, it has been designed to act as a tool for the Tawazun Economic Council to ensure that the contractors contribution activities are in line with the focus area, base program period and credit calculations formulae stated in this Guideline. This Guideline should be read in conjunction with the Tawazun Economic Program Agreement (TEPA, formerly known as “Offset Agreement”) to be entered into between the Tawazun Economic Council (TEC, formerly known as “Offset Program Bureau”) and the contractor. Unless the context indicates otherwise, terms not otherwise defined in this Guideline shall follow the definitions given to them in TEPA.

1.2 DEFINITIONS

1. Contractor means any person who secures through a contract (whether directly or indirectly through a local agent, local representative and/or local defense company) the supply of goods or services to the Government of the UAE.

2. Supply Contract means any contract entered into by the Contractor with the Government (whether directly or indirectly through a local agent, local representative and/or local defense company) for the supply of products of any description whatsoever (including without limitation, any military products) and/or services or other deliverables to the Government.

3. Input Credits means Credits awarded to the Contractor by Tawazun in respect of approved input contribution activities made by the Contractors to a Project.

4. Output Credits means Credits awarded to the Contractor by Tawazun in respect of approved output contribution activities made by the Contractors to the Project. These are based on audited financial statement at the end of each fiscal year.

5. JV Structure means a Joint-Venture company established between the Contractor and a local company.

6. Contractual Agreement (Non JV Structure) means an approved contribution activities other than JV Structure that the contractor may perform to generate Credits.
1.3 OBJECTIVES OF TAWAZUN ECONOMIC PROGRAM

1. Create knowledge based economy
2. Diversify the UAE’s economy
3. Grow the Industrial Base of the UAE
4. Create business opportunities for UAE private sector
5. Generate exports
6. Produce employment opportunities for UAE Nationals in high-tech fields

1.4 FOCUS OF THE TAWAZUN ECONOMIC PROGRAM

Tawazun has identified key sectors and capabilities of development with potential for future growth, which Contractor’s should focus on for generating Credits. Within the sectors, the contractor may focus on final system, sub-assembly, major components or key technical services.

A. Sectors:
   • Aerospace
   • Defense
   • Autonomous systems
   • Cyber Security

B. Capabilities:
   1. Designing
   2. Engineering
   3. Software Engineering and Programming
   4. System integration
   5. Manufacturing
   6. Assembly
   7. Testing & qualifications
   8. Program Management
   9. MRO (Maintenance Repairs and Overhaul)
2  PROGRAM REQUIREMENTS

2.1  VALUE OF THE OBLIGATION

In consideration of the Government entering into the Supply Contract, the Contractor undertakes to generate Credits either itself or through a United Arab Emirates company equal to sixty (60) per cent of the Contract Value of the Supply Contract (the Obligation) during the Base Program period.

Example:
Value of Supply Contract = AED 80 million
Value of TEP Obligations i.e. credits to be generated, by Contractor = AED 48 million

2.2  BASE PROGRAM

The Base Program shall be seven (7) years duration commencing from the Base Program Date (Effective Date), which will have seven (7) annual Milestone Obligations.

2.3  MILESTONES

Milestones means in relation to the Obligation, each anniversary of the Base Program Date (Effective Date) when the amount of generated Credits by the Contractor will be reviewed;

The Contractor is required to achieve the relevant proportion of the Obligation at each Milestone as shown in the below table or as approved at Tawazun discretion in the business plan approval letter.

<table>
<thead>
<tr>
<th>Number of Milestone</th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
<th>4th</th>
<th>5th</th>
<th>6th</th>
<th>7th</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min required Percentage</td>
<td>5%</td>
<td>10%</td>
<td>10%</td>
<td>15%</td>
<td>15%</td>
<td>20%</td>
<td>25%</td>
</tr>
</tbody>
</table>
2.4 **GRACE PERIOD**

Tawazun may, in its discretion, grant the Contractor a grace period which shall apply prior to the commencement of the Base Program period. The grace period is a period of time before the Base Program Date and is granted to a project which has complex infrastructure, training or facility requirements which need additional time for construction or assembly.

In order for TEC to consider the grant of a grace period, the Contractor must submit a Business Plan which justifies the grant of grace period.

2.5 **BANK GUARANTEE**

A bank guarantee to be provided by the Contractor within the agreed upon number of days from the Base Program Date (Effective Date) from one of the banks listed in part 1 of schedule 2 of the TEPA.

The amount of the bank guarantee shall be equal to 8.5% of the Obligation and shall be valid for the whole Base Program Period.

**Example:**
- Total obligation for contractor = AED 60M
- Milestone 1, End of Year 1 of Base Program: Generate minimum AED 3 million in credits
- Milestone 2, End of Year 2 of Base Program: Generate minimum AED 6 million in credits
- Milestone 3, End of Year 3 of Base Program: Generate minimum AED 6 million in credits
- Milestone 4, End of Year 4 of Base Program: Generate minimum AED 9 million in credits
- Milestone 5, End of Year 5 of Base Program: Generate minimum AED 9 million in credits
- Milestone 6, End of Year 6 of Base Program: Generate minimum AED 12 million in credits
- Milestone 7, End of Year 7 of Base Program: Generate minimum AED 15 million in credits

**Example:**
- Total obligation for contractor = AED 80 million
- Bank guarantee required = AED 6.8 million

The Contractor shall procure the issuing of the bank guarantee for such period as Tawazun may require.
2.6 DEFAULT ACCOUNT

Default account holds the balance of total unfulfilled obligations.

If the Contractor, at the end of the Base Program period, is awarded a new Supply Contract, unfulfilled obligations from the default account will be added to the new Supplemental Agreement.

In the case where no Supply Contract is entered at the end of the Base Program Period, the Contractor will be required to execute a new Supplemental Agreement at the end of the Base Program Period (within 30 days) to fulfil the outstanding obligations in the default account.

2.7 LIQUIDATED DAMAGES

Liquidated Damages are a penalty payable by the Contractor equivalent to 8.5% of the Shortfall Amount set out in the Milestone Statement that will be charged to any Contractor who fails to generate Credits when the relevant Milestone Obligation is due.

Liquidated Damages will apply to late or partly unfulfilled Milestone Obligations. In the case a Contractor has initiated a Project to fulfill the Obligations and a shortfall occurs, payment of such penalties will only enable the Contractor to be discharged from fifty (50%) per cent of its relevant Milestone Obligations. The other fifty (50%) per cent of the Shortfall Amount will be allocated to the Default Account.

In the case a Contractor fails to initiate a Project and a shortfall occurs, the Contractor will not be entitled to discharge the Milestone Obligations and one hundred (100%) per cent of the Shortfall Amount will be allocated to the Default Account.
3 GENERATION OF CREDITS

3.1 PARTNERSHIPS TO GENERATE CREDITS

The contractor shall generated credits through contributions made in accordance with the following forms of partnerships:

1. Equity Joint Venture (JV)
2. Contractual Arrangement (non JV)
3.2 **EQUITY JOINT VENTURE (JV)**

A. **Description:**
- As per this form, the Contractors shall be required to form a Joint Venture Partnership with a Local Partner as per the UAE Commercial Laws and in the UAE territory (does not include Free Zones).
- Obligation discharge shall be upon generating Credit through input and output contribution activities by the Contractor. The input contribution activities are determined through contributions made towards the project by providing industry enablers, knowledge empowerment and equity contribution. The output contribution activities results from the Net Profit generated and a bonus scheme for hiring UAE nationals.
- 49% of the JV owned by the Contractors shall generate the maximum amount of Credits from the project. Any ownership below or above 49% shall receive a pro-rata calculated amount of output credits.

B. **Total Credits Formula:**

\[
\text{Total Credits} = \text{Input Credits} + \text{Output Credits}
\]

C. **Hybrid Model:**

- 30% of the total obligation of the Base Program is the maximum fulfillment done through Input contribution activities.
- 70% of the total obligation of the Base Program is the minimum fulfillment done through Output contribution activities.

**Example:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total obligation for contractor = AED 60 million</td>
<td></td>
</tr>
<tr>
<td>Credits to be fulfilled via Inputs: No more than AED 18 million</td>
<td></td>
</tr>
<tr>
<td>Credits to be fulfilled via Outputs: No less than AED 42 million</td>
<td></td>
</tr>
</tbody>
</table>

D. **Input Credits Formula:**

\[
\text{Input Credits} = \text{Input Multiplier} \times (\text{Equity Contribution} + \text{Industry Enablers} + \text{Knowledge Empowerment})
\]

\[
\text{Input Multiplier} = 2
\]
**Equity Contribution** = Cash or Assets Contributed by Contractor in JV

**Industry Enablers** = Value of IP, Certifications, Licenses, Enablers contributed by Contractor in JV

**Knowledge Empowerment** = Value of Training of UAE National Staff contributed by Contractor in JV

### E. Output Credits Formula:

**Total Output Credits** = Output year 1 + Output year 2 + Output year 3 + Output year 4 + Output year 5 + Output year 6 + Output year 7

**Output year value** = (End of Fiscal Year Net Profits x Net Profits Multiplier) + (UAE National Compensation during Fiscal Year x UAE National Compensation Multiplier)

**Net Profits Multiplier** = 2 + (Export Sales as % of Total Sales x 6).

Therefore, contractors have significant incentive to create JVs with export sales.

Note: Net Profits Multiplier cannot exceed 5. Range 2 to 5.

#### Example:

| Net Profits | 15 | 25 | 20 | 18 |
| Exports as % of Sales | 0% | 14% | 35% | 65% |
| Net Profits Multiplier | 2 | 2.84 | 4.1 | 5 |
| Credits generated by Net Profits | 30 | 71 | 82 | 90 |

**UAE Nationals Compensation Multiplier** = 2 + (UAE Nationals Compensation as % of Total Compensation x 4)

Therefore, contractors have significant incentive to hire UAE nationals.

Note: UAE Nationals Compensation Multiplier cannot exceed 4. Range 2 to 4.

#### Example:

| UAE National compensation | 12 | 18 | 20 | 25 |
| UAE National comp as % of Total comp | 11% | 34% | 22% | 55% |
| UAE National comp Multiplier | 2.44 | 3.36 | 2.88 | 4 |
| Credits generated by UAE National comp | 29.3 | 60.5 | 57.6 | 100.0 |
3.3 **CONTRACTUAL ARRANGEMENT (NON-JV)**

**A. DESCRIPTION**

NON JV contribution activities shall be through such activities as approved by Tawazun and which will achieve, inter alia, the following objectives:

i. Investment through work packages.
ii. Other contribution activities as may be communicated and approved by TEC.

**B. HYBRID MODEL**

The hybrid model percentages shall be allocated on a case to case depending on the nature of the project. TEC shall inform the Contractor about the percentage under their discretion.

**C. TYPES OF CONTRACTUAL ARRANGEMENTS**

1. **WORK PACKAGES**

*Definition*

i. Credits could be generated when a Contractor, with an obligation, enters into contract(s) with UAE defense related company(s) to carry out a service or supply a UAE made product/sub-system.

ii. The basis of the credit calculation would be based on the contract value between the UAE defense related company and the Contractor.

iii. Under the discretion of TEC, a Cap or limit could be placed on the amount of obligation the Contractor would require to fulfill via this mean.

*Conditions*

TEC only may consider giving approval for investment in work packages if the following conditions are available:

i. Products or services procured by a Contractor should be related to their core business;

ii. A Contractor cannot generate credits through this mean by procuring a product or service from a UAE based firm that the Contractor is part of;

iii. Commercial consultancy services are excluded from generating Credits.
iv. The product/service procured is not part of a Contract with the UAE Armed Forces.

Calculation Methodology

- Contribution made by Contractor shall be eligible to generate Input Credits. Calculation method shall follow section 3.1.1. (D).
- Contract value between Contractor and UAE Company shall be the basis of calculating Output Credits. An appropriate Multiplier may be assigned under TEC’s sole discretion.

2. OTHER CONTRIBUTION ACTIVITIES AS COMMUNICATED AND APPROVED BY TEC

Depending on the needs of the UAE defense industry, Tawazun Economic Council may communicate to Contractors via different means certain opportunities to fulfill its Obligations.
4 PROGRAM FULFILMENT PROCESS

TEC normally follows the following process highlighted below.

GHQ/PGC sends Request for Proposal (RFP) to the Defense Contractors (DCs) along with Tawazun Economic Program (TEP) requirements

- DCs approach Tawazun Economic Council (TEC) to start discussing, while they are preparing to respond to RFP for GHQ/PGC
  - TEP requirements
  - TEP Fulfilment plan (Concept paper, Business plan)

- DCs send proposal to GHQ/PGC

- GHQ/PGC select DCs proposal, and send proposal approval letter to DCs

- DCs approach TEC to
  - Sign Tawazun Economic Program Agreement (TEPA)
  - Collect in-principal approval for the Concept Papers
  - Collect Continue Discussion (CD) letter

- DCs hand the continue discussion letter to GHQ/PGC to allow DCs to continue the discussions about the supply contract terms

- DCs sign the supply contract with GHQ/PGC

- GHQ/PGC send Notification letter to DCs when the supply contract gets signed

- DCs approach TEC to
  - Sign Supplemental Agreement
  - Submit Bank Guarantee
  - Collect Clearance Letter

- DCs hand Clearance Letter to the GHQ/PGC to release their supply contract

- DCs submit a Business Plan to Tawazun Economic Council
Tawazun Economic Council evaluates the business plan and:
If Accepted, TEC issues a Business Plan Approval Letter
If Rejected, TEC issues a Rejection Letter with feedback, and requires a resubmission of business plan

Once business plan is accepted, TEC and the DC sign a Term Sheet which highlights the total credits to be awarded to the DC per the business plan

DCs begin project implementation

TEC regularly audits project progress and reviews the annual audited financial statements of the project

TEC awards credits to DCs and provides credit award certificate against milestone obligations

If DC achieves excess credits, TEC banks them per conditions in the TEPA, and if DC has a shortfall in credits despite initiating a project, bank guarantee is liquidated. (If no project is initiated, liquidated damages apply but do not fulfil obligations)

TEC regularly informs GHQ/PGC about defaulting contractors, especially highlighting contractors who have failed to initiate projects

TEC issues obligation fulfilment certificate upon full completion of TEP requirements