



# POLAND'S LARGEST ARMS PROCUREMENTS WILL NOT BE BASED ON FULLY COMPETITIVE TENDERS: "WE WILL RELY ON ARTICLE 346"

Poland's new offset law entered into force on 30<sup>th</sup> July. Responsibility for concluding offset deals will be transferred to the Defence Ministry, with the offset committee in the Economy Ministry responsible only for the continuation of programmes that are already underway.

Deputy Defence Minister Czeslaw Mroczek said that Poland's largest arms procurements, the missile defence program, the acquisition of military helicopters, and the requirement for unmanned aircraft, will not be based on fully competitive tenders because they would not allow the government to impose requirements such as "Polonisation."

As exceptional procurements linked to national security, the purchases will qualify under Article 346, Mr Mroczek said. The government can therefore consider offers of engagement with the domestic defence sector proposed by bidders.

Mr Mroczek contended, confidently, that Poland can satisfy the EC that it is complying with the defence directive when it relies on Article 346.

Exemption from full competition rules does not mean excluding all competition, he made clear. Three major manufacturers are vying for the helicopter contract. Negotiations would be held with a single manufacturer only in exceptional circumstances.

"We must demonstrate that the exemption is justified by national security interests," he told the Polish language newspaper *Rzeczpospolita*. "We have a special team, relevant procedures, experts from various divisions of the Defence Ministry to help us formulate complete and convincing arguments. I am making no secret of the fact that there are cells in the Ministry that advocate full competition rules."

Industrial benefits for the missile defence system may be no less than 40 percent of supply contract value, which is about what the producers are currently offering. Hopefully, he commented, the final offers will be larger.

Poland will make significant demands for drones because the country's firms already have experience in that field. The country may invest up to several billion zlotys in the drone project.

The scope of the "Polonisation" will depend on the defence sector's potential, its current technological capabilities, and its ability to acquire new foreign technologies. The minimum requirement would be for the defence sector to maintain the hardware delivered by foreign suppliers in situations when normal relations with the producers are severed. Polish defence manufacturers will need to be ready to implement all the programs.

"There will be no second chance if they waste this one. There will be no other military modernisation program like this," he said.

Mr Mroczek acknowledged that the defence sector remains scattered with specific firms forced to form consortiums to implement relatively simple projects for the army, such as the modernisation of Leopard tanks.

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"This is why we are pursuing consolidation and forming the Polish Defence Group [PGZ]," he said.

Mr Mroczek was asked by *Rzeczpospolita* to clarify whether the PGZ will be independent or allowed to be "internationalised."

"That is a very important issue and a subject of major analyses," he replied. Foreign groups are offering cooperation and consolidation on a European scale, but consolidation comes first.

## Offsets.....

### RAYTHEON DEEPENS RELATIONSHIP WITH POLAND'S TELDAT

Raytheon has signed a Letter of Intent with Poland's TELDAT to explore "mutually beneficial" business opportunities related to Poland's air defence architecture and increase exports to global markets, a Raytheon release said. TELDAT is a designer and manufacturer of specialised defence IT solutions.

The companies will examine partnership opportunities in the following categories:

- IP-based networking solutions, software and devices;
- Militarized communications equipment;
- Command and control software;
- System integration, verification and validation testing.

Mike Shaughnessy, Raytheon Integrated Defence Systems' supply chain VP, said that the company is committed to delivering significant and sustainable benefits to Poland's defence industry. These include work share, co-development, co-production and technology transfer agreements.

"TELDAT and Raytheon have been working together for more than two years, and we are actively pursuing business opportunities with them in electromechanical design, software engineering and overarching systems engineering," he said.

The announcement comes just weeks after Poland's Armaments Inspectorate selected Raytheon's Patriot as one of the two finalists for the WISLA program.

### INDIA HAS 24 OFFSET CONTRACTS IN IMPLEMENTATION STAGE

India has so far concluded 24 offset contracts amounting to approximately \$4.87bn. These contracts

are currently in the implementation stage with the execution period of some lasting until 2022, Minister of State for Defence Rao Inderjit Singh told parliament.

Foreign vendors that do not adhere to the offset implementation schedule receive penalties amounting to 5 percent of the unfulfilled obligations, Mr Singh confirmed. He did not indicate how many contractors had been fined, nor did he identify them.

Last September CTO reported that default warnings were issued concerning two offset contracts. Action had been initiated concerning a further eight contracts where interim shortfalls of \$23m had been reported by contractors.

Mr Singh made no reference to any planned policy changes.

### IDSA CALLS FOR AMENDMENTS TO INDIA'S 2012 GUIDELINES

India's Institute for Defence Studies and Analysis (IDSA) has called for amendments to be made to five policies in the Defence Offset Guidelines of 2012. The author of the document is Amit Cowshish, a partner at the law firm **Dua Associates** and a Distinguished Fellow at IDSA.

Mr Cowshish focuses on five areas to which he thinks improvements should be made.

In general, offsets should be "buyer-demanded" rather than "vendor-driven," he says, and the quota should be increased from 30 percent. He does not, however, state what he believes the quota should be.

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Offset credit banking and the monitoring of its implementation are not working well, Mr Cowshish complains. Offset credits should be tradable, he adds, although he expresses reservations about the effect this would have on the purpose of the offset policy.

The Indian government should decide whether to remove or uphold the freeze on awarding credits for services, and Tier-I vendors should be permitted to discharge offset obligations exceeding their work share. Overall responsibility, however, should remain with the prime vendor.

The document calls for an enabling clause to permit the MoD to specify in the Request for Proposal (RfP) the areas in which it would expect the offset obligation to be discharged. An enabling provision, it says, would give the MoD time to put the mechanism in place and enable it to start routing offsets without having to amend the guidelines.

Mr Cowshish also notes three procedural issues that cause difficulty in implementing the 2012 guidelines.

Vendors must buy back 40 percent of the product when the obligation is discharged through transfer of equipment but the manner in which the cost of the equipment is determined needs to be clarified.

Too many parties are involved when a vendor needs to change an Indian offset partner and alter the offset component of a contract. And submitting a full implementation schedule at the time of submitting the offset offer is impractical, Mr Cowshish states.

#### **Dassault is Offset Compliant:**

The technologies proposed by **Dassault Aviation** for transfer to Indian defence companies is fully compliant with the requirements specified in the tender for the multi-billion dollar combat aircraft deal, Defence Minister Arun Jaitley told parliament in a written reply to a question. Contract negotiations for the supply of 126 Rafale multirole combat aircraft are continuing.

#### **SSM's CHIEF HINTS AT BIO PARTNERSHIPS**

Biological defence partnerships could become an area of interest for foreign contractors in Turkey.

**SSM** is working on projects that would defend the country against biological weapons, Ismail Demir, SSM's CEO said, and added that one of the most critical issues hampering progress in reaching agreement with

China was technology transfer. "Nobody is willing to deliver their technologies to others," he told Turkey's *Daily Sabah* newspaper.

"When you sit around a table you have to clearly talk about many issues ranging from domestic participation rates to technology transfer. Our negotiations with China haven't come to the point where both sides can say 'Yes, we could agree' yet."

Domestic participation is necessary, he remarked. The focus should be on improving the competitiveness of defence systems and increasing their export potential through higher added value.

"We don't have oil but we have human resources. We should invest in this," he asserted.

#### **SPANISH IP POLICY: "I AM NOT ALLOWED TO EXPLAIN ANYTHING"**

Spain's industrial participation policy remains a mystery even to personnel at the MoD. The official line is that the MoD applies an industrial cooperation policy to boost the development of the country's defence industrial and technological base and to promote its products competitively in the international market. But nobody seems to know what the policy is or what effect the recently announced organisational restructuring within the MoD will have on existing industrial participation contracts.

"I am not allowed to explain anything about this," an MoD spokesman repeated when asked to explain vendors' requirements.

At the Industrial Cooperation Directorate (DICOIN) of the Gerencia de Cooperación Industrial (Isdefe) the response was politer, but the refrain was similar. "A good question," we were told before being directed to other departments. The trade organisation did not respond.

According to the MoD's website, which otherwise is up-to-date but may be an antique in this regard, "Spain has developed a very effective model of industrial cooperation with foreign suppliers, which is in line with what is established in the Code of Conduct drawn up by the European Defence Agency (EDA)."

The intention of the policy, the site continues hopefully, "is that foreign supplying companies commit to generating industrial or technological developments in Spain similar to the value of the purchase made abroad."

There is no reference to the defence directive or to Article 346. The objectives, however, are clear: self-sufficiency to support the systems acquired during their life cycle; development and consolidation of strategic industrial sectors; and establishing an industrial defence base "contributing to its consolidation at European level."

The possibility that Spain's offset policy might meet those goals however, is weakened by its failure to meet the goals of its own website. "Our desire is to help and satisfy your information needs in the simplest and clearest possible way," the site concludes.

### **KENYAN LAW IMPOSES 30 PERCENT PARTNERSHIP QUOTA FOR CONSTRUCTION PROJECTS**

The Kenyan government has responded to pressure from local contractors by introducing regulations which aim to protect the local construction industry. The regulations restrict the categories of work open to foreign contractors and also stipulate that foreign contractors must either enter into joint ventures with local contractors or locally subcontract a percentage of the work.

Local contractors were concerned by the number of foreign contractors tendering for infrastructure work.

The law now states that a foreign contractor is only eligible to register for a Category 1 contract (i.e. a building contract above Kenya Shillings 500m, or \$5.7m); local contractors are eligible to register for all categories of contracts.

The regulations provide that a foreign contractor must submit its registration application to the National Construction Authority (NCA) together with an undertaking in writing to sub-contract or enter into a joint venture with a local firm for not less than thirty percent of the value of the contract work for which temporary registration is sought.

The joint venture must be at least 30 percent Kenyan-owned and any profits derived from the construction works carried out by the joint venture must be split based on this ownership arrangement.

Alternatively, at least 30 percent of the value of the work must be subcontracted.

The foreign contractor shall transfer technical skills not available locally to a local person or firm. Employees shall be competitively recruited from the local labour market. Recruitment or employment of foreign technical or

skilled workers shall only be allowed with NCA approval and where such skills are not available locally.

The regulations do not require the foreign contractor to have entered into a joint venture agreement or subcontract agreement before submitting a registration application.

A foreign contractor in breach of its undertaking to the NCA will be subject to a claim in damages.

### **SAUDI ARABIA'S AEC QUALIFIES FOR TYPHOON AVIONIC REPAIRS**

Saudi Arabia's **Advanced Electronics Company**, established in 1988 as part of an offset program, is now approved as a Typhoon avionics repair agent and is qualified to supply **BAE Systems** with avionics boxes.

A BAE Systems release said AEC and BAE can now further their local support arrangements to the Royal Saudi Air Force's (RSAF) Typhoon aircraft.

The company has been working closely with AEC and **Rockwell Collins Deutschland** as part of BAE's industrialisation programme to establish indigenous repair capabilities in the Kingdom. Over the next three years, the release said, BAE Systems Saudi Arabia and AEC, working together with other OEMs, will transfer the repair capability of a further 35 Avionics boxes to the Kingdom, creating in excess of 120 skilled technical jobs for Saudis.

### **MCKINSEY RAISES THE BAR ON OFFSETS BUT SHOULD CONSIDER A DIFFERENT KIND OF BAR**

Although they are not usually reported in annual filings, offset contracts are increasingly becoming a C-suite agenda item, says **McKinsey & Company** in an insight report on the industry. Over the past twenty years, they say, U.S. defence contractors have typically entered into an average of 30 to 60 offset agreements each year, representing between \$3bn and \$7bn in obligations per year.

A number of Western defence contractors have already realised success in international markets, the report says, citing **Lockheed Martin's** 2003 win in Poland's Peace Sky fighter competition, a deal enabled by a competitive offset package. The unprecedented offset offer was valued at more than \$9bn and included 55 defence-sector programs and 49 programs benefiting the Polish economy overall. No mention is made of the

many downsides that bedevilled both the obligor and the government in fulfilling the Polish obligations.

“That deal set the bar for others that followed,” the report noted.

In Korea’s assessment of bidders for its F-X III fighter program, for example, proposed offsets and technology-transfer arrangements accounted for 17 percent of the total evaluation score while acquisition costs accounted for 15 percent.

Over the past few years, the report says, several nations have introduced reforms in their offset policies that are raising the bar for contractors’ industrial participation and prompting customers to judge bids and enforce offsets with refined criteria for success. India, for instance, recently created the Defence Offset Monitoring Wing to provide stronger oversight of and standardized performance reporting on offset programs.

The report is replete with banalities and appears to be targeting clients with a limited understanding of offsets, although it is doubtful that there is an audience at CEO level whose understanding is so inadequate.

McKinsey & Company’s experience “advising defence companies on a range of global sourcing, operations, and strategy issues” has taught it that “a successful offset strategy is based on an objective evaluation of methodologies that have proved successful in the past.... Any proposed offsets should be consistent with the company’s overall international strategy...[and] in some countries, the rulebook is not as straightforward as it may appear.”

Meanwhile another management consulting firm, **Avascent**, has produced a more focused report. It says that it has calculated that outstanding offset commitments added up to \$90bn worldwide from 2011-2013.

“Those offsets are bearing fruit, as **Abu Dhabi Shipbuilding** demonstrates in the Middle East.”

While Abu Dhabi Shipbuilding may not yet be a global challenger, its Baynunah corvette shows it is a formidable entrant in a crucial market. A regional sale can have the effect of closing out an opportunity for a U.S. or European company, Avascent says.

“Competitive regional firms leverage existing ties and elevate local partners beyond what established firms will do.”

According to Avascent’s survey responses a majority of companies receive poor scores for rarely performing or never performing key activities, including effectively managing offsets.

## **BRAZIL: AIRBUS COMPLETES P-3 ORION MODERNISATION PROGRAMME**

**Airbus Defence and Space** has delivered the last of nine P-3 Orion anti-submarine warfare aircraft modernised with new systems and avionics for the Brazilian Air Force. The contract calls for Airbus to provide a comprehensive package of offsets including a range of industrial projects, training, and R&D in the aerospace sector.

The nine aircraft were acquired by the FAB from the U.S. Navy in 2006.

On the civil side Brazil has imposed strict local content rules that oblige turbine-makers to source 60 percent of their hardware from domestic suppliers and to secure finance from the state-owned **Brazil Development Bank**. The outcome is a restriction on the number of manufacturers in the region.

## **FEISTY MP TELLS SERITI COMMISSION “ALL OFFSET DEALS ARE CROOKED”**

Arms Deal Commission Chairman Judge Willie Seriti has begun phase two of the commission’s public hearings by calling Cape Town Mayor Patricia De Lille to testify about the allegations she presented to parliament in 1999 when she was an MP. Judge Seriti ruled that De Lille should only be asked questions about matters about which she had personal knowledge.

Phase two of the hearings deals with allegations of fraud and corruption.

Ms De Lille had criticised a lack of transparency about the offset deals. She has called for the establishment of a formal judicial commission of enquiry into the arms acquisition and offset process to determine whether certain officials and public representatives are guilty of criminal conduct.

Asked by evidence leader Simmy Lebala why offsets were mentioned specifically, Ms De Lille replied that the public were told that purchasing R30bn in armaments would result in R110bn of investment and would create 65,000 jobs. “That is how it was sold to South Africa.”

Ms De Lille then accused officials from the DTI who had already testified, including former Director General Mr Jordaan and current Director General Lionel October, of being incompetent and inefficient by making unrealistic projections.

“You cannot thumb-suck something because you want to sell this deal to the country as creating 65,000 jobs.... Do they not know there is something called an actuary that can actually bring you closer to a projected figure?... I think they lied.”

“Do you mean that all those who spoke about jobs and all those who spoke about investments before this commission were all lying?” wondered Judge Seriti.

“I am not saying the political leaders lied. I am saying that they were lied to by the officials,” Ms De Lille replied before widening her allegations to embrace the entire offset industry.

“Let me say all the crooked arms deals around the world are structured with these offsets.... All over the world this is how they structure these things, because there are a lot of crooks running around and making deals amongst themselves and gainsaying us these jobs.”

Softening her approach she commented that there is a perception that not all the NIPS and DIPS have been delivered.

But under cross-examination Ms De Lille was obliged to accept that references to the 65,000 jobs were just projections. “You have indicated in your evidence that these particular projections are a lie, by officials, to the principals,” said counsel for the DTI.

“I would like to withdraw it,” she said.

After appearing before the commission Ms de Lille said she had no reservations about being the original whistle-blower.

Meanwhile two of the evidence leaders tendered their resignations. Advocates Barry Skinner and Carol Sibaya gave no reasons but were reported to have complained they had been undermined by colleagues in the commission.

## **SOUTH AFRICA’S CIVIL AIRWAYS PRESENT SIGNIFICANT OPPORTUNITIES FOR DENEL**

**Denel Aerostructures** is anticipating a windfall of industrial participation benefits from the proposed

acquisition of new wide-body aircraft by the state-owned carriers **South African Airways** and **South African Express**. The government requires local industrial participation on civil deals.

Denel says it is ideally placed to manufacture components for the winning bidders.

Ismail Dockrat, the company’s CEO, said the turnaround strategy to make Denel a profitable enterprise has several components. A credible business plan had to be drawn up and key contracts with **Airbus** for A400M components were renegotiated. Non-profitable contracts were restructured or terminated.

Denel Aerostructures is focusing its marketing activities on diversifying its customer portfolio to include more Tier 1 companies such as **GKN Aerospace**, **Spirit Aerosystems** and **Sogerma**. The company is looking to expand its product portfolio to include major structures for commercial aircraft, specifically within the single-aisle and wide-body segment of the market.

Boeing has previously subcontracted **Aerosud** to make components for its aircraft. **Boeing** said it is looking to expand its presence in South Africa through a range of activities including biofuels, training and manufacturing. The company has partnered with 43 Air School on pilot training and is working on additive manufacturing and titanium powder in conjunction with local researchers. It also has a biofuels programme with South African Airways.

Mr Dockrat said that South African Express was engaging with market players for new jets from manufacturers including **Superjet**, **Bombardier** and **Embraer**, while South African Airways was looking to Boeing and Airbus.

## **EC BLUSTER: “WE WILL FIGHT UNJUSTIFIED DISCRIMINATORY REQUIREMENTS IN PROCUREMENT”**

The European Commission has presented a report to the European Parliament re-stating its intention to phase out requirements for economic compensation “no matter how [such requirements] are labelled”.

For several years the commission has worked with member states on the revision of national offset rules, the report said. This work was done alongside the transposition of the Defence Procurement Directive and continues with member states that have not yet revised their offset legislation.

The commission will monitor the application of the provisions on subcontracting of Directive 2009/81/EC. Initiatives on how to improve market access for SMEs may be put forward to the European Council in June 2015.

The commission will also hold discussions with stakeholders on support for the European defence industry in third markets. Issues to be addressed include the impact of offset requirements in third countries on the European defence sector. Other offset-related activities that the European Commission has undertaken include:

- Market Monitoring – Analyse the impact of the Defence Procurement Directive 2009/81/EC through assessment of procurement opportunities published on the EU's Tenders Electronic Daily (TED) and other public sources.
- Clarification of exclusions from the Defence Procurement Directive – Issue guidance notes to help member states use exclusions correctly in the areas of Government-to-Government sales and International Agreements/Organisations.
- Offsets – Identify and fight unjustified discriminatory requirements in procurement. In parallel, the commission will look together with member states and industry at ways of promoting cross-border market access for SMEs by non-discriminatory means. The commission will form an ad hoc advisory group.

## **RUSSIAN OFFSET PROGRAM FOR PERU**

Russia will open a comprehensive technical service centre for helicopters in Peru in 2016 in compliance with an offset program. The pledge is part of the latest bilateral agreement.

Contractual terms for the service centre are expected to be settled by the end of 2015.

Peru ordered eight new Mi-171SH combat helicopters in addition to the batch of 25 helicopters contracted for in December of 2013. The value of the deal signed in 2013 was estimated at \$528m.

The centre will maintain and repair helicopters supplied under the contract as well as helicopters already bought by the country.

# **Trade Finance.....**

## **HUGE 'DEBT FOR GOODS' LOANS TO SOUTH AMERICA AS CHINA SPLASHES THE CASH**

China has turned its financial firepower towards South America by offering billions of dollars in credit to cash-

strapped leftist leaders in return for access to its oil, food and minerals. A feature article in *The Times* of London remarks that Latin leaders were effusive in their praise for the new deals.

With Venezuela and Argentina all but locked out of global capital markets, Xi Jinping, the Chinese President, has taken advantage of their isolation and thrown a monetary lifeline to Nicolas Maduro and Cristina Kirchner.

The Chinese leader has signed a series of oil and mineral deals with Venezuela after offering loans worth \$4bn. The socialist government will repay China with crude oil from its huge reserves.

"Venezuela has become one of the top countries for Chinese investment," said Mr Xi, who also promised to help in developing Venezuela's gold and copper reserves.

Mr Xi has pledged about \$11bn of financing to Argentina. "It's a day we can define as foundational in the relations between our two countries," Cristina Kirchner said.

"Chinese hunger for commodities has boosted many economies in the region in the past decade.... A Hong Kong consortium plans to start work on a canal across Nicaragua later this year, a \$40bn project to rival the US-built Panama Canal," commented the Venezuelan political analyst Carlos Romero. "It's not about ideology or competition with the United States, but a Chinese policy of looking long-term for natural resources in different parts of the world."

China knows that Argentina and Venezuela hold huge natural resource deposits: oil and food in the case of Argentina, and oil and gas in the case of Venezuela.

Mr Xi told his Venezuelan counterpart, Nicolas Maduro, that China is ready to expand the level of satellite technology passed to Venezuela.

The China Aerospace Science and Technology Corporation (**CASC**) has been contracted to deliver a second remote sensing satellite. CASC subsidiary **Great Wall Industry Corporation** will be the major contractor of the project.

Mr Xi said China would encourage Chinese companies to participate in the construction of Venezuela's special economic zone. He urged the two countries

to strengthen cooperation in the fields of finance, investment and energy and to promote cooperation in the areas of mining, infrastructure construction, and science and technology.

## Conference Update....

### GOCA OPENS REGISTRATION FOR CARTAGENA CONFERENCE – INDONESIA AND KUWAIT TO SPEAK

The **GOCA** Fall 2014 conference at Cartagena, Colombia, has opened for registration with a preliminary agenda that includes government presentations on:

Argentina, Brazil, Canada, Colombia, Indonesia, Israel, Mexico, and Peru.

Silmy Karim, Indonesia's Expert on the KKIP, is a confirmed speaker who will address the country's new offset and countertrade guidelines. Reem Al-Khader, Acting General Manager for the National Offset Company will speak on Kuwait's offset program.

Industry experts representing the following companies are to speak about their experiences in markets that include India, Korea, South Africa, Taiwan, and Turkey:

Baker & McKenzie, Boeing, Cisco, Dolin, GE, HP, Havelan, Intergoup, Northrop Grumman,

PricewaterhouseCoopers, Rafael, Ruag, Sikorsky, Telephonics, and Textron.

There also will be presentations on trade financing solutions, FCPA compliance, cyber security issues, civil offset programs, and an update on EU developments.

The event is from Sunday September 28<sup>th</sup> to Wednesday October 1<sup>st</sup>, 2014 at the Cartagena Hilton.

### ECCO Prepares for Vienna:

ECCO will hold its 9th symposium on November 19<sup>th</sup>-20<sup>th</sup>, 2014 in Vienna, Austria. The forum will cover offsets in Canada and South Korea. The workshop will be dedicated to compliance issues.

### EC Funds Technology Transfer Workshop in Brazil:

A workshop in Belem, Brazil from September 22<sup>nd</sup>-25<sup>th</sup> will discuss science parks, business incubation, and technology transfer in the context of EU-Brazil bilateral cooperation.

The workshop will promote cooperation on technology transfers. The final agenda will be announced after speakers have been selected through a call for "expressions of interest."

The organiser is B.BICE+, an International Cooperation (INCO) project funded by the European Commission.

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