

CHAPTER IV

Contract Management

4.1 Audit analysed the procurement of goods and services at three distinct stages as indicated below:

- Pre-tender stage involving appointment of the GC and preparation of detailed estimates;
- Tender stage involving pre qualification, preparation of tender documents, inviting and opening of tenders, evaluation of tenders and award of works; and
- Execution stage involving compliance of contract conditions relating to payments, quality assurance and timely completion of project.

4.2 Audit reviewed the process of appointment of the GC and 27 contracts valuing Rs. 6540.03 crore (*Annexure VI*) out of 100 high value contracts (*i.e.*, contracts for more than Rs. five crore) amounting to Rs. 8900.57 crore. Out of 27 contracts, 13 were lump sum price contracts in the nature of 'design and construct' wherein the designs were developed by the contractors. The remaining 14 contracts reviewed were based on bill of quantities.

4.3 The principal requirements of safety and environment protection were incorporated as conditions of the contract. The company has prepared Environmental Quality Management Manual which was generally followed by the contractors. The environmental monitoring was carried out by the company on regular basis. The company ensured that necessary fire protection and fire fighting facilities, like sprinkler systems, fire hose reels, raw water storage tanks, etc. were maintained at sites during construction.

4.4 The contractors were required to develop an integrated traffic management plan by making arrangements for road and pedestrian traffic at construction sites for smooth traffic operations and for safety of both construction workers and road users. Any traffic related facility (bus stop, parking, etc.) affected by construction was generally maintained or relocated. The arrangements made by the company to minimise inconvenience to the public were noteworthy.

Recommendation No. 8

The good practices adopted by the company for traffic management, safety and environment should be documented to enable their sharing and adoption by other or similar construction projects.

4.5 Manual for procurement

4.5.1 The company followed guidelines of the JBIC in case of the JBIC funded contracts. The company has, however, not documented guidelines, policy and procedures for domestically funded contracts. The management stated (April 2008) that the company had formulated General Conditions of Contract, Notice Inviting Tender, and Instructions to Tenderers, which coupled with delegation of powers to different levels of officers and

constitution of tender committees, ensured an efficient procurement system as existing in most of the government organisations. They added that many government departments have approached the company to make procurement on their behalf, which confirmed the efficacy, efficiency and transparency of its procurement system.

4.5.2 As the basic objective of a manual is to provide written guidance in a transparent manner and to make sure that actions and decisions of individual officers are not arbitrary, the company needs to manualise the whole set of guidelines for procurement at one place as a good management practice.

Recommendation No. 9

The company should formulate and manualise the procurement guidelines for each stage relating to pre-qualification, short listing of vendors, estimation, bids evaluation, award and execution of contracts.

4.6 Appointment of general consultant

4.6.1 The JBIC guidelines for the appointment of the GC provided for financial negotiations only with the first ranked technical bidder. So, the selection of the GC was not based on a system where the best bid was selected on the basis of technical quality cum cost basis. As the DPR had already prepared, it was possible for the company to define inputs from the consultant and open the financial bids of all bidders whose technical scores were beyond a bench mark, as permitted under the guidelines of other multi-lateral funding agencies in cases where it was possible to define inputs required from the consultants.

4.6.2 Financial bid of the highest ranked technical bidder viz., PCI led consortium* of Rs. 347.38 crore (exclusive of taxes, duties, levies and escalation) was opened and after negotiations, the contract was awarded at a price of Rs. 208.15 crore. The reduction in price was achieved by adjustments in vehicle cost, staffing schedule, reduction of scope and reduction in daily allowances, mobilisation and demobilisation charges, overheads, fees and profit.

4.6.3 A total of Rs. 254.10 crore was paid to the GC up to June 2006. Audit analysis of the work of the GC indicated that some factors were not anticipated by the GC while forecasting the requirements of the number of cars for Phase I (***Annexure VII***). Similarly, certain facts were not considered by the GC while recommending 1500 V DC TS in the underground corridor, as discussed in Chapter III.

4.6.4 The management stated (April 2008) that the JBIC guidelines for negotiating with the highest technically ranked bidder were based on the principle that the best consultant should be in place to manage the Project. It is, however, not clear how the reasonableness of the price negotiated with the highest ranked technical bidder was ensured under such a system.

Recommendation No. 10

In case it is possible to give a clear definition of inputs required from the consultants, their appointment should be based on a system where the best bid is selected on the basis of both technical quality as well as financial cost.

* comprising of PCI (Japan), PBI (USA), Tonichi (Japan), JARTS (Japan) and RITES (India).

4.7 Tendering Procedures

4.7.1 Preparation of estimates

4.7.1.1 Finalisation of the cost estimates before the receipt/opening of financial bids is an established best practice, which helps in ascertaining the reasonableness of the prices obtained. This could have been done by the company as a consultant (GC) had been appointed for this purpose. It was seen in Audit that out of 13 ‘design and construct’ contracts reviewed, in 7 cases (award value Rs. 3314.50 crore), the estimates were revised or approved after opening of financial bids. Thus, tenders were invited without benchmark estimates, in the absence of which efforts undertaken to optimise costs could not be ascertained. Further, out of these seven cases, in three cases (award value Rs. 3097.89 crore), even financial concurrence was not obtained before approval of the estimates by the competent authority (*Annexure VIII*).

4.7.1.2 Audit analysed the different stages of tendering process in two contracts, viz., Metro Corridor (MC) 1A and 1B contracts as appearing at *Annexure IX*. It is observed that the tenders were invited in October 1999 for both these contracts on the basis of the initial estimates in the DPR without firming up the cost estimates. The process of approval of cost estimates in both these contracts was initiated only after negotiations and opening of revised financial bids in October 2000. The estimates were approved in December 2000/January 2001 after receipt of the final negotiated bids.

4.7.1.3 The management stated (April 2008) that all major works were done on ‘design and construct’ basis and as such preparation of detailed estimates was not possible. They added that the five tier contract awarding procedure involving the GC, two internal committees, acceptance of the competent authority and concurrence by the JBIC, ensured that optimum prices were obtained for all the major works. The fact, however, is that the company had expressed its concern to the JBIC regarding lack of competition for major contracts. In such a situation, firming up of the estimates before opening of financial bids would have helped the company in ascertaining the reasonableness of the prices obtained and in optimising the prices during negotiation.

Recommendation No. 11

The company should evolve a system of finalising the cost estimates before inviting financial bids to maintain transparency and to ensure reasonableness of the offers received.

4.7.2 System of opening of bids

4.7.2.1 The JBIC guidelines permitted rejection of tenders and invitation of fresh ones in case the lowest evaluated bid exceeded the cost estimates by a substantial amount. The guidelines further provided that where exceptional circumstances justified this, the borrower may, as an alternative to re-tendering, negotiate with the lowest evaluated tenderer (or failing a satisfactory result of such negotiation, with the next lowest evaluated tenderer) to try to obtain a satisfactory contract.

4.7.2.2 In case of MC 1A and 1B contracts, the company requested (28 March 2000) for simultaneous negotiation with two or three the bidders as a departure from these guidelines. After initial reluctance to allow negotiation with two or three bidders simultaneously, the JBIC relaxed (August 2000) its guidelines after considering revision

of the specifications or modifications of the Project and advised the company to conduct negotiations with both the bidders in both the contracts. This departure from guidelines by the JBIC without the concurrence of the GOI was not in consonance with the loan agreement which laid down that any departure was to be requested by the borrower (*i.e.*, the GOI).

4.7.2.3 Revised bids were received (13 and 16 October 2000) from these consortia. Consortium 'A' remained the lowest evaluated tenderer for MC1B and Consortium 'B' (previously the second lowest tenderer) became the lowest evaluated tenderer for MC1A. The procedures adopted in bid opening and evaluation procedures of MC1A contract were examined and the following were noticed:

- (i) Before the opening of the original bids it was recorded in the tender opening register that the seals of the envelopes were intact, but no such statement was recorded at the time of revised bids. Besides, the tender opening register for revised bids did not contain signatures of the tenderer's representatives.
- (ii) A letter indicating a discount of 13 *per cent* on the contract price, stated to be in a separate envelope by the management, was placed on top of the revised financial bid documents of Consortium 'B' after making corrections to the page numbers of the bid documents. This letter did not find any mention in the covering letter of Consortium 'B' or in the tender opening register.
- (iii) The corrections in page numbering, which have financial implication allowing the bidder to become the lowest evaluated tenderer, were not recorded by the GC in the financial evaluation report, as was done by it in the evaluation report of the original bids.
- (iv) The fact that discount rate of 13 *per cent* was not mentioned in words, was not recorded by the tender opening committee.

4.7.2.4 The management stated (April 2008) that it was quite common that such discount letters were included in the bids at the last moment and, therefore, did not necessarily find place in the covering letter. Tender opening was witnessed by 17 representatives of the contractors and 10 representatives of the GC/the company; and bid prices were acknowledged by the two bidders by affixing their signatures in the 'negotiated price bid opening sheet'. The fact, however, remains that there were procedural shortcomings in the processing of bids and there was no mention of receipt of the sealed envelope in the tender opening register.

4.7.3 System of evaluation of bids

In one of the contracts for track works of Line 3, single tender was called for from IRCON International Limited. After negotiations, IRCON gave an offer for Rs. 86.61 crore which was 4.64 *per cent* higher than the estimated amount of Rs. 83.03 crore and the Tender Committee recommended award of the contract to IRCON at the negotiated offer value of Rs. 86.61 crore. The tender accepting authority observed that "Since our estimate does not include works contract tax (WCT) we should give a counter offer of our estimated cost and WCT on actual incidence". Accordingly the company gave a counter offer of Rs. 84.46 crore which was accepted by IRCON and the work was awarded to them. Audit noticed that the in-house estimates of cost were prepared based on the rates of last accepted order which already included WCT. Hence inclusion of WCT again has resulted in the counter offer being higher by Rs. 1.43 crore. The management replied (April 2008) that the intention of the competent authority was to

limit WCT to two *per cent* of the contract value. The reply is not tenable since the tender accepting authority was under the impression that the estimates did not include WCT which was not correct.

4.7.4 Relaxations in commercial and technical terms

As per the JBIC guidelines, a contract was to be awarded to a bidder who met the technical criteria and whose price bid was determined as the lowest. Audit found that in four contracts (MC 1A, MC 1B, SYS 1, RS 1) relaxations in commercial and technical terms (*Annexure X*) were allowed after the opening of the financial bids while negotiating with the lowest bidder (s). This practice was non-equitable as the other pre-qualified bidders were denied the opportunity to revise their bids in view of the change in commercial and technical terms. The management stated (April 2008) that the changes were not substantial and did not affect the functionality and safety of the product. Further, it resulted in reduction in the quoted price and the bid prices of other bidders were far too high to make a difference on this account and the practice was as per the JBIC guidelines. The fact, however, is that the JBIC guidelines were silent on technical and commercial changes in the bids during negotiations.

Recommendation No. 12

The company needs to further strengthen its system of processing of bids to bring in more accountability, transparency and fairness.

4.8 Construction supervision and contract execution

For Line 1 and Line 2, the company assigned the work of construction supervision to the GC who was responsible for the development of a suitable system for ensuring quality and time schedule for the work. In respect of Line 3, the company took upon itself the responsibility of construction supervision. Audit analysis of the time schedule and quality requirements and issues arising therefrom are discussed in Chapter V on Project Monitoring. Issues relating to payments are discussed below:

4.8.1 Payment of advances beyond contract provisions

In six cases, advances amounting to Rs. 38.72 crore not contemplated in the agreements were sanctioned to the contractors (*Annexure XI*). The management stated (April 2008) that the interest bearing advances (except in one case) beyond contract provisions were given to contractors under compelling circumstances in the interest of the Project; and this had not resulted in any loss to the company. The fact remains that this was a deviation from the terms of the agreement.

4.8.2 Short recovery from contractors

(a) For effecting recoveries from the contractor (MC 1B contract) towards exemption of duties on supply of equipment, the company applied the rates applicable on the date of import/supplies, which were lower as compared to the rates prevailing on the date of submission of bids. This resulted in short-recovery of Rs. 14.41 crore towards excise duty (Rs. 9.50 crore) and customs duty (Rs. 4.91 crore). The management stated (April 2008) that the actual benefit, which could have accrued to the contractor on account of exemption, was only to be recovered from the contractor as per the contract. The reply is not tenable, as the rate applicable on the date of submission of bids, should have been the basis for effecting recoveries.

(b) During execution of the MCIA contract, the company allowed the contractor (October 2002) to replace 20-30 *per cent* of cement by fly ash for structural concrete subject to adjustment in contract price. However, the company did not recover Rs. 3.47 crore on this account, as the contractor argued that non-replacement of part cement with fly ash would have led to inferior concrete. The management stated (April 2008) that no adjustment was made as the use of fly ash was permitted as per the technical conditions. The reply is not acceptable because saving was to be passed on to the company as per the technical conditions and according to the IIT non-replacement of part cement would not have led to inferior concrete.

(c) As per the contract agreement, interest on advances was to be calculated from the first day of the month in which the advance was paid to the contractor. It was observed that there were short recoveries totalling Rs. 40.20 lakh from the contractors in four contracts, due to non-charging of interest for the month in which advances (second installment onwards) were released. The management stated (April 2008) that all the recoveries had been correctly carried out. However, Audit found (February 2008) that interest of Rs. 40.20 lakh had still not been recovered.

4.8.3 Payment of inadmissible claims

The company paid Rs. 6.92 crore against contractors' claims in eight contracts which were not admissible as per the contract agreement, as discussed below:

(a) In respect of four contracts*, the company allowed (September 2003) inadmissible claims of Rs. 4.43 crore to contractors towards price variation by revising the price variation formula for aggregates. This price variation should not have been allowed because of the failure of the contractors to adhere to the existing law.

(b) A contractor, while executing the work of bridge across river Yamuna, proposed a new design for construction of one pier, which did not require sand filling in remaining 14 wells. The company accepted the proposal and paid Rs. 10.89 lakh for this. Though the contractor has not filled sand in 14 wells, the company has released the payment of Rs. 49.43 lakh towards sand filling on the plea that it was a lump sum contract.

(c) Though the contract† did not have any price variation clause, the company accepted the contractor's claim of Rs. two crore towards increase in steel prices on the plea that SAIL's Kolkata stockyard prices (on which bid prices were based) had increased and there had been huge wastage of steel in fabrication of girders.

The management stated (April 2008) that the claims were admitted in order to complete the work on time. They added that in case these claims were not settled, the commissioning of the respective lines would not have been possible on time, thus incurring much more losses in terms of interest. Though acceptance of the inadmissible claims was stated to be in the interest of timely completion of work, the aforesaid contracts were not completed in time.

4.8.4 Non-levy of penalty

4.8.4.1 While discussing proposal for award of work of design, manufacture, supply and commissioning of passenger rolling stock comprising 240 cars, the BOD was informed

* RC2B lot 2, RC2B lot 3, RC2B lot 4 and RC2B lot 5

† fabrication, supply and erection of steel girders for viaduct on Barakhambha Road-Dwarka section

that body shells of 100 cars were to be fully manufactured in India with indigenous material and any deviation would attract penalty of Rs. 150 crore on the contractor. The contract was awarded (22 May 2001) to Mitsubishi led consortium for Rs. 1456.30 crore with the condition that if the contractor failed to carry out the indigenous programme it would be treated as default on his part, entailing termination of the contract. There was, however, no provision for levy of any pecuniary penalty.

4.8.4.2 The management stated (April 2008) that in the event of the contractor failing to set up facilities for indigenisation, inordinate delay in commissioning of trains would have occurred, leading to levy of liquidated damages equivalent to 10 *per cent* of the contract value, which roughly worked out to Rs. 150 crore. Further, knocked down sub-assemblies of the shells were imported and car bodies of 180 coaches were assembled indigenously at Bharat Earth Movers Limited, Bangalore using these sub-assemblies. However, the assembly of body-shells from knocked-down sub-assemblies cannot be considered equivalent to manufacture of the same in the country with indigenous material and in the absence of any explicit clause in the contract agreement, no penalty could be imposed for non-utilisation of indigenous material.

Recommendation No. 13

To enforce utilisation of indigenous material by a contractor, explicit penalty clause should be incorporated in the contract agreement to serve as an adequate deterrent to the contractor.

4.8.5 Avoidable payment due to not allowing demobilisation of the plant

The company did not allow the contractor to demobilise the welding plant, though the welding work had been completed in one section (R2) of RC3 contract. As the plant remained idle for five months (April-August 2003), the company had to pay the contractor Rs. 1.43 crore. The management stated (April 2008) that the plant was an essential equipment having a bearing on the completion of the Project and thus a decision was taken not to allow the contractor to demobilise it. However, as the contractor had assured the demobilisation of the plant at the appropriate time, the company should have allowed the demobilisation and avoided payment of Rs. 1.43 crore.