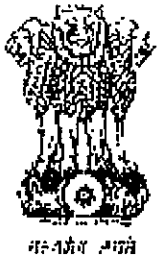

REPORT

OF

THE COMMITTEE ON PUBLIC PROCUREMENT

June 2011

Report of
The Committee on Public Procurement

The Committee constituted by Cabinet Secretariat vide Order No. 483/1/1/2011-Cab dated 31st January 2011, along with subsequent modifications, consisted of the following:

1. Shri Vinod Dhall
Chairman

2. Smt. Vilasini Ramachandran
Member

3. Shri C.S. Prasad
Member

4. Shri A.K. Mangotra
Member

5. Shri Vivek Rae
Member

6. Shri S. Chandrasekhar
Member

7. Shri S. C. Sharma
Member

8. Shri M. P. Gupta
Member

9. Shri J. S. Deepak
Member

10. Shri Gajendra Haldea
Member

11. Smt. Ajanta Dayalan
Member Secretary

The Committee presents its Report for consideration of the Government.

New Delhi,
June 09, 2011

Note: Three members viz. Shri S.C.Sharma, Shri M.P.Gupta and Shri Gajendra Haldea have signed this Report subsequently after their respective Notes of Dissent were included at Annexure -VIII and Annexure- IX along with a clarificatory paragraph No. 11.3.8 in chapter 11.

INDEX

FOREWORD

Public procurement is a necessary and all pervasive activity within Government and its organisations, stretching across the breadth and depth of the Government structure. Efficiency and probity in public procurement, on the one hand, determine the efficacy of the utilization of public funds and resources and the quality of services that Government is expected to deliver. On the other hand, it affects the public perception of the credibility of public procurement in particular and the level of governance in general.

Needless to say, the public generally has a dim view of public procurement practices in India; these are regarded by many as a by-word for corruption and inefficiency. The view has long been held that there is need to undertake systemic and procedural improvements in this area. Some recent revelations of mal-practices in high profile procurements have only brought out in stark relief the urgency of reform in this area. Government has indicated its mind to undertake serious measures in this direction, and has set up the Committee on Public Procurement with the responsibility to study and make recommendations in this regard. I was privileged to head this Committee.

At the outset I, and through me, the Committee benefited from the guidance I received from the Finance Minister, Shri Pranab Mukherjee, the Deputy Chairman of the Planning Commission, Dr. Montek Singh Ahluwalia and the Cabinet Secretary, Shri K.M. Chandrasekhar. The Committee itself comprised of very knowledgeable and experienced officers from the relevant ministries and organizations as well as respected professionals in the field. The Committee's proceedings gave us invaluable insight into the conduct of public procurement in the Central Government and its organizations. The deliberations in the Committee were free, frank and vigorous, but united by

the objective of finding sound solutions to the problems afflicting public procurement. The Committee's labours extended into long hours on working and non-working days, but conscious that we had too little time for a mandate of this magnitude and complexity.

We examined the Indian public procurement system and viewed this in the light of international best practices. We do not lay any claim to the exhaustiveness of the report. Suffice it to say that all the salient features of the system have been studied and specific recommendations made towards systemic improvements and plugging of various loopholes.

What we are recommending are not incremental modifications of the existing system. We are proposing basic reform of the whole area of public procurement, including the legal and regulatory framework, the institutional structure, the deployment of modern technology in aid of public procurement, as well as overhaul of certain specific prevailing practices.

The exercise, laborious and time consuming as it was, has been an enormously satisfying one. On behalf of the august Committee, it is my privilege to commend this report to Government. I am confident that the report would receive the due consideration of Government, and thus the Committee on Public Procurement would have made a small contribution towards the much needed reform of the public procurement system in India.

(Vinod Dhall)
Chairman, Committee on Public Procurement

ACKNOWLEDGEMENTS

The Committee was assigned the task of looking into various issues having an impact on public procurement policy, standards and procedures. In view of the fact that public procurement is a major activity spread over all Ministries/Departments and organizations of the Government and spanning all levels of hierarchy, consideration of the myriad issues involved therein would not have been possible without support and assistance of a large number of organizations and individuals.

2. In this regard, first and foremost, the Committee is grateful to the Finance Minister; Deputy Chairman, Planning Commission; Deputy Comptroller and Auditor General of India; Central Vigilance Commissioner; and Chairman and Members, Competition Commission of India, for taking time out from their busy schedule to hold discussions with the Chairman of the Committee. The Committee has greatly benefitted from their valuable insights and guidance. The Committee is equally obliged to the Cabinet Secretary for unstinting support and guidance, without which the Committee may not have been in a position to hold deliberations in a meaningful manner and firm up its recommendations. The Committee is also grateful for the cooperation and contributions made by Secretaries, including Finance Secretary and Commerce Secretary, and other senior officers of several Ministries and Departments of the Government of India, including the D/o Expenditure, M/o Defence, M/o Railways and D/o Commerce, in its efforts at having a wider and in-depth understanding of the current procurement practices and shortcomings therein. The Committee also benefited from information and insights provided by various Public Sector Enterprises as well as by Chambers of commerce and industry. Interactions with them facilitated the Committee in finalizing its recommendations.

3. The Committee also wishes to acknowledge the support extended by Cabinet Secretariat and D/o Commerce, particularly the Office of Director General, Supplies and Disposals, as well as the Planning Commission in providing logistics and secretarial support for the Committee.

4. The Committee also received inputs from the National Institute of Financial Management which was engaged as the consultants during the initial work of the Committee.

5. The Committee also places on record its appreciation of the efforts of individual members of the Committee in making the Report comprehensive, yet simple, to make it amenable for consideration by the Government.

LIST OF ABBREVIATIONS

CVC	Central Vigilance Commission
DGS&D	Directorate General of Supplies & Disposals
DPR	Detailed Project Report
EPC	Engineering, Procurement and Construction
GOM	Group of Ministers
GDP	Gross Domestic Product
GFR	General Financial Rules
NHAI	National Highways Authority of India
OECD	Organisation of Economic Cooperation and Development
PPP	Public Private Partnership
PSE	Public Sector Enterprise
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organisation

Chapter 1

INTRODUCTION

1.1 In India, public perception about the quality, credibility and probity of public procurement is generally poor. There is a general feeling that corrupt practices abound, and the system is by and large inefficient and wasteful. A few high profile scandals that have erupted recently have further heightened public disenchantment and distrust of Government procurement systems. As a result, public procurement is often perceived as the soft underbelly of the governance structure.

1.2 Following some recent developments, the Government of India, at the highest levels, has been considering measures for tackling corruption in various spheres of national activity. The importance given to this matter may be gauged from the fact that while presenting the Union Budget for the year 2011-12, the Finance Minister announced that a Group of Ministers (GOM) has been constituted to consider measures that can be taken by the Government to tackle corruption. The GOM is to address issues relating to state funding of elections, speedier processing of corruption cases relating to public servants, transparency in public procurement and contracts, discretionary powers of Central Ministers and competitive systems for exploiting natural resources. In its first meeting, the GOM, which is headed by the Finance Minister, decided to set up a Committee to look into various issues that impact public procurement policy, standards and procedures; this was the genesis of this Committee on Public Procurement. A brief description of the mandate and Terms of Reference of the GOM and the Committee may be seen at Annexure-I.

1.3 Different authorities and organizations may have different definitions for public procurement; but it is generally understood to mean procurement of various types of supplies by public authorities; the

supplies are generally regarded in three categories, viz., goods, works (construction), and services. The general view also is that public procurement includes procurement by all public bodies, such as subordinate organisations of the Government, autonomous organisations, and local bodies. Consistent with general practice, a simple and clear definition of procurement adopted by the Committee is as follows: "Public procurement is the acquisition of works, goods and services by public bodies for a consideration." The procurement may be under formal contract or otherwise, and it may range from routine supplies and services to large infrastructure projects.

1.4 Needless to say, public procurement in India is a major activity within the Government, not merely for meeting day to day functional requirements, but also for underpinning various services that are expected from the Government, e.g. infrastructure, national defence and security, utilities, economic development, employment generation, social services, and so on. The "command and control" regime of earlier years and the enormous growth of public sector enterprises (PSEs) have added a major dimension to the body of public procurement in India. Thus, apart from the ministries and departments, vast amounts of procurement are undertaken by the PSEs and other subordinate organisations of the Government—at the levels of both the Central and the State Governments. In addition to this horizontal spread, vertically public procurement is undertaken at all levels of the hierarchy. Public procurement thus is an all- pervasive function across the Governmental machinery.

1.5 Public procurement has grown phenomenally over the years –in volume, scale, variety as well as complexity. Whereas in the earlier years public procurement comprised simpler goods and works, today it includes sophisticated and hi-tech items, complex works and a wide range of services. No definitive estimates of the total size of India's public procurement are available at any one place. An OECD quick estimate puts the figure for public procurement in India at 30 per cent

of GDP whereas another rough WTO estimate puts this figure at 20 per cent of GDP. The Competition Commission of India had estimated in a paper that the annual public sector procurement in India would be of the order of Rs. 8 lakh crore while a rough estimation of direct Government procurement is between Rs. 2.5 to 3 lakh crore. This puts the total public procurement figure for India at around Rs. 10 to 11 lakh crore per year.

1.6 Though procurement is a major and widespread activity in Government, the Committee noted that the regulatory and institutional framework for public procurement is, in several respects, incomplete and weak, so that it does not provide a sufficient basis for ensuring its essential qualities: transparency, accountability, efficiency, economy, competition and professionalism.

1.7 The Committee noted that the OECD has drawn up a matrix of items that enables a quick assessment of the state of procurement practices in a country. The said matrix may be seen at Annexure-II. It suggests that India may be lagging behind on many of the items contained in this matrix such as a legislative framework, including subordinate legislation, model documents, general conditions of contract, procedures for contracting, multi-year planning and integration with budget, timely procurement and payments, conflict of interest, quality control and performance evaluation, contract administration, dispute resolution, appeals, etc.

1.8 There is no public procurement policy or public procurement law in India. The States of Tamil Nadu and Karnataka have enacted simplistic versions of transparency laws for public procurement, but these may be regarded as rather rudimentary, and lacking in teeth. There is no separate department or division in the Central Government to which the public procurement authorities can refer any matter for guidance and leadership. At present, many such references on public procurement are being made to the CVC by the procuring authorities,

mostly as a measure of abundant precaution from the vigilance viewpoint. The CVC sometimes issues clarifications and circulars even though such work should primarily be done by the Government.

1.9 In the absence of an overarching procurement law, public procurement is governed largely by the General Financial Rules (GFR) issued by the Department of Expenditure in the Ministry of Finance. Only two chapters of GFR pertain to the procurement of goods, services and works. Under the broad framework of the GFR, the various departments and other public organisations develop their own procurement manuals and procedures which guide them in conducting procurement activity in their respective fields. Though the Department of Expenditure is the repository of the GFR, it is saddled with more urgent and pressing issues. As a result, public procurement does not get the priority it deserves under the present arrangement.

1.10 The Committee noted that though the GFR was substantially improved through the 2005 revision, critical gaps still exist, especially in the field of works and services. A review of the procurement systems and procedures by this Committee revealed marked differences in the practices being followed across ministries and organisations, some of which were at odds with the GFR. The GFR, not being a law per se, their violation cannot attract penal action; the GFR thus cannot be a substitute for a comprehensive law in this area.

1.11 During its proceedings, the Committee held extensive deliberations and invited various ministries and industry organisations for consultations. While reviewing the current public procurement framework in the country, the Committee also reviewed information about the public procurement systems prevailing in other countries, developed as well as developing, such as the United States, Canada, South Korea, China, Afghanistan, Bangladesh and Nepal. The practice and procedures of international organisations like the UNCITRAL, WTO, OECD and World Bank were also studied. These yielded valuable lessons relating to best practices.

1.12 The Committee envisages a basic reform of the public procurement system as it exists in the country today. The reform is required both in the legal and institutional framework governing public procurement in India as well as in some of the practices presently being followed by the procuring departments to which the Committee has drawn attention in this report. There is need to enunciate a Public Procurement Policy that would set out in clear terms the Government's approach to this important activity. The Policy should be backed by a Procurement Law that would give an enforceable form to key provisions of the Policy including penal action against violations by the procurers or the suppliers. To provide effective leadership in public procurement and bring about the reforms suggested herein, the Committee recommends the setting up of an institutional framework, preferably in the shape of a dedicated department, within the Ministry of Finance. This department would have no operational responsibility for direct procurement per se; it would act as a repository of the law, rules and policy on public procurement, and monitor compliance therewith. It would institute best practices, professionalise the public procurement function, arrange for capacity building, create and maintain the overarching public procurement portal, and maintain management information systems and statistics pertaining to public procurement.

1.13 The Committee on Public Procurement is of the view that if its recommendations are implemented in totality, these would lead to substantial improvements in public procurement in terms of its objectives of transparency, accountability, efficiency, economy, competition, and professionalism. These measures would in turn improve the public perception of the state of public procurement in the Central Government. The Committee also hopes that the reforms at the national level would set the pattern for similar reforms at the level of the State Governments.

Chapter 2

PUBLIC PROCUREMENT POLICY

2.1 Introduction

2.1.1 Currently, Government of India does not have a separate policy statement on public procurement. It is common for Government to put out dedicated policy documents in respect of several of its major activities, e.g. industrial policy, export-import policy, environment policy, and so on. Considering the volume of public procurement and its all pervasive nature spread over the length and breadth of the Government machinery, it is a matter of concern that there is no policy document addressing the issue of public procurement.

2.1.2 It could be argued that since the essential principles of public procurement such as transparency, competition, economy, efficiency and accountability are already embedded in the General Financial Rules (GFR), a separate policy statement on public procurement may not be required. However, the GFR are essentially internal guidelines, not readily available in the public domain, and do not have the profile of a policy document. This gap should now be effectively filled by formulating a policy document on public procurement. The policy document would articulate the broad approach of the Government on the subject, and set out the objectives and principles of public procurement and the processes related to it. The statement would also outline the vision of the Government as to the direction in which the Government intends to move in future with regard to public procurement. It could also help bring out the expectations that Government have from the bidding organisations which seek to supply the required goods, works or services arising out of public procurement.

2.1.3 The policy statement would serve a dual purpose: as guidance for the procuring agencies, as well as a public commitment by the Government to the general public and the body of vendors about the good governance principles that shall guide public procurement. The policy could also serve as a means to encourage the States to move towards similar reforms in public procurement.

2.2 Public Procurement Policy

2.2.1 The Committee recommends the proposed Statement on Public Procurement Policy be issued on the lines suggested below.

2.2.2 Government believes that public procurement, including procurement by the Government, public sector entities and statutory authorities, should at all times and in all of its stages be guided by the principles of transparency, economy, efficiency, competition, accountability, and fairness and non-discrimination. Government would undertake systemic reforms with a view to ensuring that the above principles are ingrained into the public procurement system. The improvements resulting from the reforms are likely to result in substantial savings to the Government. Government has resolved to plug the loopholes that leave scope for corruption or other forms of leakages and malpractices, and hope that this will also alter the widely held negative perceptions about public procurement. Government expects ethical behaviour, not only from the public officials who undertake procurement but also from the vendors; it would spell out a code of conduct that the vendors would be required to subscribe to when supplying to Government.

2.2.3 A pre-requisite for reforming the public procurement system is to build a sound and stable legal and institutional framework. Given the volume of public procurement and its all pervasive nature within Government, it is proposed to have a law that will underpin the binding principles and mandatory practices that must inform all public procurement. The law would also include deterrent provisions and penalties for

violation of its mandatory provisions, whether these violations are committed by the procuring authorities or by the vendors.

2.2.4 There would be provisions to exempt from the application of the law certain categories of public procurement such as small procurements below specified thresholds where it is not feasible or economical to follow standard procedures, procurements in cases of emergencies, and sensitive procurements such as for defence and national security; the exemptions would be tightly defined so as to prevent their misuse.

2.2.5 The proposed public procurement law would be complemented by a body of public procurement rules that would provide for operational level details. These public procurement rules would replace and bring together the existing General Financial Rules as well as other instructions of generic nature that are currently widely scattered and fragmented, and sometimes at cross purposes with one another. The law and the rules would, however, permit sufficient flexibility in dealing with the immense variety in the nature and scale of public procurement; the various procurement entities would have their own procurement manuals carrying detailed instructions specific to the needs of that procuring entity.

2.2.6 Government also recognizes that there is inadequate leadership within Government in respect of public procurement, which too has contributed to a relative lack of professionalism in handling public procurement activities. Modern day procurement has grown in scale, variety and complexity; there is therefore a need to view public procurement as a discipline in itself that needs a high level of professionalism. It is proposed to constitute a separate Department of Procurement as the nodal and central authority for public procurement in Government. The department, that would be located within the Ministry of Finance, would be a professionally staffed department of the Government, and would be responsible for evolving Government policy and coordinating and monitoring its implementation across the various levels of Government, as well

as providing professional guidance to procuring entities. The department would have no direct operational role in undertaking procurement.

2.2.7 The fundamental principles of effective procurement require that any proposed procurement should be given sufficient publicity, commensurate with its size and nature, to attract maximum participation and competition. The law, rules and subordinate instructions would mandate appropriate publicity and placement of the proposed procurement in the public domain through various means such as the media, website, and trade journals. Competitive bidding would be the norm for procurement, unless permitted and justified in special cases.

2.2.8 The Government recognises the need for standardisation, including in the procedures, tender documents, and general conditions of contract. The specifications set out in the tender documents should be clear, generic as far as possible, and provide no advantage to any one party; the procurement process should provide a level playing field to all players. The criteria for evaluation should be clearly spelt out in the tender documents; evaluation should be carried out only on the basis of the so declared criteria. Public opening of bids should be mandatory. The result of the tendering process should be put out in the public domain. Unsuccessful parties shall, on request, be entitled to know the grounds on which their bids were not successful. Debriefing would be provided for to allow unsuccessful parties to submit more responsive bids in future; Government encourages a more participative process in public procurement instead of viewing it as an adversarial relationship. The law and rules would contain measures for timely payments, grievance redressal and appeal through an independent mechanism.

2.2.9 There would be a general bar on negotiations as these create opportunities for mal-practices and do not necessarily lead to lower prices since vendors would keep a cushion in their bids and the

Government would rarely be able to extract the entire over-bid amount. Negotiations would be permitted only in exceptional cases of great complexity, and only with the permission of higher authorities.

2.2.10 Modern information and communications technology (ICT) could provide solutions to many of the current deficiencies in public procurement, as well as facilitate access to relevant information and maximum participation. The Government would create and maintain an over-arching public procurement portal; the portal would serve multiple objectives. It would enable wide publicity to the proposed procurements/ tender enquiries, provide access to procurement rules and bid documents, disclose bid results and decisions on complaints relating to the bid process, and enable e-payment.

2.2.11 Government would progressively move towards e-procurement. This measure would be undertaken in a project mode, thus also carrying forward the progress towards e-Governance.

2.2.12 In some aspects, public procurement is caught in antiquated procedures, and has to embrace newer forms of global best practices, including newer forms of procurement. This deficiency is most visible in the case of procurement of works. Immediate steps are being taken to address this deficiency. In particular, Government is of the view that works procurement should, with suitable exceptions, migrate to the EPC (Engineering, Procurement and Construction) form of contracting; this mode is also often referred to as the turnkey or lump-sum mode. In suitable cases, projects would be procured in the Public Private Partnership (PPP) mode. Procurement should have built-in incentives for good performance and dis-incentives for poor performance, which are currently not provided.

2.2.13 With a view to professionalising the function of public procurement, it is important to institute an elaborate system for capacity building and training in all aspects of public procurement. The training would

not be confined to mere knowledge of extant rules and procedures applied mechanically, but also to basic principles and concepts of public procurement, writing of specifications, qualification and evaluation criteria, and contract terms, assessment of life-time costs, knowledge of best practices, etc. Government would seek cooperation in capacity building with governmental and other training and professional institutes. These institutes would be encouraged to provide short-term and long-term courses in public procurement.

2.2.14 The public procurement law and policy would apply to all Government ministries and departments as well as to all Government bodies and organisations. It will also apply to Public Sector Enterprises, care being taken, however, not to affect their commercial flexibility; the law, rules and policy would be confined to broad principles and practices. Government hopes that the reform of the public procurement would encourage the State Governments as well as their subordinate organisations and local bodies to undertake similar measures.

Chapter 3

PUBLIC PROCUREMENT LAW

3.1 Introduction

3.1.1 India does not have an Act of Parliament to govern public procurement. Article 299 of Constitution relevant for public procurement only provides that Government contracts shall be expressed to be made by the President, and executed on behalf of the President through persons authorised for this purpose. Therefore, only the Indian Contract Act, 1872 and the Sale of Goods Act, 1930 govern contracts and sale and purchase of goods in general.

3.1.2 In the absence of a law on public procurement, each ministry, department and PSE, while following the basic rules of the open tender system, feels free to devise its own variations, with its own perceptions of public interest. The Government is the same, the procurement objectives are the same, even the specific work/goods or the bidders can be the same, but the procedures and policies practiced by each agency are different. This takes away the credibility and public confidence in the system. The rules and procedures are viewed more as guidelines and the ministries can override these in the name of expediency and public interest, without a serious challenge from the public and the potential bidders. A Public Procurement Act complemented by a set of Procurement Rules, will improve the transparency of the process and accountability of public officials. The law would discourage the corrupt elements from short-cutting procedures in the name of 'public interest' unless the action could be defended in a court of law. Some States have taken a lead on this initiative. Tamil Nadu has enacted the Tamil Nadu Transparency in Tenders Act, 1998 and Karnataka has enacted the Karnataka Transparency in Public Procurement Act, 1999.

3.1.3 Article 77, clause (3) of the Constitution of India states that the President shall make rules for the more convenient transaction of the business of the Government of India, and for the allocation among Ministers of the said business. Under this article, the Government of India (Allocation of Business) Rules, 1961 have been issued. These Rules, in Schedule II, allocate to the Ministry of Finance, Department of Expenditure the 'financial rules and regulations and delegation of financial powers'.

3.1.4 Presently, public procurement by the Central Government is largely governed by the General Financial Rules (GFR), 2005 issued by Department of Expenditure, Ministry of Finance. The GFR were first issued in 1947 in the form of executive instructions. These were subsequently modified in 1963. The rules were further simplified and put in a logical sequence for easy comprehension. The GFR can only regulate the conduct of Government business and does not provide any right to the public in the matter of public procurement. As a result, the GFR is internal to the Government. So far as Government officials are concerned, any violation of GFR can only be penalised under the Service Conduct Rules.

3.1.5 The only procurement law in India comprises the judgements of the Supreme Court laying down some basic principles of public procurement emanating from the fundamental rights enshrined in the Constitution. In the absence of a codified law, any enforcement of rights and duties becomes difficult and comes only through expensive recourse to High Courts or the Supreme Court. Some of the important case laws are:

(a) Government organisations are not allowed to work in secrecy in dealing with contracts, barring rare exceptions.*

* State of U.P. v. Raj Narain & Ors.(1975) 4 SCC 428, recalled in G. B. Mahajan v Jalgaon Municipal Corporation JT 1990 (2) S.C. 401.)

(b) Reasons for administrative decisions must be recorded, based on facts, or opinions of knowledgeable persons, again based on facts.†

(c) Adequate publicity of procurement is essential.‡

(d) Officers engaged in public procurement have to perform fiduciary duty.#

(e) There has to be fair play in the actions for procurement.**

(f) Bid evaluation has to be strictly in accordance with the bid evaluation criteria stated while inviting the bids.‼

3.1.6 Codified law governs public procurement in a large number of countries. UNCITRAL has also published a model law on procurement in 1994. The World Trade Organisation (WTO) has published yet another model in its Government Procurement Agreement. A bird's eye view of the legal framework in different countries is given below:

(a) In the ***US***, the Congress has enacted the Title 41 Public Contract Code, and the Office of Federal Procurement Policy Act that set forth the procedures used for award of public contracts. These are supplemented by the legally binding and exhaustive Federal Acquisition Regulations *(FAR)* prescribed under Title 41 of the US Code. Another important Act is the Truth in Negotiations Act of 1962 for negotiations in single-source contracts with an award exceeding $650,000.

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† G. B. Mahajan v Jalgaon Municipal Corporation JT 1990 (2) S.C. 401.

‡ Committee of Management of Pachaiyappa's Trust vs Official Trustee of Madras & Another (1994)1 SCC 475)

Delhi Science Forum vs. U.O.I. 1996(2) SCALE 218

** Mahesh Chandra vs. Regional Manager, U.P. Financial Corporation and others, JT 1992 (2) S.C. 326

‼ M/s Prestress India Corporation vs. U.P. State Electricity Board and others 1988 (Supp) S.C.C. 716

(b) In the ***European Union***, the Directive 2004/18/EC of the European Parliament and of the Council lays down the law on public procurement of works, goods, and services.

(c) **Afghanistan**, ***Bangladesh*** and ***Nepal*** **are among the 29 countries** in Asia, Africa and Europe which have enacted procurements laws largely on the pattern of the UNCITRAL Model Law on Public Procurement.

(d) ***South Korea*** enacted its Government Procurement Act in 1994.

(e) In ***Canada***, the public procurement framework is governed by the Financial Administration Act and regulations under it.

(f) ***China*** enacted its public procurement law in June 2002.

3.2 Need for public procurement law

3.2.1 The absence of a law in India raises the following concerns:

(a) lack of public visibility about legally enforceable provisions in public procurement;

(b) a legislative gap when public procurement is a very significant proportion of GDP;

(c) important conditions of contract do not emanate from a specific legal frame work on public procurement and as a result, different departments have followed a diverse set of manuals, procedures and practices;

(d) absence of a credible process for grievance redressal ; and

(e) absence of any deterrent legal penalty that would prevent Government officers or bidders from short-changing the public exchequer.

3. 3 Recommendations on the contents of the law

3.3.1 The ideal structure of a Public Procurement Act would require it to lay down clearly the objectives and principles of public procurement. It is further expected to serve as an effective guide for procurement decisions to be taken by different ministries/departments, while allowing adequate flexibility to them to cater to their specific needs. The Committee recommends that the proposed law may include the following:-

(a) The Act would apply not only to the Government departments, but also to the public sector enterprises, statutory bodies and autonomous bodies, as all of them engage in public procurement.

(b) The Act should provide for an effective grievance redressal system to address unlawful actions prior to signing of the procurement contract. Once a contract is signed, it may be reopened only in the exceptional circumstances since rights would get vested in the awardee. So far as a complainant is concerned, in the event his complaint is upheld, he would be entitled to compensation for the costs incurred by him. The proposed redressal system may be created on the following lines:

(i) An internal review mechanism at the level of the Head of the procuring entity or a senior officer designated by him;

(ii) An independent quasi-judicial review mechanism with an appeal to a Procurement Tribunal and exclude the jurisdiction of the courts except for writ jurisdiction, which cannot be excluded..

(c) The Act must provide for the principles and procedures of

procurement, and methods of procurement and the conditions for their application in order to ensure that the procuring authorities observe them. This basic requirement cannot be left for prescription by rules.

(d) The Act should provide for:

(i) adequate competition in public procurement by broad-basing the bidders and allowing reasonable time for bids; competitive bidding should be the norm for public procurement;

(ii) adequate and effective publicity, including publishing of the bid invitation on the procurement e-portal; and public opening of bids;

(iii) adequate disclosure in public procurement;

(iv) setting out in the bidding documents, all the applicable specifications of the goods, works and services to be procured, as well as the criteria for determining the qualification / eligibility of bidders;

(v) the evaluation of bids on the basis of pre-disclosed criteria;

(vi) promotion of e-procurement;

(vii) restricting cartelisation and anti-competitive behaviour;

(viii) dealing with delays during the bid process;

(ix) dealing with inadequate and arbitrary responses by either party during the bid process;

(x) provisions against delay in payments to suppliers, contractors and service providers; payment of interest for delay in settling their claims; and

(xi) disclosure of the result of the bid process and communicating, on request, the grounds for rejection of a bid.

(e) The law should provide for setting up of special courts to

ensure that the penal provisions of law are enforced expeditiously. It should have stringent penal provisions for:

(i) violation of the law by the procurement authority / staff;

(ii) bidders' acts such as misrepresentation of facts with a view to obtaining award of contract or receiving undue benefit from the Government, lodging of false claims;

(iii) bidders' acts in engaging in any form of bid-rigging, cartelisation, collusive bidding, etc; these are being added as criminal offences here since they only attract civil penalties under the Competition Act; and

(iv) undue interference in the bidding process, securing undue gains, wasting a bid process, non-compliance with the directions of the Tribunal etc.

(f) The Act should provide for exemption of defined categories of procurement on grounds such as national security, emergencies, and smaller procurements below prescribed thresholds. This is the common practice around the world.

(g) The Act should exclude the jurisdiction of the courts in respect of the provisions of the Act since a separate Tribunal is being constituted.

(h) In order to eliminate frivolous complaints and litigation, appropriate penalties may be stipulated.

3.3.2 There are concerns that the enactment of the proposed law could lead to multi-fold increase in litigation and even delays in public procurement on account of unsuccessful bidders approaching the Courts on various grounds and obtaining stay orders. Such litigation, would lead to diversion of considerable effort, time and money on the part of Government in defending the cases. It is therefore desirable that the law should provide for a separate Tribunal and exclude the jurisdiction of the courts except for writ jurisdiction,

which cannot be excluded. To discourage frivolous litigation, penalties may be provided.

3.3.3 There is a wide spectrum of laws in different countries ranging from those that incorporate only broad principles to those that include even procedural matters in great detail. In view of the apprehensions of unnecessary and excessive litigation, it is felt that the proposed Public Procurement Act should confine itself to the broad principles enumerated above and avoid going into procedural details. This will avoid rigidity in the legal provisions and will also allow sufficient flexibility for the wide variety of procurements in Government. Based on the broad principles / provisions of the proposed Act, the procurement rules would be formulated by Government and the present GFR would be substituted by the rules under the Procurement Act.

3.3.4 The proposed Public Procurement Act, since it would incorporate only broad principles, would cover all public procurement, including that by other public authorities and public sector enterprises. It has been brought to the notice of the Committee that often Government departments outsource their procurement to PSEs under their administrative control. The law would also be applicable to all such procurements.

3.3.5 In case a Public Procurement Act is passed, the States could be encouraged and incentivised to adopt the same as a model law.

3.4 Procurement Rules

3.4.1 The Procurement Act will have to be supplemented by rules to provide for the details of the fundamental principles laid down by the Act. At present, the GFR only has two chapters on

procurement: Chapter 5 for procurement of works, and Chapter 6 for the procurement of goods and services. These Rules would have to be substantially elaborated, especially in respect of works and services.

3.4.2 The Committee recommends that the Government should bring out comprehensive rules for procurement of (i) works, (ii) goods, and (iii) services respectively. The procurement law will serve as the legal basis for these rules.

3.5 Dissenting views of Members:

Some members of the Committee had dissenting views. Their views are at Annexures- V, VI and IV.

Chapter 4

DEPARTMENT OF PUBLIC PROCUREMENT

4.1 Creation of the Department of Public Procurement

4.1.1 At present, the rules for public procurement as a subject is assigned to the Department of Expenditure (DoE), Ministry of Finance. In exercise of this responsibility, the DoE has formulated two chapters within the General Financial Rules (GFR), and these constitute instructions regarding the principles and procedures to be observed in matters of public procurement of goods, works and services. A separate chapter in the GFR is dedicated to public procurement of goods and services, and another brief chapter to works.

4.1.2 It may be observed, however, that given the very wide work entrusted to the DoE, work relating to public procurement is only a miniscule part of its responsibilities. The GFR comprise only one of the several subjects that the DoE has to handle, and within the GFR, the rules on public procurement are a very small part of a large body of rules. There are therefore natural constraints on the time and attention that the DoE can devote to the function of public procurement despite its best efforts. In fact, it forms a small part of the functions of a Joint Secretary in DoE. The absence of a department dedicated to policy and oversight of public procurement has resulted in a multiplicity of rules, manuals, procedures, directives and orders issued by different ministries, Central Vigilance Commission etc. Similarly, there is a multiplicity of tender and contract documents issued by different departments and PSEs. The Committee, therefore, observes that there is a felt need for real time leadership and coordination in the Government for ensuring economy, efficiency,. transparency and accountability in public procurement.

4.1.3 Public procurement has grown over the years, not only in volume but also in variety and complexity. Government departments and other organisations are increasingly being called upon to handle larger, more complex, and newer forms of procurements. It is a function that is undertaken necessarily across all departments and organisations, and at all levels of the Government machinery. The Committee observes that there are deficiencies in the capacities and levels of professionalism of the procurement entities, and absence of real time guidance on complex issues.

4.1.4 Around 2004, the Department of Expenditure undertook an exercise to revise and update the GFR, as a result of which there were substantial changes in the GFR, but these were confined mostly to goods. After a review of the new GFR, the Committee notes that:

(a) GFR 2005 has virtually no rules for the procurement of works;

(b) GFR 2005 for the procurement of services is inadequate to address the issues relating to the selection of consultants and other providers of services; and

(c) While the GFR relating to procurement of goods is broadly adequate, there are certain improvements required here too to overcome the current gaps and malpractices.

4.1.5 The Committee is of the view that there should be an institutional framework, preferably as a Department of Public Procurement in the Central Government to regulate the functions of public procurement in a more focussed and professional manner than hitherto, and to provide on-going guidance, framework for oversight and capacity building across all departments and organisations in Government and to reform and professionalise the system on a continuing basis. Such an office exists in several countries, For

example, Public Contract Code Title 41 of the United States has created office of Office of Federal Procurement Policy in the office of Management and Budget. An administrator, appointed by the President of the **United States** with the consent of the Senate heads the office of the Federal Procurement Policy. In the **United Kingdom**, the Office of Government Committee (OGC) was created under the Treasury in 2000 with the objective of improving procurement capabilities. It has been placed under the Cabinet Office in 2010.

4.1.6 The proposed Department of Public Procurement would have the responsibility to set up the legal, institutional and oversight framework for an effective public procurement system. It would monitor broad compliance with the Act and Rules, and the public procurement policy. It would encourage uniformity and harmonisation in public procurement manuals and processes to the extent feasible, prescribe standard bidding and contract documents, disseminate best practices, arrange for capacity building of procurement staff and vendor capacity building, create and maintain the public procurement portal, develop and manage databases, and use the portal as a management and information tool. It will bring out an annual report on public procurement.

4.1.7 The Department of Public Procurement would have no direct procurement role and this proposal does not in any way recommend centralisation of procurement or interference with the existing delegation of powers to the various departments and organisations. In addition, it is felt that any direct procurement role would conflict with its other functions.

4.2 Perceptions relating to more staff and expenditure

4.2.1 The Committee notes that creation of more bureaucracy normally attracts public criticism and should, therefore, be handled with caution. Given the critical need for creating a Department of Public Procurement, the Committee feels that

the number of new posts required for this department may be created by abolishing an equal number of posts elsewhere. This would allay possible criticism regarding more bureaucracy. It should also be emphasised that the proposed department would not centralise any procurement. In fact, it would not undertake any procurement for or on behalf of any other ministry or department.

4.2.2 Even if the new department involves any new expenditure, it should be emphasised that streamlining of the procurement functions across departments would save large amounts of public funds, improve efficiency, ensure competition and reduce the potential for corruption.

4.3 Location of the Department of Public Procurement

The Committee is of the view that the most logical location for the proposed department is within the Ministry of Finance keeping in mind its proposed role and alignment with the functions of the Ministry of Finance. The next question is whether the proposed office should be a subordinate office of the Government under the Ministry of Finance, or an autonomous organisation or a department of the Government. It is the Committee's majority view that the office should be a department of the Ministry of Finance and designated as the Department of Public Procurement. This will give it the necessary authority and effectiveness in discharging its functions.

4.4 Recommendations

4.4.1 After reviewing the international experience as well as the present institutional structure in India, the Committee believes that it is essential to create a dedicated Department of Public Procurement under the Ministry of Finance. This will enable the formulation of an efficient and effective public procurement policy, rules, regulations etc. and their enforcement. Its subjects should include:

(a) Matters relating to the Public Procurement Act;

(b) formulation of Public Procurement Policy;

(c) formulation of Public Procurement Rules for Works;

(d) formulation of Public Procurement Rules for Goods;

(e) formulation of Public Procurement Rules for Services;

(f) establishing a system for grievance redressal;

(g) formulation of Standard Bidding Documents and contract forms;

(h) standard procedures and processes;

(i) promotion of e-procurement and creation and maintenance of the public procurement portal;

(j) promote quality and excellence among vendors and procuring departments;

(k) standards for evaluating past performance;

(l) formulation of Users' Guide for procurement of Works, Goods and Services;

(m) promoting capacity building measures relating to procurement;

(n) research and development relating to procurement;

(o) matters relating to the Tribunal for public procurement;

(p) formulation of Public Procurement Policy for the Public Sector Undertakings, statutory bodies and other entities under the control of the Central Government or substantially funded from the Consolidated Fund of India;

(q) promotion of competition, transparency and fairness in all procurement; and

(r) development and management of data bases relating to public procurement.

4.4.2 The proposed department would provide overall direction of procurement policy and leadership in the development of a uniform and simplified procurement system for application to all procuring departments. It will lay down the Procurement Rules for application to all public procurement.

4.4.3 The proposed department would not engage in any procurement for and on behalf of any other department. It should only formulate rules, regulations, policies, procedures and standard documents. It should also act as a reference department for all procurement matters. It should also have the responsibility to set up the legal, institutional and oversight framework for an effective public procurement system.

4.4.4 At present, the Central Vigilance Commission (CVC) issues instructions relating to procurement matters. This is essentially a function of the Government and should, therefore, be performed by the proposed Department of Public Procurement.

4.4.5 The Committee could not reach unanimity on the issue of creation of a Department of Public Procurement in the immediate future. Most of the members felt that given the enormity of challenges and complexities brought out in this Report, a new department with sufficient capacity must be created at the earliest. Some members, however, felt that creation of yet another department may lead only to adding more bureaucracy. In their view, a better course would be to initially create a new Division in the Department of Expenditure and later upgrade it if found necessary. The Committee decided to leave this decision to the Group of Ministers that would consider this Report.

Chapter 5

PUBLIC PROCUREMENT PORTAL

5.1 Introduction

A major area of concern in public sector procurement is often the lack of transparency in the entire exercise. One manifestation of this is the absence of publicity of tender enquiries which often prevents wide participation of vendors, and the consequent lack of competition and loss of value for the Government. While guidelines exist about advertising procurement enquiries through newspapers, the level of publicity they receive can be manipulated by choosing media with little reach. This clearly needs to be addressed urgently by establishing a centralised portal. Further, the portal will provide opportunities for further improvements in the process.

5.2 Establishing a Public Procurement Portal

5.2.1 Creating and maintaining an interactive portal to publicise procurement / tender enquiries and making it compulsory that all such enquiries, other than for small and exempted procurement, are published on the website will go a long way in ensuring wide publicity and consequent competition in Government purchases. The effectiveness of this measure could further be enhanced by ensuring that bid / tender documents for all procurements are available on websites which are linked to this portal. This would prevent situations where prospective bidders are deprived of tender documents to reduce competition.

5.2.2 Even though the platform is shared, each Government agency can be treated as a unique entity and provided access to the common procurement infrastructure. The sharing of the procurement portal will not result in centralisation of public procurement nor is it intended to be used as a supervisory tool. The primary objective of the portal is to provide a one-stop shop for all procurement activity under the

Central Government and its public sector enterprises. All user departments and agencies would be required to link up their individual portals with this centralised procurement portal.

5.2.3 The Government agencies using the procurement portal will continue to handle their public procurement activities independently i.e. issue of notice inviting tender, bid submission, evaluation of bids, award of contracts, making payments, etc. The centralised portal would be meant to enable disclosure of information on procurements made across ministries/departments, comparison and analysis of information uploaded and providing early warning signals to concerned ministries/departments on the results of analysis and exceptions noted. The portal could also be used to serve as a management tool for creating MIS capabilities to provide key public procurement statistics for the country. The proposed portal can also provide statistical information including:

(i) annual procurement data at the national level;

(ii) annual sector wise and industry wise procurement details;

(iii) category-wise details of procurement;

(iv) information related to new vendor development; and

(v) capacity building initiatives.

5.2.4 This portal will serve as an over-arching public procurement portal that would function as a gateway for procurement related information from various public procurement entities in India. Such a portal when evolved and consolidated, will facilitate the following:

(i) enabling of e-disclosure;

(ii) publicising tender enquires and details of other procurement activities by the Government;

(iii) publicising details of tenders finalised, relevant prices and suppliers within the Government as well as in the private sector;

(iv) enabling analysis of information uploaded by various ministries/ departments; and

(v) sending early warning signals to ministries/departments in respect of exceptions observed, if any.

5.2.5 As the first element of transparency in public procurement reform, it should be mandated that a public procurement portal will be established in mission mode. Further, it should be prescribed that after six months of the setting up of the portal, no payments for any purchases, other than for small and exempted procurement, can be made by the Central Government or any of its entities for an item the tender enquiry for which was not published on this portal.

5.3 Compulsorily publishing tender results

The Committee recommends that the results of each bid, including the winner and winning price should be announced on the portal. At present, the bidders do not always get to know the results of a bidding process. This results in speculation regarding the winning bidder, the winning price and the terms and conditions of the contract. It is not always in the public domain whether the conditions of the contract, or the quantities being procured, have been modified during the processing of the tender. This, in turn, prevents effective disclosure about the entire process and its results. Thus, it is imperative that the results of all tender enquiries that have been published on the portal are also compulsorily displayed on it. This would also give an opportunity to bidders and others to make representations and seek redressal.

5.4 Monitoring delays in bid finalisation

5.4.1 There should be a system for collecting and disseminating procurement information, including tender invitations by type and category, requests for proposals, contract award information, vendor details, etc. These functions can also be performed through use of the public procurement portal.

5.4.2 Experience shows that delays in procurement decisions not only result in expensive time and cost over runs but are also an important source of malpractice. Therefore, it is critical to monitor extraordinary delays in large value procurements. Since all tenders / enquiries and results, other than small and exempted categories, would compulsorily be published on the procurement portal, it should be easy to monitor delays. A mechanism could be developed where an automatic alarm is set off to alert procuring agencies and the central authority (Department of Public Procurement or other) for taking corrective actions.

5.5 Efficiency of procurement

5.5.1 A good performance monitoring system should make procurement efficient and those responsible for it, accountable. A system needs to be devised to monitor a number of efficiency indicators which could include the following:

- number and nature of complaints received;
- time taken for examining and redressing complaints;
- comparison of prices of similar items across procuring entities;
- comparison of time taken in processing tenders and finalizing contracts;
- proportion of procurement taking place based on competitive bidding; and
- proportion of procurement taking place through e-procurement.

5.5.2 Performance on each of these indicators can be tracked over different periods of time and displayed on the procurement portal for all procurement entities that use it.

5.6 Adoption of e-Procurement

5.6.1 The Internet can serve as a powerful tool for improving the efficiency

and transparency in government procurements. The use of the web for issues related to e-disclosure/e-tendering has been mentioned earlier. These would include disclosing business opportunities by publishing tender enquiries; making bid documents available to bidders; making public bidding rules and contract texts; and disclosing bid results.

5.6.2 The next step would be e-procurement or the use of the internet for procurement of goods, services and contracts through complex bidding systems, which involve evaluation of both technical and financial proposals. Efforts should be made to graduate from e-disclosure/e-tendering to a comprehensive end-to-end e-procurement solution in a calibrated fashion. E-disclosure should become compulsory for all Government contracts, say, from January 2012 and the departments should be encouraged to switch over to e-procurement at the earliest.

5.7 Grievance redressal system

Complaints/ representations in respect of a bid process should be posted and tracked in a separate section of the portal so that the grievance redressal mechanism becomes more transparent and effective.

5.8 Recommendations

5.8.1 The Committee recommends setting up of a Public Procurement Portal on which all bid invitations should be published compulsorily. The Portal should also provide comprehensive information and data relating to public procurement.

5.8.2 The Portal should be used for monitoring delays in the bid process and for enhancing efficiency and economy in public procurement. It should also be used for posting and tracking complaints relating to any bid process.

Chapter 6

PROCUREMENT OF WORKS

6.1 Procurement of Works

6.1.1. Public expenditure on works constitutes the largest proportion of the total expenditure on procurement. This is reflected in the Central Plan Outlay by Heads of Development below:

(Rs. in crore)

Sectors	Budget Estimates 2011-12	Percentage
1	2	3
Power	72,754	35.24
Railways	56,589	27.41
Roads and Bridges	44,836	21.72
Housing	16,278	7.88
Ports and Lighthouses	2,541	1.23
Shipping	3,795	1.84
Civil Aviation	8,978	4.35
Inland Water Transport	49	0.02
Other Transport Services	73	0.04
Irrigation and Flood Control	565	0.27
Total	2,06,458	100

6.1.2 Bulk of the above plan allocations is expended on works, plant and equipment. In addition, large expenditure is also incurred on defence procurement under non-plan head.

6.1.3 As compared to goods and services, the procurement of works is a complex process as it involves construction of civil works or erection of plant and machinery usually at the site. It differs from the procurement of goods which are

manufactured in factories and delivered to the procuring agencies.

6.2 The existing procurement method: Item rate contracts for civil works

6.2.1 The existing procurement of works is known in India as item-rate (procurement on unit price or rate) system. This system is a relic of the past when contractors were mostly ill-equipped and essentially labour contractors. The whole system is antiquated, repetitive and based on technology and office systems followed fifty years ago, with practically no modernisation. This system has been abandoned in the developed countries many years ago. In this system, the Government:

(a) provides detailed design and estimates of quantities of different units of work to be done;

(b) lays down the specifications, testing etc.; and

(c) pays the contractor on the basis of measurement of the quantity of work done in respect of each item comprising the works.

6.2.2 The work done by the contractor is measured at frequent intervals; the payment is made only for the measured quantities. In this mode of procurement, actual quantities differ from estimated quantities by a wide margin. For example, for the road works, the conditions of contract allow a difference of up to 25 per cent of the estimated quantity for the entire works. Thus the bid may have been invited on the basis of estimated quantities but payment could be made for an increase or decrease of upto 25 per cent in each item.

6.2.3 A look at the road sector brings out the following concerns:

(a) **Time Over-runs:** The Planning Commission compared 20 national highway projects that were executed by the National Highway Authority of India

(NHAI) on item-rate contracts (which NHAI incorrectly refers to as EPC contracts) with the works executed under the Public Private Partnership mode. The item Rate projects took, on an average, 61 months to complete as against 29 months taken by projects executed through Public Private Partnership.

(b) **Cost Over-runs:** In a scrutiny of the said 20 projects, the Planning Commission found that cost overruns are on an average 48 per cent (ranging from 25 per cent to 183 per cent) when compared to the original contracted amount. In the Public Private Partnership projects, there are no cost overruns as the construction risk is borne by the private party.

(c) **Disputes**: No data is published on the amount claimed by contractors in arbitration cases. However, disputes arise in full force under the item rate contracts. The annual report (2007-08) of NHAI reads:

"There are 121 arbitration cases pending. Under these cases, claims amounting to around Rs.7,268 crore have been made by various contractors. In respect of other claims/legal cases, the liability is not ascertainable at present."

6.2.4 The disputes lock up the funds of the construction industry as the arbitration proceedings take a long time; and even after the arbitration awards, they are further contested in courts. Moreover, Government ceases to have any meaningful financial control on project costs as the final cost will not be known for years till the claims of contractors are settled through arbitration, and then the courts. The major causes of disputes relate to:

(i) change in specifications and issue of variation orders when the work is being executed;

(ii) deficiencies in detailed project reports and designs;

subsequent delays in approval of revised designs;

(iii) absence of a proper method in the conditions of contract for valuing the variations or change of scope of the works; and

(iv) delays in handing over stretches of site to the contractor and absence of any formula in the conditions of contract for working out the compensation for such delays.

6.2.5 Another serious drawback is that the regulation of procurement of works has been left to the different Government departments. The GFR, 2005 do not have any substantive provisions for the procurement of works on the lines similar to the provisions it has for the procurement of goods and services. While several State Governments have issued detailed GFR for works, no such exercise has been undertaken in the Central Government.

6.3 EPC (Engineering, Procurement and Construction) contracts

6.3.1 The developed world has been moving more and more to the Engineering, Procurement and Construction (EPC) contracts, popularly known as "Turnkey" contracts, to overcome the problems of the item-rate contracts. EPC is used for

(a) greater certainty of price and time;

(b) transferring the design and construction risks to the contractor.

6.3.2 In the EPC contracts:

(a) The Government only prepares the feasibility report. It neither prepares detailed project reports nor works out the detailed quantities of various items of work to be executed by the contractor.

(b) The bidder quotes only one lump sum amount for both design and execution of the works in

accordance with the specifications laid down in the contract.

(c) The contractor gets paid only on the basis of completed stages of works specified in the contract and bears all risks of unforeseen events, except those beyond his control.

6.3.3 The major advantages of the EPC approach are:

(a) The contractor accepts the risk and responsibility for both the design and construction of works. (In the item rate contract, the Government has the responsibility for the design, and the contractor for construction. For defects in the final product, they blame each other for poor construction and design.) EPC contract is a single point responsibility contract. The single point responsibility results in emphasis on performance criteria (which is normally absent in the item rate contracts).

(b) In item rate contracts, the designer, which is Government or its agent, is not required to guarantee the results. In EPC, the contractor guarantees the result from its design.

(c) Lump sum price ensures greater certainty in overall cost, and timing of payments.

(d) EPC results in speed of procurement as the contractor can follow its own judgement in planning the execution of the works.

(e) EPC ensures efficiency as the contractor does not have to spend time in understanding and adopting the design provided by Government engineers.

The number and quantum of contractor's claims get reduced, because in the case of item rate contracts, such claims arise from the frequent directions of Government engineers.

6.3.4 Several concerns are expressed regarding the efficacy of EPC contracts. Some of the common concerns about the EPC contracts are explained below:

(a) **Reasonableness of bid price**: A concern is commonly expressed that in the item rate contract, the Government gets a detailed project report (DPR) prepared. The DPR shows the quantities of various items of works, and the estimated cost for each item. Since there is no DPR prepared in the EPC contract, how does one decide the reasonableness of the bid price?

The Committee observed that in an EPC contract, the Government has to prepare a feasibility report showing the results of semi-detailed surveys, approximate quantum of work and an estimate of the project cost. The Government provides the feasibility report to the bidders who use it for costing their bids, apart from their own surveys. It also serves as a benchmark for judging the reasonableness of the lowest bid. Even in the Public Private Partnership (PPP) projects, the Government has laid down detailed guidelines for preparing the feasibility reports on the basis of which bids are invited and evaluated.

(b) **Potential for under-designing**: A concern is sometimes expressed that the contractor may want to cut costs by resorting to under-designing of the project.

The Committee observed that the above risk can be addressed by a well specified and documented system of tests and inspections by the Government Engineer, and having the contractor assume the additional responsibility to maintain or operate the project for a period of two to five years after its completion. This would ensure that the contractor will not compromise on quality.

(c) **Cost of bidding**: Yet another concern is that the cost of tendering in EPC contracts will be high as the bidder must

spend money in working out the design and its cost before he can bid. This cost will dissuade serious bidders, especially if the bidding is also open to non-serious players.

The Committee observed that in order to invite bids from competent and serious bidders, it is necessary to pre-qualify the bidders through a well-designed pre-qualification system. Only the pre-qualified and short-listed bidders will normally spend the time and costs required for preparing a bid, but this would provide a more competitive and precise response from the bidders, which would also afford greater certainty of bid price for the Government.

(d) **Pricing of risks**: A concern is expressed that if the contractor is asked to accept the risks for variations in quantities, cost of unforeseen events, etc. he may price the risks and include it in the bid amount.

The Committee observed that the DPRs for item-rate contracts do not have any element of costing the risks and these risks are usually translated into variations in quantities and items that increase the project costs significantly during the course of construction. Moreover, the actual cost of completed works is not published as it often takes three to five years for settling the contractor's claims through arbitration and litigation. As a result of this entire process, the final cost borne by the Government is usually much higher than the costs anticipated at the time of project award. In this system, the contractor has no incentive in controlling costs. On the contrary, he has an incentive in seeking variations and additional payments. In an EPC contract, most of these risks are transferred to the contractor who may charge an appropriate risk premium, but this will be limited by the pressures of competitive bidding.

(e) **Time and cost over-runs in EPC contracts**: It is pointed out that EPC contracts are not a panacea for all ills of the item-rate contracts and that they can also suffer from time and cost

over-runs.

The Committee observed that there could be cost and time over-runs in EPC contracts too. For example, if the land required for a project is not handed over in time, the EPC contract would also have to allow for compensation to the contractor. However, EPC contracts contain two clear limitations viz (a) the items which require additional payments are clearly specified such as delay in handing over land or change in scope; and (b) the manner of determining the additional payments on account of these changes is spelt out precisely in the contract itself. Thus, variations in quantities, site conditions etc. are all left to the contractor. Only the exceptions are carved out for a pre-determined treatment. This ensures a clear delineations of risks and obligations which incentivises efficiencies and minimises delays and disputes.

(f) **Level of detailing prior to bidding**: It is pointed out that EPC contracts would require the detailed designs and specifications to be frozen prior to invitation of bids. This is a time consuming exercise which is difficult to manage in public contracts.

The Committee observed that the need for sound project preparation can hardly be over-emphasised. It is true that this would delay bid invitation but that would be more than off-set by a significant reduction in time and cost over-runs which usually affect the item rate contracts. Further, the procuring entity would normally be free to provide detailed designs and specifications or leave a pre-determined part of designing and specifications to the contractor while specifying the output specifications of the project. These options would provide sufficient flexibility to procuring departments in devising their respective methodologies.

(g) **Reservations expressed by DG, CPWD**: DG, CPWD has brought out that the estimated cost in respect of EPC contracts cannot be worked out unless the architectural designs are also

finalised before submission of bids. The Committee feels that in the interest of efficiency and economy of bids, the architectural drawings should be finalised before inviting bids so as to enable speedy construction and eliminate delays on account of architectural drawings. Such drawings may or may not be detailed, as the construction would be governed by the specifications and standards. Where necessary, modifications during construction may be addressed through a change in scope to be approved by an authorised committee and restricted to say, 5 per cent of the project costs.

DG, CPWD has also expressed concern about estimating the cost of building projects. This is already being done in a large number of PPP projects and should not pose a serious problem.

DG, CPWD has mentioned that it may be necessary to make deviations or substitutions during the course of construction. As indicated above, the contract should provide for change of scope which may be authorised by an empowered committee subject to a ceiling of say, 5 per cent of the project costs.

DG, CPWD suggested that where CPWD builds a project as a deposit work, the limit on change in scope could be left to the entity funding the project.

DG, CPWD has stated that the EPC system may discourage competitive bidding as the bidders would have to incur significant costs in preparing their respective bids. This is not borne out by any experience as CPWD has never invited bids for an EPC project. In fact, intense competition has been observed in PPP projects which require greater expenditure for preparing bids. Moreover, this would also ensure that only serious bidders compete for works.

The Committee noted that the conditions where EPC may not

be suited have been specified in paragraph 6.4.4.

6.3.5 Taking into account the different aspects of EPC contracts, India has moved in this direction of EPC contracts. The Committee on Infrastructure, chaired by the Prime Minister of India, had decided in 2006 that the national highway projects should be done on EPC basis. The Cabinet approved the construction of the railway freight corridor only on EPC basis. The Planning Commission is engaged in formulating a draft model EPC agreement for highways after extensive consultations with the stakeholders and experts.

6.4 Recommendations

6.4.1 The proposed Department of Public Procurement should bring out the Procurement Rules for Works. The EPC (lump sum/ turnkey) contract system should be adopted for all projects except for cases referred to in para 6.4.4. The EPC contracts should be awarded by following the two stage system of pre-qualifying the bidders and requesting the pre-qualified bidders to submit their financial bids. The key elements of the EPC/Turnkey contracts should include:

(a) scope of the project;

(b) specifications and standards;

(c) the time-frame for handing over the possession of the different stretches of the entire site, and obtaining environment clearances;

(d) prohibition of inviting bids without 80 per cent of the site being in the possession of the authority inviting the bids;

(e) formula for working out compensation to be paid to the contractor for delays in handing over the possession of site, or providing clearances for the project;

(f) liquidated damages payable by the contractor for delays in completing the works, the amount to be described as "pre-determined estimated agreed amount of liquidated

damages";

(g) laying down the payment procedure with details of completion of different stages of work and the percentage of the contract price payable for each completed stage;

(h) method of valuing the change of scope;

(i) clear enunciation of the condition that the contractor shall bear the risks of un-foreseen or un-foreseeable difficulties or events, except for force majeure;

(j) Government right to review the design only within the terms of the contract;

(k) Quality assurance requirements, supervision and monitoring arrangements;

(l) Performance Security, and Retention Money;

(m) Defects Liability Period;

(n) Maintenance requirements and performance standards;

(o) Method for adjustment of the contract price on account of rise in the cost of labour, material etc.; and

(p) Suspension and Termination of Contract.

6.4.2 The Ministry of Finance has already issued two standard documents for bidding of PPP projects: (i) Prequalification; and (ii) Request for Proposal. The proposed Department of Public Procurement may undertake consultations through an inter-ministerial group and formulate similar bid documents for EPC contracts.

6.4.3 For item rate contracts below an estimated cost of Rs. 10 crore, the Procurement Rules for Works should lay down the rules broadly on the pattern of rules for the procurement of goods in GFR, including the aforesaid principles stated in paragraph 6.4.1, to the extent possible, and restricting variations between the detailed estimates and the actual executed quantities to say, 5 percent.

6.4.4 There could be situations where the EPC approach may not be

suited. For example, in situations of extreme urgency, it may not be possible to firm up the design parameters before inviting bids. There could also be some unique structures that do not lend themselves to predictability of costs, such as geological conditions. Similarly, there could be structures where many of the specifications cannot be finalised before starting work. While some of these situations may lead to open-ended contracts that could attract objections and criticism, there may be occasions where the EPC approach may not be workable. The Committee recommends that in such cases, the Department of Procurement may specify the authority which would approve the application of item-rate approach in certain cases.

6.4.5 Since the EPC contracting will be new to the existing engineering set- up in the country, it will require considerable preparatory work. It may, therefore, be mandated that all projects (other than exempted projects) costing more than Rs. 100 crore should be bid out only on EPC basis after April 1, 2012 and all projects (other than exempted categories) above Rs. 5 crore may be taken up through EPC after April 1, 2013.

6.5 Black listing rules

Not enough is done to blacklist corrupt, unethical or non-performing firms. The Government has every right to deal only with ethical firms who should be required to adhere to a code of conduct while dealing with public entities. The Government should lay down clear and transparent rules to permit exclusion of black-listed firms from public contracts for a specified period, depending upon the seriousness of the offence. These rules should also deal with the possibilities of partners or directors of black-listed firms creating new entities for defeating such black-listing.

6.6 Delay in tender processing and award

In public procurement, the longer the time taken for making a

decision during the tender process, the more the problems as well as potential for corruption and manipulation. Bidders take positions, political pressures develop, each layer of review becomes an opportunity for corruption and eventually, a decision becomes very difficult. This results in delays, re-tender and additional costs to the exchequer while robust bidders are discouraged from participating. Those who bid tend to add a premium in their bid price to offset the costs of delay. The Department of Procurement should prescribe time-lines for each stage of bidding and bidders should be compensated for undue delays.

6.7 Standard contract documents

There continues to be a multiplicity of tender and contract documents used by different ministries and PSEs for identical procurements. This causes avoidable confusion, risks, disputes and costs. Even where standardised documents exists, each department has a penchant to modify, reward or rephrase the clauses, thus destroying the purpose of the standardisation and also introducing ambiguities. The Committee recommends that the proposed Department of Public Procurement may set up an inter-ministerial group to bring out standard EPC bid documents for (i) civil works, and (ii) Plant and Equipment, as these are new to the existing procurement system. Other bid documents and processes should also be streamlined and standardised. It should be compulsory for all ministries to use these standard documents.

6.8 Use of Government land

In cases where land is provided by a public entity to a private entity as part of a procurement contract which involves construction of buildings, roads, structures or facilities for full or partial use by a public entity or users, such transactions should either have to follow the rules for procurement of works or the rules and procedures applicable for appraisal

and approval of PPP projects.

6.9 Dissenting views of Members:

Some members of the Committee had dissenting views. Their views are at Annexures- VI and IV.

Chapter 7

PROCUREMENT OF GOODS

7.1 Procurement of Goods

7.1.1 Chapter 6 of the General Financial Rules, 2005 lays down detailed rules on the procurement of goods applicable to all ministries and departments. These cover: fundamental principles of public buying; essential elements of a transparent, competitive, fair and equitable treatment in the procurement process; methods of procurement - advertised tender enquiry, limited tender enquiry, and single tender enquiry; contents of bidding document; Government orders regarding price or purchase preference; reserved items; and other essential requirements relating to procurement of goods. The Department of Expenditure, Ministry of Finance has also issued a "Manual on Policies and Procedures for Purchase of Goods" in 2006.

7.1.2 Detailed instructions and bid documents relating to procurement of goods are issued by the procuring departments as per their specific requirements and in conformity with the GFR and Government orders and guidelines issued from time to time.

7.2 Compliance with GFR and areas of improvement

7.2.1 The GFR has incorporated the best practices of public procurement of goods. However, the procurement procedures followed by Government offices do not often comply with the provisions of the GFR. These deviations need to be addressed.

7.2.2 Inadequacies of contracts and GFR

The procuring departments often introduce deviations in their bidding documents. It is necessary to curb this practice of making deviations. By way of example, some of the common deviations from the stipulations in the GFR are illustrated below:

(a) The conditions of contract sometime lay down that the contractor shall not charge any price higher than it has charged other individuals/firms/organisations. The price quoted depends on market conditions over time, terms of payment and several other factors. If competition in tendering process is ensured, such a condition is not necessary. However, in negotiated contracts, such a condition could be imposed.

(b) Conditions of contract often do not specify the time limit for inspection of the goods. This leads to unnecessary delays.

(c) The conditions of contract often do not specify the method of testing the goods and it is left to the discretion of inspectors. The international practice is to specify the method of testing in the bidding documents. Where the BIS standards do not exist, requisite standards should be specified.

7.2.3 Review of GFR

The Committee recommends a comprehensive review of the GFR. The Department of Expenditure may constitute a committee involving experts and representatives from concerned ministries to review the GFR. Such a review may also include the following:

(a) The term 'goods' as defined in Rule 136 of GFR does not include service or maintenance contracts that may be necessary for ensuring the requisite level of

service and for optimising on the life cycle costs of a product. For enabling such procurement, the definition of the term 'goods' requires to be modified to include 'services incidental to the supply of the goods if the value of those incidental services does not exceed that of the goods'.

(b) Pre-determined damages

There should be an effective mechanism in the contract to deal with the Contractor's failure to fulfil its obligations under the contract. The usual risk and purchase clause cannot be enforced without legal action. It is a very costly and time consuming process to recover the extra cost caused to the department owing to the contractor's failure. Instead of the Contractor's risk and expense clause, the contract should provide for predetermined damages (a certain percentage of cost of balance supply) and forfeiture of the performance guarantee in the eventuality of the contractor's failure to perform. As a policy, the contractor who fails to perform may also be debarred from entering into future contracts for a specified period.

(c) Additional provisions

Rule 160 of GFR should specify that the Conditions of Contract should contain suitable provisions for: (a) force majeure; (b) termination; (c) tests and the method of testing; and (d) indemnification against violations of intellectual property rights, copyright and patents.

(d) Restriction on negotiations

The GFR permits negotiations in exceptional circumstances with the lowest bidder. In the absence of any prescribed objective criteria for need of negotiations, the clause leaves room for its misuse. The Government should move towards a system where negotiations are not allowed even with the lowest

bidder.

(e) After sale maintenance

Rate contracts particularly for electronic, electric and mechanical equipment must incorporate the concept of life cycle cost and energy efficiency. Maintenance / service contracts for a period of 3 to 5 years should be integral to the procurement contract.

This requirement should also be applicable to purchase of goods outside the rate contracts.

(f) Inspection and payment

This is often a grey area. After the goods are delivered at the premises of the consignee, the conditions of contract: require that these be inspected and checked within a period of thirty days. However, the supplier will not get any payment until the goods have been checked and inspected. It puts the supplier at the mercy of the Government agencies. A time period for payment should be specified with the provision for interest on delayed payments.

(g) Pre-bid clarifications

Rule 160 (ii) provides that suitable provision for bidder's right to ask questions from the purchaser should be kept in the bidding document. This should be enforced as a mandatory requirement in the case of any clarifications sought by an eligible bidder. The procuring department should also have an obligation to respond within a reasonable time to enable the bidders to take the clarification into account while bidding.

(h) Enhanced delegation

The delegated powers and financial limits need to be reviewed and enhanced. For example, GFR allows purchases of upto Rs. 15,000 without inviting quotations and Rs. one lakh through a Local Purchase Committee. These limits should at

least be more than doubled. There is need for enhanced delegation in other cases too.

7.3 Model contracts and templates

The Committee recommends that the Department of Expenditure should provide model contracts/ templates which should serve as standard terms and conditions of contract in order to eliminate suboptimal practices and unintended outcomes. These templates may include: (a) instruction to bidders, and (b) general conditions of contract. The procuring department may add special conditions specific to its requirements without modifying the mandatory clauses.

7.4 Procurement of medicines

7.4.1 Users of public healthcare services are skeptical about the quality of medicines provided in Government hospitals and dispensaries. This is one sector which affects every citizen, one time or the other.

7.4.2 The Committee recommends that an effective and uniform system for procurement of pharmaceutical drugs should be laid down for all the Central Government departments in line with industry best practices with a view to ensuring the quality and efficacy of such pharmaceutical drugs.

7.5 Procurement of commercial items

7.5.1 The economy and the markets have grown vastly compared to the time when the procurement philosophy underlying the GFR was evolved. A large part of the public procurement now relates to goods which are commonly sold in the market at competitive prices. Engaging in a cumbersome tender process for buying such commercial items involves considerable time and effort on the part of government staff and also involves other costs.

The savings, if any, do not justify these costs.

7.5.2 The Committee recommends that procurement of commercial items may be simplified and enhanced powers may be given to the procurement staff for purchase of such items. Suitable oversight and checks and balances, including monetary limits, may be built for preventing abuse. In its Federal Acquisition Regulations (FAR), the USA has prescribed a system for this purpose. Some elements of this system may have relevance in the Indian context also. The Committee recommends a comprehensive review of the procurement of commercial items with a view to ensuring its simplification, streamlining, efficiency and delegated authority.

7.6 Recommendations

7.6.1 The General Financial Rules, 2005 should be reviewed as brought out in para 7.2. A committee may be constituted by the Department of Expenditure involving experts and representatives from concerned ministries to review the GFR.

7.6.2 The bidding documents should be strictly in conformity with the GFR and best practices. In order to ensure this, it is recommended that standard templates should be prepared for compulsory use by procuring departments. The procuring departments may add special conditions specific to their requirements, without changing the mandatory clauses.

7.6.3 An effective and uniform system of procurement of pharmaceutical drugs should be laid down with a view to providing quality assurance to users.

7.6.4 The procurement of commercial items should be simplified and enhanced powers may be delegated to the departmental functionaries for procuring such commercial items without following a tender process.

Chapter 8

PROCUREMENT OF SERVICES

8.1 Procurement/ outsourcing of Services

8.1.1 Government offices have been increasingly relying on outsourcing several services like engaging experts/ consultant, management contracts, hiring of taxis, maintenance of civil works, collection of user charges, caretaking of office premises, engaging security services, house-keeping, data operations, etc.

8.1.2 The GFR lays down the basic rule that limited tenders may be issued for contract values up to Rs. 25 lakh, and advertisement be issued in all other cases. The ministries and departments are free to work out their own terms and conditions. However, they face serious problems in ensuring efficient, economical and competitive procurement as this is a nascent subject where little guidance is available for structuring and awarding these service contracts. For example, several departments hire a large number of taxies which are often of poor quality even though the Government pays a high cost. If these procurements are handled professionally, their quality, efficiency and economy would improve significantly.

8.1.3 Over the last decade, many of the aforesaid services which were performed by departmental staff are now being outsourced. However, no detailed guidelines or templates are available for hiring these services. The proposed Department of Public Procurement should issue guidelines/ templates to ensure that value for public money is obtained.

8.1.4 Hiring of consultants is among the more complex of procurement activities in the services segment. This is briefly dealt with below.

8.2 Consultancy Services

8.2.1 Consulting services refer to professional services that consultants provide using their skills to study, design, organise, and manage projects or build capacities. With the growth of knowledge economy, their importance has grown.

8.2.2 The Government often requires professionals or experts with in-depth knowledge and skills in a particular subject for which the Government either does not have the expertise or cannot spare its existing experts. For example, the process of structuring Public Private Partnership (PPP) in infrastructure is complex and the requisite expertise is normally not available within the Government. The project authorities usually do not have the time and staff resources that go into fine- tuning of the complex documentation for PPPs. Employing experienced consultants enables the Government to enhance the possibilities of a successful project, helps in avoiding costly mistakes, promotes capacity building within the Government and builds investor confidence in the entire process.

8.3 Selecting consultants for complex assignment

8.3.1 The GFR 2005 and Manual of Policies and Procedure of Employment of Consultants (issued by the Department of Expenditure) provides guidance on selecting professionals for normal assignments, but they are not considered adequate for highly complex assignments which are growing rapidly. Owing to lack of experience, the project authorities sometimes seek the comfort of a single consultancy firm to handle all the multidisciplinary aspects of project preparation and award. This often leads to sub-optimal outcomes in the form of a poorly structured project which may compromise the quality of service, impose avoidable costs, and create potential liabilities or claims arising out of the project contract. The model documents published by the Department of Expenditure for engaging consultants mandate that legal, financial and

technical consultants should be engaged separately. For example, asking a technical consultant to hire legal consultants for drafting a contract would deprive the project authority of expert legal advice as the advice of a legal counsel hired by the technical consultant would tend to be encumbered with the perceptions of the latter who may also have a preference for hiring a low-cost lawyer in order to maximise his own profit.

8.3.2 Two critical parameters for evaluation and selection of consultants can hardly be overlooked. The first is that consultants cannot be selected solely on the basis of lowest financial bids which are applicable in the case of works and goods. It is well recognised that advisers/ consultants can only be selected through a technical-cum-financial evaluation where the technical score should have a weight of 70 to 80 per cent. Secondly, consultants should not be selected mainly on the basis of the firms they work for. While some weightage could be given to a firm, the important aspect is the identification and deployment of individual experts. For example, the Government may hire a top law firm for a competitive price but the firm may depute an inexperienced lawyer for the assignment, thus defeating the entire purpose of the selection.

8.3.3 The Department of Expenditure has issued three model documents titled Model Request for Proposal for the Selection of Technical Advisers, Financial Advisers, and Legal Consultants. While some Government departments have followed these documents successfully, many others are continuing with an ad hoc approach. It is necessary to lay down a clear set of rules so that Government interests are not compromised by: (a) wrong selection of consultants and payment of unjustified fees to them, and (b) allowing public interest to suffer on account of sub-optimal advice by such improperly selected consultants.

8. 4 Conflict of interest in consultancy

8.4.1 Procurement of consultancy services calls for great care in preventing any conflict of interest from which consultancy services may suffer. Therefore, the process for selection of consultants should avoid both actual and perceived conflict of interest. The Rules for procurement of services should set standards for persons who provide consulting services with a view to identifying and eliminating conflict of interest. Conflict of interest may arise between the project authorities and a potential consultant where the consultant:

(a) has been privy to information from the project authority which is not available to others;

(b) has defined the project when earlier working for the project authority; and

(c) has recently worked for the project authority overseeing the project.

8.4.2 Similarly, conflict of interest may arise between consultants and present or future concessionaries/ contractors where a consultant:

(a) has an ownership interest or a continuing business or lending interest etc. with a potential bidder;

(b) will be involved in owning or operating entities resulting from the project;

(c) bids for works arising from the project.

8.4.3 Some other examples of conflict of interest are:

(a) giving to a consultant any continuation assignments like preparing detailed project report or design after he has prepared a feasibility study. This may influence the terms of reference (TOR) and bias the feasibility study recommendations;

(b) giving conflicting assignments to the same person such as asking the person who prepared the project design to do its environmental audit;

(c) giving related assignment to the same consultant such as the restructuring study of a public asset after he had prepared its privatisation plan.

(d) giving assignment to a firm which is also a consultant to firms that will be bidding;

(e) giving unnecessary assignments to give monetary benefit to the consultant; or

(f) existence of conflicting relationships such as a consultant's staff having a family relationship with a person engaged in the selection process.

8.5 Nature and types of consulting contracts

Department of Expenditure has provided model consultancy contracts as part of the consultancy bidding documents. However, some of the departments are not following the same. Planning Commission has also published a short volume on best practices for hiring consultants. Yet, many sub-optimal practices continue to be followed. For example, consultants are being hired on the basis of success fee which is an unduly expensive and seriously flawed form of contracting. However, some members felt that in cases such as disinvestment and auction of assets, where Government receipts are to be maximised, a carefully and conservatively calibrated form of success fee may not be ruled out. Strict guidelines/ rules need to be issued for ensuring that consultants are hired in a transparent, efficient and economical manner because flawed consultancy assignments can affect the projects adversely.

8.6 Recommendations

8.6.1 The Committee recommends that the Government should bring out Procurement Rules for Services which should:

(a) lay down an efficient and effective method of selection of consultants;

(b) disallow hiring of a single consultant for advising on diverse disciplines in which it has no core competence. However, in projects below a threshold to be specified by the Department of Public Procurement, single consulting firms may be engaged for the entire transaction and in cases above such threshold, a deviation may be permitted with the approval of the specified authority within the procuring ministry or department. Some members, however, felt that the power to make exception may lie only with the Department of Public Procurement;

(c) address potential conflict of interest;

(d) eliminate the possibilities of flawed consultancy contracts such as success-fee based assignments but some members felt that in cases such as disinvestment, where Government revenues are to be maximised, a carefully calibrated success fee may not be ruled out; and

(e) provide for adequate delegation of powers for procuring services.

8.6.2 The Committee further recommends that the aforesaid Rules should address procurement/ outsourcing of other services referred to in paragraph 8.1 above.

8.6.3 The Committee also recommends that suitable templates may be developed and published for use in procurement of different types of services which are commonly required by the Government departments.

Chapter 9

PUBLIC SECTOR ENTERPRISES

9.1 Legal status of Public Sector Enterprises (PSEs)

9.1.1 It is noteworthy that the Supreme Court of India has held the public sector enterprise, whether Central or State, to be an instrumentality or agency of the Government, and falling within the definition of 'State' under Article 12 of the Constitution of India. Therefore, the public enterprise has to honour all the fundamental rights of the citizens and others guaranteed by the Constitution of India.

9.1.2 In the United States, the Public Procurement law applies to establishments, other agencies and wholly owned Government corporations.

9.2 Advocacy of freedom to PSEs

9.2.1 The most prominent reason given for keeping the PSEs outside the purview of public procurement rules is that the enterprises have to compete with the private sector who are not governed by these rules.

9.2.2 The above argument is not entirely convincing because it is not possible for a public sector enterprise to state a procurement policy which is arbitrary or non-transparent. Nor can it be said that a transparent, efficient and competitive procurement will lead to higher costs as compared to an opaque system of procurement that some private enterprises may adopt. On the contrary, a prudent procurement policy would help PSEs to improve efficiencies while reducing costs, especially those arising out of potential corruption. The Committee, therefore, recommends that PSEs should be brought within the ambit of public procurement policy, rules and laws.

9.3 Volume of public procurement by PSEs

9.3.1 In 2009-10, 246 Government companies (incorporated under the Companies Act) procured goods, works, and services worth over Rs.9,40,000 crore which is equivalent to about 14 per cent of GDP. Details are as follows:

(Rs. in crore)

1.Addition to fixed assets during the year	1,15,658
2.Purchases for manufacturing, re-selling etc.	
(a) Purchase of finished goods/consumption of raw materials	7,53,346
(b) Stores & spares	20,875
(c) Power & fuel	52,932
Total (1) + (2)	9,42,811
GDP Quick Estimates	65,50,271
Percentage of Procurement to GDP	14.39
Total PSEs	246

Source: http://dpe.nic.in/newsite/survey0910/Survey01/volI/volI.htm

9.3.2 In addition to the above, there are public sector enterprises set up under the Acts of Parliament like the Highways Authority of India, Airports Authority of India, Port Trusts, Food Corporation of India etc. Besides, there are statutory boards, commissions etc. as well as autonomous bodies set up under the Societies Registration Act 1860. No data is available about the amount of procurement by these entities; however, it is expected to be a significant percentage of the GDP.

9.3.3 Since a very significant part of public procurement is undertaken through public sector enterprises, statutory bodies etc., they should not be excluded from the scope of procurement reforms. It is, therefore, necessary to apply the proposed procurement laws, rules and policies

to these entities also. Their rules should, however, provide for requisite flexibility and delegation so as to ensure commercially prudent outcomes without compromising the fundamental principles of public procurement.

9.4 Procurement by Government from PSEs

9.4.1 Sometimes, Government departments take recourse to procuring goods, works and services through PSEs on the basis of negotiated rates. The PSEs, in turn, procure works, goods and services without following a competitive process. The entire procurement policy of the Government is thus subverted by nominating PSEs who in turn often resort to 'cost plus' pricing for their supplies. This creates a potential for favouritism, inefficiency and additional costs, besides curbing competition. It also reduces the assurance that transparency and competition provide against corruption. In effect, Government may also end up paying a higher cost and may also compromise on quality.

9.4.2 Procurement from PSEs is at times also supported on the ground that the manufacturing is being done by a public sector entity. However, the Committee understands that in many of the PSEs, the operations are basically one of assembly with little value addition or technology within the unit. For example, in the case of two locomotive factories of the Railways, over 80 per cent of its total expenditure was accounted for by purchase of components from private vendors while a significant part of the balance was expended on salary and allowances. The situation in other production units of Railways as well as in defence production may not be materially different. Moreover, in-house production in such factories is often associated with a low level of technology. As a result, such factories mainly function as assembly units or aggregators who do not possess the know-how relating to the core components of their products. In such cases, there is little merit in allowing such production units to supply their products to the Government on a nomination basis. These and all such units should, therefore, be required to compete in open bidding for the tenders invited by the Government.

9.4.3 The Committee noted that the Railways and perhaps, some other ministries/ departments follow the practice of awarding contracts to their respective PSEs on a nomination basis and these PSEs, in turn, recover payments from the Government on a 'cost plus' basis. This appears to be a subversion of procurement through competitive bidding and needs to be discontinued forthwith. Introduction of a PSE as an intermediary in the supply chain should not be used as a device for bypassing the rules that govern public procurement.

9.4.4 In view of the above, public interest would be served better if procurement from PSEs is not undertaken through nomination and only the PSEs who win bids in a competitive process are awarded contracts for public procurement. In the transition, PSEs could be given a price preference of 5 per cent in the short term and thereafter, they should compete on a level playing field.

9.5 Recommendations

9.5.1 The Committee recommends that the proposed Public Procurement Act, rules and policy should apply to all public sector enterprises, statutory bodies, commissions and autonomous bodies under the control of Government of India. In the case of these entities, however, there should be provisions for requisite flexibility and delegation so as to ensure commercially prudent outcomes without compromising the fundamental principles of public procurement.

9.5.2 Until the Public Procurement Act is enacted, the Government should issue a directive to all the above bodies to revise their procurement policies in conformity with the Public Procurement Policy of the Government.

9.5.3 All procurement by the Government from any PSE should be undertaken through competitive bidding and the practice of nominated or negotiated award of contracts to PSEs should be discontinued in the interests of probity, transparency, efficiency and competition.

Chapter 10

PROCUREMENT THROUGH DGS&D

10.1 Organisation and Functions:

Directorate General of Supplies & Disposals (DGS&D), an attached office of the Department of Commerce is the Central Purchase Organisation of the Government of India which undertakes rate contracting etc. for other departments of the Government. Until 1974, it was the sole procurement agency for the Government of India when Defence, Railways and Post & Telegraph were authorised to purchase items meant for their exclusive use. With the liberalisation of the Indian economy in 1991, DGS&D was required to concentrate on its core activity of conclusion of rate contracts for items of common use. The present role of DGS&D continues to be mainly to conclude rate contracts for items of common use required on recurrent basis by various Government organisations who procure supplies at the contracted rates with quality assurance by DGS&D. However, during the last two decades, the economy has undergone significant changes and it is necessary to review and redefine the role of DGS&D.

10.2 Value of orders

The value of orders placed on DGS&D rate contracts during the last five years is given below:

(in Rs. cr.)

Year	Amount
2005-2006	3,053
2006-2007	4,069
2007-2008	4,951
2008-2009	6,638
2009-2010	6,540

10.3 Items on Rate Contract

There are 265 categories of items which are placed on the rate contract by DGS&D. Each of these categories may have a large number of sub-items. The annual drawals (estimated) during 2009-10 and their break up in terms of value of orders is summarised below:

Annual drawals	-	Rs 6,540 cr
Top 37 items	-	Order value Rs 25 cr - 600 cr
Bottom 20 items	-	Order value Rs 2 lakh to Rs 45 lakh
Number of items having drawals above Rs 100 cr (Total value Rs. 2,234 cr i.e. 46 % of drawals)	-	8
Number of items having drawals between Rs 10 cr and Rs 100 cr (Total value Rs 2,082 cr i.e. 43% of drawals)	-	61
Number of items having drawals of less than Rs 10 cr (Total value Rs 516 cr i.e. 11% of drawals)	-	196

10.4 Drawbacks of the rate contracting system

The present system of centralised rate contracting is criticised on the following grounds:

(i) delay in timely conclusion of Rate Contracts;
(ii) non-participation of market leaders in the Rate Contract system;
(iii) issues related to quality of stores actually supplied;
(iv) gap in timely upgradation of specifications;
(v) time lag in bringing new items on the rate contract after their launch in the market;

(vi) inadequate choice for the procuring departments;

(vii) lack of capacity to finalise specifications;

(viii) inadequate capacity for inspection and quality assurance; and

(ix) delayed payments to vendors.

Some of these issues are explained below:

10.5 Relevance and problems of Rate Contracts

10.5.1 Annual drawals on Rate Contracts by DGS&D are in the range of Rs5,000 to 6,000 cr over the last 3 years. No data is available on direct purchase by various departments through Rate Contracts.

I0.5.2 The Rate Contract system offers the advantage of effecting reduction in purchase cost. It enables the user departments to place orders without inviting tenders. However, in the present circumstances where lot more varieties, makes and brands characterised by rapid technological changes and product specifications are available in the market, the system is constrained to keep pace with the user needs and choices.

10.5.3 There is a growing preference towards branded products because of their quality and performance in items such as air-conditioners, water-coolers, PCs and laptops, servers, etc., where preferred makes are often not on rate contract. As a result, departments are constrained by the limited choices offered by DGS&D contracts. Quality, flexibility and value for money are often compromised in this process. There is also a general feeling that DGS&D does not respond promptly to the indenters/consignees/trade and others.

10.6 Finalisation of specifications

Fair amount of discretion is exercised in DGS&D while firming up the specifications especially for items which are highly technical in nature. In some cases, the indenting departments and the

DGS&D both are unfamiliar with the specifications of the items involved. Allegations and counter allegations are made that the specifications are being finalised to favour a particular firm. A common complaint is that a small feature is introduced and it is available in only one set of equipment to the detriment of all others. This can be a ground for complaints and allegations in the absence of a fair and transparent procedure for laying down the best suited specifications that create a level playing field.

10.7 Inspection of stores

The stores procured through DGS&D are required to undergo an inspection prior to dispatch. This is the soft under-belly of all the procurement practices. The first weakness of the system is that the required number of inspectors for physical inspection of all the stores is simply not available since recruitment was frozen in 1997. Moreover, those that undertake the inspection/registration do not necessarily have the special technical knowledge or the qualifications. For example, an electrical item may be inspected by a chemical inspector and vice-versa. The range of items is so vast that it is not possible to have specialised inspectors for all sectors. This leads to an unsatisfactory system of inspections. Moreover, inspecting each and every item which is made for Government of India is a mammoth task and very often it is done under an enormous time pressure. For example, inspection of almost Rs. 3000 crore worth of jute bags is required to be undertaken in Kolkata within a period of 2 to 3 months when food-grain procurement takes place in Punjab/Haryana.

10.8 Centralised payment through Chief Control of Accounts (CCA)

The present payment structure within the DGS&D involves placing of indents with DGS&D, supply against these indents by the vendors to the indentors directly, endorsement of receipt of goods by the indentors and presenting these receipts before the CCA for

centralised payment. Over a period of time, this process has degenerated like many over-centralised processes and there are allegations of delays and rent seeking. While DGS&D places the orders and makes the payments, the procuring departments either become mute spectators who may end up buying goods of sub-optimal quality. At times, the procuring entities allegedly engage in rent-seeking by withholding certificates of receipt of stores, thus preventing the CCA from making payments.

10.9 Inadequate accountability

The present system suffers from inadequate accountability as the DGS&D is rarely held accountable for its specifications and product quality. Yet it exercises a great deal of purchasing authority. On the other hand, procuring departments exercise little control over the suppliers, the quality of suppliers or the product specifications. This divorces the owner/ user from its legitimate authority which is currently being shifted to another entity.

10.10 Lack of quality assurance

While the price paid on the basis of a rate contract may appear comparatively low, the product quality may not offer value for money, especially if the product performance, maintenance costs and the costs of spares are taken into account. The DGS&D methodology does not appear to be optimal in terms of value for money.

10.11 Recommendations

10.11.1 Direct procurement by the user departments

The procurement of goods should be undertaken directly by the user departments who should bear the responsibility, authority and accountability for the same. The departments presently procure several goods that are not on rate contract. They should be allowed to exercise this choice for all their procurement needs and only a few select products may be procured through rate contracts of DGS&D especially in respect of sophisticated products or

equipment. The capabilities and expertise of the DGS&D, developed over several decades, needs to be utilised more effectively and with a greater focus. Towards this end, the following recommendations are made:

(a) DGS&D should not enter into rate contracts for products where the unit cost is less than about Rs. 10,000 per unit. Products of a lower unit value are not likely to be complex or sophisticated and can, therefore, be handled directly by the user departments. GFR (Rule 145) allows purchases upto Rs. 15,000 without inviting quotations. Purchases upto Rs. one lakh can be made through a Local Purchase Committee consisting of 3 members. These provisions can be used for small purchases by every office without the need for rate contract. The aforesaid delegation of powers may also be enhanced. Moreover, if DGS&D is able to provide the maximum procurement price of commercially available products, as recommended in paragraph 10.11.6, the procuring departments will be able to procure such items with greater ease and efficiency.

(b) DGS&D should not enter into rate contracts for bulk commodities such as steel, cement, bitumen, oil etc. as they are not amenable to long-term contracts. Moreover, the market prices of these commodities are established in the market through open competition among public sector and private sector entities, and the same are well publicized. The Committee did not see any merit in subjecting the procurement of these commodities through rate contracts.

(c) DGS&D should not enter into rate contracts for products which may have a likely annual off-take of less than Rs. 25 crore.

(d) DGS&D may enter into rate contracts for equipment which the departments may have difficulty in procuring through individual tenders because they may not have the expertise for this purpose. Such equipment may include automobiles, air-conditioners, computers, photocopiers etc.

(e) In fixing the rates for equipment, DGS&D should include an annual maintenance contract (AMC) for 3 to 5 years, inclusive of specified spares so as to ensure better product quality and life cycle costs.

(f) Where a product is chosen for rate contract, at least five options from different manufacturers with a fair range of specifications and quality should be provided, as far as possible, so that the user departments have sufficient choice.

(g) DGS&D should increasingly rely on catalogue prices of select commercial products and negotiate a discount on such prices. Based on such discounts, a Maximum Procurement Price (MPP) may be fixed for a variety of products to enable user departments to procure such goods off the shelf without following a tender process. This would enable a much wider inclusion of products and choices. Such an approach is already being followed in the case of automobiles. DGS&D may adopt a similar practice for a wide variety of products which may also include items with a unit price of less than Rs. 10,000.

(h) The GFR (Rule 147) requires DGS&D to host the specifications, prices and other salient details on its website for use by procuring departments. DGS&D may continue to perform this service but it should provide at least five choices for each item, as far as possible, with a range of specifications and quality.

(i) For all procurements by the user departments, payments should be made directly by such departments to the respective suppliers upon satisfactory delivery of the goods. Where required, inspection and tests may also be undertaken by the user departments (Rule 147).

10.11.2 Need for clarity relating to Rate Contracts

There seems to be a general impression that departments must only procure goods through rate contracts wherever these are available.

The Committee notes that the GFR does not mandate that the departments must only procure goods through rate contracts. It should, therefore, be clarified that the departments should be free to exercise their discretion to procure from other sources by following the GFR in order to exercise choice for meeting their respective requirements. DGS&D rate contracts should only be viewed as a facility and not as a mandate.

10.11.3 Role of DGS&D

Based on the above recommendations, the DGS&D should cease to engage in any inspections or payments relating to items on rate contract. These functions should be reverted to individual departments who not only undertake this expenditure but are also users of the procured goods. The expertise of DGS&D should be utilised mainly for performing an advisory role where departments seek its assistance on a voluntary basis and against payment of a fee. This may include formulation of standard processes, model documents etc. that may be used by individual departments. DGS&D may also offer advice/ consultancy to the departments seeking their help for dealing with complex procurement issues. However, such assistance should not extend to inspections or payments by DGS&D on behalf of the procuring departments.

10.11.4 Inspections

It is not possible to have specialised inspectors for carrying out inspections of all types of products. It can be economically and effectively done by the departments themselves either directly or through third parties. It is recommended that mandatory inspections by DGS&D are done away with. A more efficient and quality oriented professional inspection arrangement needs to be instituted where the accountability for quality assurance must remain with the procuring entity. The concept of green channel and self-certification where goods are accepted against manufacturers' guarantee/ warranty can be introduced for prompt procurement of goods. There are also several internationally known

and established quality assurance firms, who undertake this work in a professional manner. The responsibility for conducting inspections, directly or through a third party, may be assigned to the user departments. This is also consistent with Rule 147 of GFR.

10.11.5 Payments

The system of centralised payment through CCA needs to be discontinued and left entirely to the purchasing organisation which should be fully accountable for its procurement. As a measure of general procurement reforms, there should be an assured payment period and interest should be paid on delayed payments.

10.11.6 Fixing of Maximum Retail Price for Public Procurement

The Committee has recommended a simplified regime for procurement of commercial items (refer para 7.5). To facilitate further efficiency and economy in procurement of such goods, the DGS&D should develop a new line of activity for fixing the Maximum Procurement Price (MPP) of such goods. For this purpose, DGS&D should engage in cost analysis and price fixation with at least five reputed manufacturers of commonly used goods. For example, in the case of products such as automobiles, air conditioners, photocopiers, office furniture and equipment etc., DGS&D should either fix the MPP or an agreed discount on the catalogue price for each such product and leave it to the procuring agencies to make a choice. MPP could also be fixed for a variety of products that are commonly used by several departments. This will enable the user departments to undertake off-the-shelf purchases without inviting tenders or quotations.

10.11.7 Procurement for Railways and Defence forces

The Railways have a full-fledged stores wing which is manned by a dedicated Central Service (Class I) called the Indian Railways Stores Service. Similarly, the defence forces have a well-structured institutional arrangement for procuring their supplies. It is, therefore, logical to expect these departments to undertake their

respective procurements without relying on the rate contracts of DGS&D. The Committee, therefore, recommends that DGS&D may not engage in entering into rate contracts for supplies specifically required for Railways or Defence Services. These two departments should be fully responsible and accountable for their respective procurements. This approach is also consistent with the provisions of Rule 140 of GFR.

10.11.8 Costing

DGS&D may also engage in costing standards, research, cost studies for price discovery and life-cycle costing, updating procurement practices and, specialist technical support to buyers, procurement consultancy and management.

10.11.9 Technical Specifications

DGS&D may also engage in drawing up technical specifications and performance standards for newer and high technology products to meet the requirements of the user organisations and to assist them in ensuring a good response and competition.

10.12 Dissenting views of Members:

Some members of the Committee had dissenting views. Their views are at Annexures- III, VI, IV and VII.

Chapter 11

PROCUREMENT BY THE RAILWAYS

11.1 Introduction

11.1.1 A quick review of the procurement practices followed in the Indian Railways suggests a system that has potential for restrictive, inefficient and costly outcomes which may lack in robust competition and transparency. It is, therefore, necessary to reform the on-going procurement practices in the Railways with a view to promoting transparency, efficiency, economy and competition.

11.1.2 The Railways procure goods worth about Rs. 20,000 crore from the approved vendors registered with its Research, Development and Standardisation Organisation, Lucknow (RDSO) or its 9 production units. The system of vendor approval is complex and time-consuming, besides being restrictive. A firm that approaches the Railways is first subjected to a detailed scrutiny, inspections etc. before it is approved as a Developmental Vendor which entitles the firm to bid for upto 5 per cent of the purchase of a particular item. In due course, the Developmental Vendor can be upgraded as a Part II Vendor who can bid for up to 25 per cent of the total requirement of an item. After 3 years, a Part II Vendor can be categorised as a Part I Vendor who is eligible to bid for 100 per cent of the supply of an item.

11.1.3 While there may be no objection to the registration of pre-qualified bidders, restricting the bidding process to such registered vendors alone cannot be said to be a fair, transparent and competitive system of procurement. Moreover, the system of registration is complex and time consuming, it

discourages potential bidders from participation. As a result, it restricts competition and enhances the possibilities of cartelization and corruption. It is also contrary to the provisions of GFR as well as good procurement practices followed in developed countries or recommended by UNCITRAL. None of these restrict bidding to pre-registered bidders alone. Nonetheless the combined effect of the limited number of registered vendors, the time taken in registration, and the very limited volumes of supply allowed to a newly registered vendor suggests that the registration system is functioning in a manner that is not leading to adequate development of new vendors so as to encourage competition, economy and effectiveness. Some members felt that allowing the non-registered bidders to supply only upto 5 per cent of the total procurement is a restrictive practice which is contrary to GFR 2005 as well as the CVC guidelines.

11.2 Restricting procurement to registered vendors

11.2.1 In the year 2009-10, the Railways took, on an average, between 286 to 530 days for registration of vendors for different products. Since this is an average, the actual range may be wider. As a result, the bidder/applicant does not know if and when he will be found eligible for a particular bid. In a presentation made by the Railways to the Committee, the distribution of vendors for individual products was not provided. A quick analysis of the vendor directory for 358 mechanical products was, therefore, undertaken. It suggests the following:

Approved/ Registered Vendors	% of products with Part I Vendors	% of Products with Part II Vendors
No vendor	16	34
Single Vendor	15	22

Two Vendors	23	16
Three Vendors	13	8
3-6 vendors	20	9
7-9 vendors	7	4
10 or more vendors	6	7
Total	100	100

11.2.2 The Committee has examined and analysed the system from several perspectives, as noted below:

(a) Is this an open bidding system and in accordance with the GFR?

Rule 142 (i) GFR allows a Government department to register suppliers of goods that are specifically required by that department with a view to establishing reliable sources for procurement of goods. Credentials, manufacturing capability, quality control systems, past performance, after-sales service, financial background etc. of the supplier(s) are to be carefully verified before registration. Such registered suppliers are prima facie eligible for supply of goods through Limited Tender Enquiry subject to fulfillment of two conditions viz. (a) the proposed procurement is upto a value (Rs. 25 lakh as stipulated in Rule 151 of GFR), and (b) the tender enquiry must be sent to more than 3 bidders. Some members felt that in view of the above provisions of GFR as well as accepted best practices, the system of restricting procurement to registered bidders only is not an not an open bidding system, as un-registered vendors can bid for only five percent of the total quantity. To call this an open bidding system may not be correct or true.

(b) Is the system restrictive of competition?

The Competition Act 2002 applies to the Indian Railways that falls under the definition of 'enterprise' and it could possibly be considered as a dominant enterprise. The Competition Act prohibits abuse of dominance (Section 4) and provides for stiff penalties for such violation. Railways could, therefore, be at serious risk of violating the Competition Act if found to indulge in restrictive practices that may amount to an abuse of dominance. Abuse of dominance may be constituted by discriminatory or unfair conditions, denial of access to the market, refusal to deal with certain enterprises, subject to inquiry and decision by the Competition Commission of India. The Railways may review the system so as to avoid abusing its dominant position and falling foul of the Competition Act.

(c) Has there been an independent study that finds the present practices restrictive?

In its report to the Competition Commission of India, on "Competition Issues in regulated Industries: Case of Indian Transport — Railways and Ports", The Energy and Resources Institute (TERI) has stated the following:

**Reducing barriers to entry and increasing bidders' participation However, from the stakeholder discussions and questionnaire survey the study has gained that RDSO plays a prominent role in restricting entrants into the railways procurement. Concerns like bureaucratic hassles and corruption in RDSO have in many ways assisted anti-competitive practises. Complaints like RDSO taking too long to approve any new technology have been reported by some of the stakeholders. Moreover, stakeholders*

have claimed that over- specification and tedious procedure to get approvals from RDSO has kept away many big vendors from India as well as from outside.

It is important for the policy makers to reduce 'unnecessary' entry barriers as this can directly result in increased competition and reduction in the power of the cartels to control the market. Therefore, when it comes to designing the procurement process, the selection process itself should not deprive firms from bidding on the basis of criteria which are not directly relevant to the procurement (for example, an experience or financial strength requirement may unnecessarily reduce the number of competitors), neither should the process be tedious to keep away any of the players in the market.

**(Paragraph 2.4.3.1.1 of the report of March 2009).*

(d) Has the system resulted in cartelization?

The TERI report has stated:

Stakeholders in interviews mentioned that these set of approved sources sometimes form a cartel and any attempt by the railways to penalise the defaulting cartel member by cancelling its order and calling out a new tender is boycotted by the cartel members. Audit report has pointed out that out in 27 cases, railways placed the risk and purchase orders. In 5 of these cases, the items could not be purchased; in 5 other cases, the risk and purchase orders were placed on the same firms who had failed to supply material. (Paragraph 2.4.2.21 of the Report).

The report recommends:

where even in the cases where the vendors fail to supply the contracted quantity, the procurement authority are forced by

rules to procure items from the same approved sources. ...Therefore, it is important that the legislative and regulatory framework on public procurement be designed to allow sufficient flexibility on the purchasing side. (Paragraph 2.4.3 of the Report).

(e) Is the railways system conducive to vendor development?

Normally, a vendor development system should imply that the buyer assures the selected vendor of a minimum annual off-take for some years to enable the vendor to make investments and recover the same over time. In such an arrangement, a vendor would be able to invest in developing a new product line and offer competitive rates based on an assured off-take. This practice would be particularly relevant for products which do not have a market and are specific to the use of the purchaser. That is the basis on which large private sector manufacturers, such as automobile manufacturers, develop and procure their ancillary products. It is unlikely that a manufacturer of ancillary products would make the requisite investments without any assured off-take if the product does not have a market elsewhere. The present arrangement based on annual purchases cannot, therefore, be viewed as an efficient and economical vendor development system. It may only operate as a vendor registration system that restricts the procurement of Railways to a select club of suppliers.

(f) Is this system followed in the DMRC?

Some members pointed out that the Delhi Metro Rail Corporation (DMRC) is also a rail system, though on a

much smaller scale. However, it operates a rail system just like the Indian Railways and also procures goods similar to the Railways. It has similar safety concerns too. These members also noted that DMRC does not follow the vendor registration system for procurement of goods. Some other members felt that DMRC system need not be used as a benchmark for Indian Railways.

(g) What is said in defence of the present system?

The following points have been made in defence of the existing system:

(i) The system of registration of vendors is essential for procurement of goods from manufacturing organisations;

(ii) the system has stood the test of time, and has been devised after studies by experts;

(iii) there is open competitive bidding for registered vendors, and entry (up to 5 per cent of the quantity) is also allowed to new entrants found fit; and

(iv) since the registration is centralised in RDSO, all efforts are made to complete the registration process as early as possible.

11.2.3 *Role of RDSO*: Following an announcement made in the Railway Budget, a Committee of 10 Executive Directors was reportedly set up by MoR. This Committee concluded that 90 per cent of RDSO's job in respect of vendor approval is for items for which specifications have been standardised and sources have been developed. This is a routine exercise and is not very critical but consumes lot of manpower.

11.2.4 In view of the above, the Committee recommends that:

(a) Railways should allow all vendors, registered or otherwise, to

compete for advertised tenders and if necessary, the bidders could be asked to obtain certificates from IITs or other specified research institutes to the effect that they possess the specified machinery, manpower etc, and that the prototypes meet the prescribed tests conducted by them.

(b) The practice of RDSO registering the vendors should be discontinued with effect from April 1, 2012 and its role should be confined to testing of random samples for quality assurance. RDSO should normally not be involved in procurement as its primary function is research, development and standard setting which are important functions that seem to have been relegated on account of its pre-occupation with procurement matters that are not its area of core competence. Further, since the RDSO is not accountable for the consequences of flawed procurement, it causes a disconnect between authority and accountability.
However, some members did not agree with this recommendation.

(c) Vendor development may be undertaken through competitive bidding only when the following conditions are fulfilled:

(i) The required product can only be manufactured if significant additional investment is made;

(ii) The investment made will cater mainly to production of railway supplies and would be substantially wasted if the Railways do not buy that product; and

(iii) The Railways should be able to offer a guaranteed minimum off-take for about five years so that the producers are able to offer competitive rates.

11.3 Procurement by Diesel Locomotive Works

11.3.1 Some members brought to the notice of the Committee that they had undertaken a detailed examination of the production of 4,000 horsepower diesel locomotive at Diesel Locomotive Works (DLW), Varanasi and their findings were as follows, which illustrate the sub-optimal practices followed by the Railways:

- DLW is a departmental unit of the Railways that produced 110 locomotives of 4,000 horsepower in 2009-10. The design of these locomotives was provided by EMD, USA with whom an agreement was signed in 1997 for transfer of technology (ToT) to enable DLW to produce the locomotive indigenously.

- The production cost per locomotive was Rs. 10.74 crore, Rs.10.94 crore and Rs. 11.49 crore in the years 2007-08, 2008-09 and 2009-10 respectively[#]. The information for 2010-11 has not been considered as the same was provisional.

- Out of the total production cost of Rs. 1,264 crore in 2009-10 on the aforesaid production, DLW spent Rs. 1,140 crore (90 per cent) on purchase of subsystems and components from private suppliers in India and abroad. Purchase of raw materials accounted for Rs. 23 crore while staff and other costs were Rs. 100 crore[#]. These figures indicate that DLW is primarily an assembly plant and not a manufacturing unit. The value addition at DLW can be regarded as marginal.

- Out of Rs. 1,140 crore spent on procuring locomotive components, imports account for Rs. 404 crore (35 per cent) [#] even though the ToT agreement was signed in

[#] Information furnished by the Railway Board vide letter No.2011/M(W)/964/28 dated 18.04.2011 to DGS&D.

1997.

- Out of the total expenditure on procurement of components (Rs. 1,140 crore), DLW spent Rs. 414 crore (36 per cent) on single-source procurement[#]. In other words, only one vendor has been approved for purchase of these components which effectively means negotiated prices from monopoly suppliers year after year.

- Most of the imported/single-source procurement is from EMD or its agents/associates. Hence, a high level of monopoly rents have been assured to EMD during the past decade and this will continue in future too. As such, the more the production at DLW, the greater the assured profits for EMD. In this context, it is noteworthy that the Railways intend to increase the production of EMD locomotives from 110 in 2009-10 to 290 in 2013-14[*].

- Contrary to the extant rules, the Railways have reportedly paid a commission of 5% on the negotiated price of goods procured from EMD, USA. The Commission was paid for several years to the Indian agent of EMD.

- The aforesaid production cost does not include (a) interest, dividend and depreciation on the capital costs, and (b) pension liability for a staff strength of about 6000. This may be assumed as about 10 per cent of the production cost indicated above. Thus, the total cost would be about Rs. 12.64 crore per locomotive in 2009-10. This presumption is based on the fact that out of a production cost of Rs. 1,264 crore, an expenditure of Rs. 1,163 crore was attributed to procurement of components and new materials, leaving a balance of about Rs. 100 crore for

[*] Letter no. 2010/M(PU)/1/46 dtd. 02.02.2011 of the Railway Board.

other costs. It is unlikely that Rs. 100 crore can cover salaries, allowances, labour costs, etc. and yet leave enough to provide for interest, dividend, depreciation and pensions.

- The factory mainly assembles components procured from private entities and yet employs about 6,000 staff. Similarly, the Chittaranjan Locomotive Works (CLW), which manufactures electric locomotives, employs about 12,000 personnel even though it is also an assembly outfit like DLW.

11.3.2 The aforesaid facts suggest the following conclusions in respect of the production of 4,000 HP locomotives at DLW:

- This is not a case of production; it is mainly an assembly unit as 90 per cent of the cost of production is expended on purchases from outside. To call DLW a public sector unit and seek preferential treatment on that basis would, therefore, not be justified.

- There is little transfer of technology to DLW because 90 per cent of the cost of production is incurred on components procured from other suppliers. As a result, DLW seems to possesses a "screw-driver technology" for assembly of locomotives. The Railways claim that some technological upgradation is now being undertaken. However, that does not alter the factual position prevailing until now as these improvements can only be evaluated in future. In any case, this technological upgradation is also tied to further procurement from EMD and tends to perpetuate its monopoly. It is also open to suspicion that these improvements are now being pushed in order to ward off growing criticism as well as the competition from other potential bidders. The situation in the Chittaranjan Locomotive Works (CLW) which produces

electric locomotives is no different as all their components are also procured from private vendors and no production is undertaken at the CLW.

- The reliance on import content of EMD locomotives continues to be high. After over a decade of production at DLW, 35 per cent of its procurement for EMD locomotives is from imports.

- The aforesaid procurement of components suffers from lack of transparency and competition. 36 per cent of the procurement by DLW is from single-source suppliers. This implies procurement from suppliers who are likely to extract monopoly rents, thus casting a corresponding undue burden on the public exchequer. Bulk of the remaining supplies are restricted to a select group of approved vendors which suggests lack of competition and potential for cartelization and corruption.

- Payment of 5% commission to the Indian agent of EMD, USA appears to be a malpractice that requires a further probe.

- The aforesaid procurement of Rs. 1,140 crore at DLW can hardly be regarded as transparent, competitive, economical or efficient. Nor can it be asserted that the production is taking place in the public sector because virtually all components and sub-systems are being procured from private vendors for assembly at DLW. Further, the said production is based on the technology procured in 1997 and the upgradation claimed by the Railways is mainly confined to further procurement from EMD, which continues to benefit as the monopoly supplier.

11.3.3. The Committee was informed that in the Railway budget of 2007-08, it was announced that a new factory would be set up in Bihar to produce

diesel locomotive with the latest technology. On February 2, 2009, the Cabinet approved the proposal to set up this factory in joint venture with a private entity to be selected through international competitive bidding. The Cabinet also approved the detailed contract documents on the basis of which the bids were to be invited for manufacturing and procurement of locomotives. When the proposal for manufacturing of diesel locomotives was approved by the Cabinet, the Railways claimed that it would attract significant foreign investment and these locomotives would be of international class energy/fuel efficiency and will usher Indian Railways into a new era of reforms[$].

11.3.4 Following the aforesaid Cabinet approval, international competitive bidding was undertaken by the Railways. In response, another leading manufacturer of diesel locomotives gave a bid to manufacture and supply 4,500 HP locomotives for a price of Rs. 11.62 crore[*] (at 2009-10 prices). Thus, the Railways got an offer of Rs. 11.62 crore per locomotive as compared to Rs. 12.64 crore of its own production price (including dividend, depreciation and pensions) and its own reserve price of Rs. 13.87 crore for this specific tender. The new locomotive will have a capacity of 4,500 HP as compared to 4,000 HP of the DLW locomotive produced in 2009-10. This implies an additional capacity of 12.5 per cent for which a price equalisation of about 5 per cent can safely be assumed. As a result, the comparable price for a DLW locomotive of 4,500 HP would be Rs. 13.27 crore. This is Rs. 1.65 crore or 14.2% higher than the bid received from an international manufacturer. Even if all these factors are ignored, the fact remains that against the actual manufacturing cost of Rs. 11.49 crore for a 4,000 HP locomotive, the bid for a 4,500 HP locomotive to be manufactured at a new factory in Bihar was Rs. 11.62 crore. The bidder would have also provided the latest technology (including fuel savings) as compared to a decade-old technology at DLW. Despite the obvious advantages, the aforesaid bid was rejected on the ground of a

[$] Press brief of MoR conveying the cabinet decision relating to the setting up of the proposed factory at Marhowra.

[*] OM No. 551/2/2/2009-Cab-III dated 19.2.2009 regarding minutes of the meeting of Committee of Secretaries in connection with the single bid for Diesel Locomotive Factory, Marhowhra.

single offer (even though large-scale single-source procurement at DLW is being undertaken for the past decade). An arithmetical error was used as a ground for discharging the bid.

11.3.5 It is also worth noting that a committee appointed by MoR had estimated a reserve price of Rs. 13.87 crore for a 4,500 HP locomotive and Rs. 16.01 crore for a 6000 HP locomotive[†]. The bids received were Rs. 11.61 crore and Rs. 13.35 crore for 4,500 HP and 6,000 HP locomotives respectively. Thus, the bids received were 14.5% lower than the estimated price of 4,500 HP locomotive and 16.4% lower for 6,000 HP locomotive. Yet these bids were discharged, presumably because the Railway Ministry did not wish to decide on these large transactions only two months before the general elections of 2009.

11.3.6 It may also be noted that the Member (Mechanical), Railway Board stated, in a COS meeting held in the Cabinet Secretariat on 17.2.2009 to consider this bid that "Diesel Locomotives are currently being manufactured in India with transfer of technology from M/s EMD and delay in setting up of new diesel locomotive factory would result in getting more orders for manufacturing diesel locomotives under present arrangement. So, the vested interests of M/s EMD in scuttling the process for setting up of new diesel locomotive factory cannot be ruled out"[*]. A news report on the front page of Financial Express dated May 23, 2011 brings out that M/s EMD has been lobbying for a long time to scuttle the bid process for setting up the proposed diesel locomotive factory at Marhowra.

11.3.7 This proposal was again taken to the Cabinet after the new government took over and the same was approved on February 18, 2010 with a time schedule of six months for finalisation of the bids. The RFQ was issued on March 23, 2010 with the bid due date of December 9, 2010 (nine months instead of six months indicated to the Cabinet). The bid date has been repeatedly postponed without assigning reasons. At present, the bid date is July 29, 2011. It is noteworthy that the Cabinet had approved

[†] Report of the Committee appointed by MoR for estimation of reserve price for PPP bids for diesel locomotive factory at Marhowra, Bihar.

[*] OM No. 551/2/2/2009-Cab-III dated 19.2.2009 regarding minutes of the meeting of Committee of Secretaries in connection with the single bid for Diesel Locomotive Factory, Marhowhra.

the bid documents and the proposed contract. It had also approved the setting up of an inter-ministerial committee to make further improvements, if necessary. However, the bid dates are being postponed repeatedly without assigning any reasons. As a result, the production of old and comparatively expensive EMD locomotives continues to expand, unchallenged by any competition.

11.3.8 Some members felt that the facts speak for themselves and should be subjected to an independent enquiry. They also felt that the response of the Railways has introduced some information relating to production of smaller locomotives (ALCO) of 3,100/3,300 HP which are based on the technology of 1960s. This is clearly not relevant to the present issues relating to EMD locomotives. Further, the information for 2010-11 was indeed provided by the Railways, but it was provisional, and hence, not used. The inability of the Railways to refute the findings based on the actual figures of 2009-10 is noteworthy. The assertion that the cost of EMD locomotives includes pension, dividend, etc. is contestable because it is unlikely that after accounting for an expenditure of Rs. 1,163 crore on purchase of components, the balance Rs. 100 crore can cover salaries, allowances, labour costs etc. and yet leave enough to provide for interest, dividend, depreciation and pensions. Further, the statement that the said bid was unresponsive is also contestable because the bid security was not forfeited as per the bid conditions which required forfeiture in the event of an unresponsive bid. However, a noteworthy fact stated by the Additional Member (Finance) to the Committee was that the response relating to the DLW case had come from the Railway Board and these were not his personal views. The support for EMD-based procurement seems to be a bit puzzling because the Railway Ministry's own proposals for international competitive bidding have been cleared twice by the Union Cabinet and this initiative is also widely claimed by the Railway Ministry as a measure of reform.

11.3.9 The new locomotive was meant to be produced in a remote area of Bihar at a factory to be set up by the selected bidder. The bid price includes all the costs of setting up the factory which would also serve the cause of regional development. Despite the additional risks and costs involved in setting up a greenfield production unit at a remote location in Bihar,

the bid price received in 2009 was significantly lower than the cost of locomotives produced by the Railways at DLW in Varanasi. This by itself reinforces several of the conclusions drawn above.

11.3.10 In sum, the DLW case clearly suggests that incumbent suppliers have a stranglehold over Railway procurement. Despite approval of the Cabinet twice, the bids are being held up in an opaque manner. There are no checks and balances or even established procedures that can analyse, evaluate and improve the on-going procurement practices being followed by the Railways. Being an inward-looking organization, Railways are often opposed to external scrutiny and advice. As a result, vested interests can manage to perpetuate sub-optimal practices that provide a fertile ground for malpractices, cartelization and corruption. Competition, economy, efficiency and probity seem to be obvious casualties. That the public exchequer loses heavily also should be obvious.

11.3.11 Additional Member (Finance), M/o Railways has contested the above facts. He has informed *that in the above analysis there is selective use of data with an intent to arrive at pre determined conclusions and the true perspective is presented as follows:*

(a) *with respect to para 11.3.1 above:*

The inference that DLW is primarily an assembly Plant and not a manufacturing unit is not correct. If one goes by this premise, then all the Automobile manufacturing units, namely Tata Motors, Hundai Motors, Maruti etc would be categorised as an assembly Plant. In this regard, it would be of interest to look at the figures of Alco locomotives manufactured in DLW for almost four decades. Out of the total production cost of Rs. 717.21 crore in 2010-11, DLW has spent Rs. 545.11 crore on purchase of domestic and imported components which works out to 76% of the total expenditure. This shows that even though DLW does not manufacture the electrics for Alco locomotive (which constitute about 50% of the cost of the locomotive), value addition by

DLW is about 24%. DLW started manufacturing ALCO locomotives when the industrial base in India had not developed and it was necessary to undertake the manufacture of sub systems and components in-house which could not effectively be outsourced. The situation is vastly different today.

The procurement of Rs. 414 crore (36%) from single source vendors has to be seen in proper perspective. Indian Railways are pursuing the development of more sources for almost all the components which are presently single sourced. For instance, for alternator and traction motor (TM), developmental orders have been placed on Indian manufacturers since long but without any successful outcome as yet. Similarly for crankshaft, orders has been placed on a large private sector firm but it has not been able to supply even the prototype. These examples also underscore the point that even reputed companies take time to develop an item. It requires a detailed design study, tooling and trial process through which these companies have to undergo.

Major single source suppliers during the past decade in value terms for 4500 HP locos are now competing with each other by trying to enter in each other's domain by developing items not hitherto manufactured by them. .

It is only during the last 2 – 3 years that the production of High Horse Power locomotives have reached a sizeable level to generate enough volume for vendors to make investments for manufacture of components and sub systems. DLW has already achieved indigenisation of 66% of its procurement in value terms which will further increase if the existing efforts to develop indigenous sources for electrics are successful.

As for the agency commission, out of the 100% FOB cost which EMD was quoting, in line with their quotation, only 95% was paid to them in foreign currency and 5% was paid as agency commission to their Indian agent in Indian currency. So what was paid to their Indian agent was

part of what was payable to EMD which was in line with the provisions for payment of agency commission.

It is clarified that the production cost of locomotive does include the depreciation cost and pension liability etc. and hence the addition of 10% of the aforesaid production cost to derive per locomotive cost as Rs. 12.64 crore in 2009-10 is factually incorrect.

(b) *with respect to para 11.3.2 above*:

As for the level of technology, the first 4000 HP locomotive was manufactured in 2001. After assimilating this technology, besides migrating from manufacture of 4000 HP locomotives to 4500 HP locomotives DLW, through its own and RDSO's efforts, have succeeded in following technological changes over the years (some of these technology improvements have taken place since 2007):

i) From GTO based to IGBT based locomotives.

ii) Single cab to dual cab passenger locomotives.

iii) From cast bogies to low weight fabricated bogie in passenger locomotives achieving reduction in weight by 1 tonne.

iv) From narrow cab to wide cab locomotives.

v) From 4 Traction Motor to 6 Traction Motor WDP4 locomotives

vi) From single control to distributed control system-successfully developed.

vii) Introduction of Hotel load - a system presently under trial.

As for monopoly rent, there is no evidence to suggest that price escalation for items with limited vendor base is more as compared to those with broad vendor base.

As for the alleged corruption, and lack of economy and transparency in purchase, suffice it to say that in 2010-11, for 4500 HP with all the

attendant technological improvements as brought out above, the loco cost was Rs. 11.82 cr at DLW, while in 1997 the cost of the imported locomotive was around Rs. 14 cr for 4000 HP, despite implementation of 6th pay commission in between.

(c) *with respect to para 11.3.4 above*:

The whole analysis about comparison of 2009-10 price with the bid price received for 4500 HP loco is fundamentally flawed as DLW has already switched over to manufacture of 4500 HP locomotives in 2010-11 and therefore, for any cost comparison with 4500 HP, the data for 2010-11 would have been more appropriate. DLW's cost of manufacture was Rs.11.82 crore for the year 2010-11 for 4500 HP locomotives. Despite this cost being available (in the same letter dt. 18.4.2011, copy of which was also sent to Advisor to Deputy Chairman to Planning Commission), an attempt is being made to derive the cost of 4500 HP locomotives from the unit price of 4000 HP loco by adding fallacious factors. This is based on incorrect assumptions without knowing the cost implications of the technical advancements made in manufacture of 4500 HP locomotives from that of 4000 HP locomotives. The difference in 4500 HP locomotives and 4000 HP locomotives are broadly as under:

i) Changes in Software in loco control computer (LCC) which releases extra Horse Power-, by higher excitation of alternators along with matching response by governors. This change has no cost implication as the change is basically in the software.

ii) Change in the setting of governor to match with the above changes in LCC. This also has no cost implication.

iii) Enhancement of inverter rating in Traction Convertor cabinet (TCC). This has insignificant cost implication.

iv) Increased core from 9 to 10 in radiators. The cost of radiators is about Rs. 12 lakh. It was seen that there was hardly any cost implication because of this change as marginal cost increase from 9 core to 10 core

radiator was perhaps absorbed by the suppliers due to higher volume of purchases.

Thus, there is no significant variation in the cost of 4000 HP locomotive and 4500 HP locomotive. It is for this reason that the cost per locomotive of Rs. 11.49 crore for 4000 HP locomotives in 2009-10 has gone up only marginally to Rs. 11.82 crore per locomotive for 4500 HP locomotives in the year 2010-11 which is essentially on account of inflation. The cost comparison should be made for like to like products, particularly when cost of manufacture of 4500 HP locomotives manufactured in DLW is available. Further, what has not been brought out by the said members is that if the PVC given in the bid document is factored in, the price of the offered bid for 4500 HP in 2010-11 would be about Rs 12.5 cr as compared to production cost of Rs 11.82 cr by DLW for 4500 HP loco during 2010-11. This again speaks volume of the economy of loco manufacturing at DLW against international benchmark.

RFP issued in 2009 was not rejected on the ground of a single bid. The bid could not be accepted as the same was found to be non responsive and the discrepancy in the bid was non-curable

(d) *with respect to para 11.3.5 above:*

It is not understood why a few committee members are talking about estimated cost data of earlier vintage when actual cost data are available. The disinformation about the so called lower price of the bid received for 4500 HP has already been refuted above and thus are not being repeated. Further, as mentioned above, the bid was discharged because the offer was non responsive and the discrepancy in the bid was non curable.

(e) *with respect to para 11.3.6 above:*

The news report referred to and the insinuation therein are not based on facts. A rejoinder has already been sent.

(f) *with respect to para 11.3.7 above:*

It is worthwhile to get government opinion on the generic issue of procurement of locomotive from the railway budget speech (2011-12) of Hon'ble M.R. (para 12)– "Railways have also been working on a number of projects involving long term supply contracts for locomotives, coaches and critical loco components at Madhepura, Marhowra, Kancharapar and Dankuni. Since these project models are being attempted for the first time in railways, it is necessary to carry out due diligence. All these projects are progressing and a core group of officers is working on these PPP/JV industries."

(g) *with respect to para 11.3.8 above*:

The disinformation about 'lower' bid price has already been dealt above and thus are not being repeated. As for the regional development, suffice it to say that the said tender was discharged with the formal approval of the competent authority.

(h) *with respect to para 11.3.9 above:*

It is not understood why a specific tender is being repeatedly used to drive a particular point of view. In any case the government view's have already been brought out above in para 11.3.10 (f). The other value judgments are without any basis. About the allegation of malpractices, corruption etc, it is to be borne in mind that the same letter dt 18.4.2011 has brought out that the loco cost for 4000HP loco in 2007-08 was Rs 10.74 cr and in 2010-11 it was Rs 11.82 cr (for 4500HP loco). This translates into 2.5% annual increase in loco cost as against average *annual* inflation (CPI) rate of more than 9% during 2008 to 2011 (taken from www.tradingeconomics.com/india/inflation-cpi). This speaks enough of the 'competition, economy, efficiency and probity' in the manufacturing of EMD locomotive at DLW.

11.3.12 After noting the above positions, the Committee was of the view that as this is a specific case and the Committee is to focus on the larger issues of public procurement policy, rules

and standards, the matter may be left to the concerned Ministry and the oversight mechanism within the government.

11.4 Land matters

11.4.1 The manner in which land is leased out by the Railways suggests lack of any clear policy or rules. The Railways own a huge amount of valuable real estate across the country but it is not dealt with on the basis of well-defined and transparent rules, leaving a potential for corruption and manipulation.

11.4.2 As an example, some members of the Committee brought out the case of a very large real estate transaction in Delhi which was recently carried out without reference to any clear rules. The land was given for a long-term lease (over 50 years) without any open auction, as is the norm for such cases. It was structured as a PPP transaction but the Cabinet-approved rules for appraisal and approval of PPP projects were not followed.

11.4.3 Land matters have been a cause for several controversies across departments. In the case of Railways, land is leased out for various purposes on the basis of divergent terms and conditions. In the particular case mentioned above, Government land would be used for building private houses and commercial spaces. Some flats would also be built for the Railways. Such transactions are not covered by any codified rules. In fact, this particular case is a PPP transaction, but it appears that a contrary view was taken in the Railways, perhaps with the intent of avoiding inter-ministerial scrutiny. It seems that all these transactions are undertaken by the civil engineering wing of the Railways which has ostensibly no special knowledge relating to complex land related issues.

11.4.4 Additional Member (Finance) informed that Ministry of Railways has set up a statutory body namely Rail Land Development Authority (RLDA) by an Act of Parliament through the Railways (Amendment

Act), 2005 to undertake commercial development through a fair, transparent, open, competitive bidding process for all the entrusted sites. Commercial development of railway land by RLDA is essentially land leasing for commercial purposes through competitive bidding process and does not fall within the purview of PPP projects. It is noted that a similar reference regarding commercial development of vacant railway land at Sarai Rohilla, Delhi was received from Adviser to Deputy Chairman, Planning Commission in July 2008 which was replied by Ministry of Railways in Nov-2008 stating that projects undertaken by RLDA for commercial development of railway land are actually leasing of land for development and do not fall in the category of PPP projects. Leasing of such land is undertaken through rules prescribed in Indian Railway Code for the Engineering Department 1999, Indian Railway Works Manual 2000 and guidelines/instructions issued by Ministry of Railways from time to time. In all above cases, ownership of land continues to vest with the railways during the period of lease & the land revert s back to railways on expiry/termination of lease.

11.4.5 After noting the above positions, the Committee was of the view that rules for leasing/licencing of land may be codified with the requisite degree of transparency. As regards the specific case, the Committee was of the view that it is to focus on the larger issues of public procurement policy, rules and standards, and the specific cases may be left to the concerned Ministry and the oversight mechanism within the government.

11.5 Civil works

The procurement of civil works is done on the basis of item rate contracts which suffer from several drawbacks. This issue is already covered in the Chapter on Procurement of Works and the recommendations contained therein apply with equal force to procurement of civil works by the Railways.

11.6 Procurement by and through Railway PSEs

11.6.1 Procurement by the Railway PSEs also seems to suffer from

inadequate transparency and competition. Procurement by nomination and negotiations is common. Quite often, Railways assign their procurement to the PSEs in order to bypass the procurement rules of the Government. For example, Railways routinely hire external consultants on nomination basis through their PSUs. The PSEs devise their own arrangements which are often flawed. This creates a potential for malpractices in PSE procurement.

11.6.2 The example of Dedicated Freight Corridor Corporation of India Ltd. (DFCCIL) was cited by some of the members. It is understood to have awarded only two major construction contracts so far involving an amount of about Rs. 1,500 crore and both these contracts are the subject matter of investigations against senior officials of the corporation, and the Managing Director of DFCCIL had to quit two years before his term ended. The progress of this project continues to be slow.

11.6.3 Additional Member (Finance) informed that the railway PSUs have their set of guidelines for procurement which are quite transparent and open to scrutiny by Audit, Vigilance etc. They are also governed by CVC guidelines. Most of the procurement by PSUs is done through competitive bidding. It is not correct to say that Railway assign their procurement to the PSU in order to avoid the procurement rules of the government. The cited case of DFCCIL is a matter of investigation. However, isolated failure cannot be taken as a basis for changing the well established system.

11.6.4 The Committee was of the view that Railways should not undertake procurement through PSEs on a nomination basis nor should PSEs undertake their own procurement on nomination basis. This will be in conformity with the recommendations contained in the Chapter on Procurement by PSEs. The Committee believes that the recommendations made in Chapter 9 on Public Sector Enterprises should also apply to Railways PSEs. As regards the specific case, the Committee was of the view that it is to focus on the larger issues of

public procurement policy, rules and standards, and the specific cases may be left to the concerned Ministry and the oversight mechanism within the government.

11.7 Departmental production and transfer pricing

11.7.1 Railways produce a large part of their requirements in departmental production units (PUs). The Committee notes that this is a practice peculiar to Railways and no other commercial entity in the Government follows this system. As a result, the Railways have two factories that produce, rather assemble, diesel and electric locomotives respectively. They have two similar units that assemble passenger coaches while yet another is under construction. Two departmental factories assemble railway wheels. More such factories are in the offing. As noted earlier, these units function mainly as aggregators or assembly units and suffer from excessive staffing and flawed procurement practices. In the absence of an "arms length" relationship, their costs and prices are not subjected to the requisite checks and balances which create potential for malpractices, inefficiency and higher costs.

11.7.2 Railways have resisted suggestions to corporatize these factories as PSEs. It seems that the flawed practices for procurement of components, the large staffing and promotion opportunities, and other forms of vested interests have perpetuated this system of departmental production units and also created pressures for setting up new ones. Efficiency and economy is at once a casualty because there is neither any competition nor any checks and balances on such production/assembly. There is neither any price discovery nor any transparent reporting of costs and prices. The costs of such production are simply passed on to the public exchequer by means of transfer pricing through the budget.

11.7.3 The Committee recommends that (a) there should be a

complete ban on setting up new departmental units; (b) the existing units should be corporatised as PSEs; (c) no expansion of departmental units should be permitted unless they have been converted into PSEs; and (d) the procurement practices of these units should be reformed and their costs of production should be placed in public domain along with a programme for their reform.

11.8 PPP in Railways

11.8.1 With a view to creating world-class infrastructure, the Government placed special emphasis on infrastructure during the Eleventh Five Year Plan and doubled the investment target as compared to the Tenth Plan. For mobilising the required resources, PPP was identified as a means of supplementing public investment. In 2004, the Committee on Infrastructure (CoI) was set up under the chairmanship of the Prime Minister and consisting of Finance Minister, Deputy Chairman, Planning Commission, Railway Minister, Minister of Road Transport and Highways, Minister of Shipping, Minister of Power, Minister of Civil Aviation etc. to steer the policy and oversee the implementation for creating world-class infrastructure. The CoI was replaced by the Cabinet Committee on Infrastructure (CCI) in 2009. As a part of the policy initiatives reinforced by CoI/ CCI, increasing reliance is being placed on introducing PPPs and competitive private investment in all infrastructure sectors.

11.8.2 Private investment constituted 24 per cent of the total investment in infrastructure during the Tenth Five Year Plan. This is likely to increase to 36 per cent during the Eleventh Plan. In absolute terms, the increase in private investment would be from Rs. 2,25,220 crore in Tenth Plan to Rs. 7,42,912 crore in the Eleventh Plan (at 2006-07 prices). During the Twelfth Five Year Plan, the share of private investment would have to increase to 50 per cent of the total

projected investment in infrastructure. In absolute terms, private investment during the Twelfth Plan is projected to be about Rs. 20 lakh crore. Without this level of mobilisation from the private sector, the effort to bridge the infrastructure deficit would be constrained.

11.8.3 In the above context, different sectors have taken several measures to enhance private investment at an accelerated pace. Private sector investment expected in the major infrastructure sectors is given below:

Telecom	82%
Ports	80%
Airports	60%
Electricity	44%
Roads	16%
Railways	4 %

11.8.4 It would be seen that private investment in the Railway sector is minimal as compared to the other sectors. Moreover, most of this investment has not been secured on a competitive basis as it is based on the use of monopoly power by the Railways which requires private investors to fund the cost of wagons, dedicated railway tracks to connect private ports etc. As a result, the gains of private investment in the Railway sector has been negligible.

11.8.5 While Railways have announced from time to time that it would rapidly expand the scope of PPP in bridging the investment gap in Railways, there has been little tangible progress so far. It appears that the monopolistic and departmental character of the Railways is not amenable to competitive private investment that would set benchmarks and contest the present practices of the Railways. As a result, the Railway sector has been deprived of much investment and modernization.

11.8.6 The inability of Railways to rationalise passenger fares creates pressures that lead to raising of freight charges that adversely affect the entire economy. There is little room left for further increase in freight charges and in any case, this method of revenue generation does not leave much investible surplus to enable the Railways to make large investments in infrastructure projects. An accelerated shift to PPPs is, therefore, inevitable but this would only be possible if ways are found to overcome the present resistance. The Committee, therefore, recommends that concerted efforts should be made for attracting the required volumes of competitive private investment in the Railways to bridge the increasing investment deficit.

11. 9 Recommendations

11.9.1 The Railways seem to follow sub-optimal procurement practices that do not always carry an assurance of probity, competition, transparency, efficiency and economy. These practices are significantly sub-optimal when compared to other departments of the Central Government. It is, therefore, necessary to undertake an in-depth review of the procurement practices followed in the Railways Board and down to the basic unit of the functioning i.e. the Division. Such a review should be external to the Railways.

11.9.2 The Railways should discontinue its vendor registration programme in the present form as it restricts competition while providing opportunities for cartelisation and corruption. The Committee recommends that it should undertake all procurement from 2012-13 onwards based on the normal single-stage two-envelope procurement system followed in the Government.

11.9.3 For enhancing competition as well as reduction in bid prices, procurement contracts for products required on a regular basis should be awarded for a period of three to five years with price indexation for the second and subsequent years. The contracts

may include a clause to the effect that procurement in subsequent years would be subject to appropriation by the Parliament.

11.9.4 Development of vendors should be restricted to products that require significant investments in manufacturing machinery and do not have sufficient alternative uses. Contracts for such procurement should be for at least 5 years. As far as possible, at least three development vendors should be chosen for a new product and after a period of 5 years, the product should be procured on an open competitive basis.

11.9.5 The extant practice of single source procurement based on annual bids from a single vendor should be brought to a close.

11.9.6 The rules for leasing/ licensing of land should be codified with the requisite degree of transparency. Where PPP is undertaken, the Cabinet-approved Rules should be strictly followed.

11.9.7 Civil works should normally be procured on the basis of EPC contracts as recommended in the Chapter on Procurement of Works.

11.9.8 Railways should not undertake procurement through PSEs on a nomination basis. Nor should PSEs undertake their own procurement on nomination basis. This will be in conformity with the recommendations contained in the Chapter on Procurement by PSEs.

11.9.9 The Railways should announce and implement a time-bound programme for attracting the requisite volumes of investment through PPP and other forms of competitive private investment.

11.10 Dissenting views of Members:

Some members of the Committee had dissenting views. Their views are at Annexures-IV, VI, VII and IX.

Chapter 12

DEFENCE PROCUREMENT

12.1 Introduction

12.1.1 The Committee recognises the complexities and sensitivities in procurement of armaments for the armed forces (the "defence procurement"). The Committee noted that defence procurement entails a complex decision-making process which seeks to balance the objectives of (i) transparency and probity (ii) fair competition (iii) expeditious procurement and (iv) self-reliance and indigenisation. Moreover, the process of defence procurement must always be subservient to national security considerations.

12.1.2 The Committee noted that the Defence Procurement Procedure (DPP) has been steadily refined since 2002 through amendments in 2003, 2005, 2006, 2008, 2009 and 2011. Under the DPP, bidders are first shortlisted and bids are invited through a "single stage-two bid system". Technical and commercial offers are received together in separate sealed envelopes. The categorisation of defence procurement has been expanded from 'Buy' cases to 'Buy and Make through TOT', 'Buy and Make (Indian)' and 'Make' procedures, which has enabled a significant expansion of defence procurement during the recent years through improved practices.

12.2 Anomalies in Policy Framework

12.2.1 An overview of some aspects of defence procurement in India suggests an anomalous conceptual framework that seems to have led to unintended outcomes. These aspects are explained below:

12.2.2 A significant part of the domestic defence procurement is sourced through defence public sector undertakings (DPSEs) or

ordnance factories (OFs). The monopoly status of the DPSEs and OFs leads to the common ills associated with monopolies in any economic activity such as inefficiencies, high costs and outdated technology. Moreover, most of these units, with notable exceptions, seem to be operating primarily as aggregators or assembly plants which source most of their components from private producers. As a result, the DPSEs and OFs usually do not manufacture much except some low technology components. The Committee was given to understand that over 70 per cent of the costs of a product supplied by these units are expended on external procurement while less than 30 per cent accounts for in-house production, staff costs, profits etc. Evidently, this can hardly qualify as a credible manufacturing capacity within the public sector.

12.2.3 As part of modern manufacturing practices, there cannot be much objection to outsourcing of components by DPSEs and OFs as this is also a common practice in the private sector. However, good private sector companies usually possess and develop the core technology associated with their products whereas in the case of DPSEs and OFs, the Committee was informed that they either outsource such hi-tech components or acquire transfer of technology that usually leaves them with a static technological base. As a result, DPSEs and OFs are not normally viewed as efficient and economical producers. Their output is, therefore, confined to captive supplies to the Government with little exports or market-based sales that would demonstrate their quality, efficiency and economy in a competitive market.

12.2.4 On the conclusions drawn by the Committee in paragraph 12.2.3 above, the Director General (Acquisition), MoD stated that there was no authentic data to suggest that OFs and DPSEs, with some exceptions, sourced a very large part of their components from outside. The Committee acknowledged that no such data was

available in public domain and the Committee's observations were based on discussions with some informed officials, though no specific data was made available to the Committee in order to enable the Committee to review and modify its findings. The Committee, therefore, leaves this matter for further examination by the Defence Ministry with the suggestion that the recommendations of this Committee may be considered by the Government after verifying the assumptions made by the Committee. The Committee also suggests that the Government consider progressive corporatization of selected OFs in order to bring greater transparency in their operations and market based accountability, as well as allowing the better performing of these entities to enjoy more flexibility in their work.

12.2.5 On the issue of expanding private sector participation in defence production, the Committee noted that, in most developed countries too, private sector plays a dominant role in defence production. For example, in the USA, which is the largest producer of hi-tech armaments, all production is reportedly undertaken in the private sector. On the other hand, in India, as a result of the policy and other constraints, indigenous production capacity has remained relatively inadequate and underdeveloped, leaving India as one of the largest importers of defence equipment. In view of the above, it seems necessary to ensure development of competitive, efficient and economic manufacturing capacity in the private sector in India to facilitate efficient and economic procurement in the interests of national security as well as the national economy.

12.2.6 The Committee recognises that unlike normal commercial products, the vendor base for defence products is comparatively restricted and sometimes monopolistic. However, ways can be found to introduce greater efficiency and economy in procurement by promoting competitive development of private sector producers who should have the freedom to attract greater foreign participation in

terms of equity as well as technology. Excessive restrictions on foreign participation could cause: (a) continued reliance on procurement of foreign products; (b) denial of technological upgradation; (c) higher costs; and (d) lower efficiencies. This is somewhat similar compared to the phenomenon that prevailed in the manufacturing sector prior to the liberalisation of the licensing regime in 1991.

12.2.7 According to the present policy, a private sector entity cannot have more than 26 per cent equity participation from foreign producers. This policy acts as a barrier to setting up of hi-tech production units because the foreign producers possessing such technology would not normally be willing to pass on their know-how to another private company which they do not control. As a result, the larger purpose of accelerating defence production on Indian soil would remain elusive. Such production would tend to get restricted to low or intermediate technology products where a foreign producer does not mind ceding intellectual property or technology to a company not under its control. While existing Indian companies may support these restrictions in the hope that they would provide a leverage to them in dealing with their prospective foreign partners, these may actually act as barriers to many worthwhile collaborations for production of advanced equipment.

12.2.8 It is sometimes argued that even if the FDI limits are increased, foreign governments and companies may not allow defence production to shift to India. While this could be true in certain cases, in any event, the Government should create an enabling environment and allow competitive forces to operate and thereby enhance indigenous defence production.

12.2.9 Defence experts sometimes argue that supplies from such companies could be uncertain in case of a war. By the same logic, advanced weapon systems procured from abroad may also face stoppage of additional supplies of weapons or spares during a war. Moreover, once manufacturing companies are set up on the Indian soil, it is unlikely that they will behave in a prejudicial manner during

a war.

12.2.10 On paragraphs 12.2.7 to 12.2.9, DG (Acquisition) stated that presently there is a cap of 26 per cent on foreign equity participation in Indian defence manufacturing. However, exceptions can be made on case by case basis. In his view, these paragraphs overlook the fact that besides a cap on FDI, there are other more important barriers to transfer of defence technology, which is tightly controlled through legislation in advanced defence manufacturing countries. Even if the FDI cap is enhanced beyond 26 per cent, there would be no certainty regarding TOT to India, since such decisions are governed by export control laws and political and strategic considerations of the exporting country. A higher cap on foreign equity in Indian defence manufacturing is therefore, not a panacea for hi-tech defence production. Further, while low end TOT and knowhow may get transferred, it is unlikely that 'design' and 'development' capability and 'know why' would be transferred to Indian manufacturing entities with higher FDI cap. Design and development capabilities and 'know why' are closely held by foreign companies and are not easily transferred to subsidiary companies or JVs. On the other hand, allowing foreign Original Equipment Manufacturers (OEMs) a higher FDI cap in defence manufacturing could be a setback for indigenous design and development efforts. The reliability of defence supplies during war would also become subject to greater uncertainty.

12.2.11 He further stated that a GOM chaired by the Union Finance Minister is already deliberating upon the FDI cap for Indian defence production and a number of sensitive and complex issues need to be taken into consideration. Since the Committee on Public Procurement has not been able to go into the matter in depth, it would be appropriate if recommendations on such complex matters are excluded from the report.

12.2.12 A viewpoint expressed in the Committee was that as an example of successfully promoting indigenous production of modern

technology products, one may cite the example of the Maruti-Suzuki. The Government had tried in the past to secure transfer of technology for production of cars in India, but did not succeed. It was on the intervention from the highest levels in Government that the foreign partner was allowed to own 40 per cent of the equity of Maruit which was set up as an Indian company. In 1992, the foreign partner was allowed to raise its stake to 50 per cent which was further raised to 60 per cent in 2002. As a result, the share-holding, production and technology are substantially controlled by a foreign equity holder who may also have earned greater profits, but the primary beneficiary of this entire exercise is the Indian economy. It was clarified that production of cars and defence equipment may not be comparable. However, this case was being cited only to address doubts that are frequently expressed regarding the linkage of transfer of technology to equity participation by Indian entities.

12.2.13 Experience since liberalization amply demonstrates the technological and volume growth that have taken place in the country in sectors where global competition has been allowed and induction of foreign investment and technologies permitted. There is no reason to believe that similar developments cannot take place in the defence industry. The Committee fully recognises that the cases of defence production units and other sectors may not be identical. However, the point being made is that production on Indian soil can be vastly increased by relaxing the restrictions on foreign equity participation. If India's defence production industry is to become world-class, it will have to adopt a global outlook. It is necessary to recognise that foreign companies owning hi-tech intellectual property and designs may not be willing to transfer the same to an Indian company over which they cannot exercise control. In ability to address this issue, may perpetuate a situation where the best products do not get produced in India and continue to be imported. The Committee feels that this anomaly needs to be addressed with a sense of urgency.

12.2.14 Under the present policy framework, advanced equipment continues to be procured from foreign private companies. They also tend to dictate their monopoly prices for supply of spares. For want of choice, the Government accepts this imbalanced arrangement. Yet the policy framework discourages these very suppliers to produce competitively in India through an Indian company that will produce on Indian soil, create jobs in India, add to Indian incomes, pay Indian taxes and also export their production.

12.2.15 The present policy framework that governs defence procurement seems to give rise to:

(a) monopoly procurement from DPSEs and OFs who are often aggregators or assembly plants with limited value addition or manufacturing capacity;

(b) large procurement from private foreign companies; and

(c) policy barriers that have prevented competitive and efficient defence production by the private sector in India.

As a result of the above, defence procurement may suffer from delays; may be comparatively expensive; may rely excessively on foreign suppliers; and obstruct a robust growth of domestic production.

12.3 Other issues

12.3.1 Excessive restrictions on foreign bidders

About two-thirds of defence procurement is on capital items costing above Rs. 10 crore each while the remaining is on items of maintenance etc. Two manuals guide the defence procurement. For low to medium technology items where the Indian industry has the adequate know-how and provides a minimum 30 per cent indigenous content, the existing system invites bids only from Indian firms. It excludes foreign bids, thus denying the

Government any method to judge the competitiveness of Indian bids. It also prevents the Indian industry to come up to international standards in pricing. This is an open-ended price preference that could enable cartelisation and high costs. A more balanced and equitable arrangement would be to provide a price preference of 5 to 10 per cent for domestic suppliers whose import component does not exceed a certain threshold, say 50 per cent of the bid price. With these modifications, international competitive bidding should be encouraged.

The above recommendation is also consistent with the GFR while the present practice is not. The Committee noted that Rule 102 (3) of GFR 1963 gave encouragement and preference to goods manufactured in India from raw materials produced in India. Second preference was given to goods wholly or partly manufactured in India from imported raw materials. Third came foreign goods held in stock in India followed by goods specially imported. The GFR 2005 has done away with these provisions (Rules 135 to 162 in Chapter 6). There is no reference to preference for goods manufactured in India, except for items such as khadi and village industries, handloom textiles etc. This clearly indicates that the preference for domestic goods to the exclusion of foreign goods has been done away. However, the defence procurement policy continues to reflect the repealed GFR and overlooks the provisions of GFR 2005. The Committee, therefore, observed that restricting foreign bidders from competitive bidding is not in public interest as it could lead to lower levels of economy and efficiency.

12.3.2 Restriction on Transfer of Technology (ToT) to private companies

For high technology products not available from Indian industry, the present system allows purchase of foreign products as well as a complete transfer of technology (ToT) licence. However, in case of a ToT licence, only a DPSE is nominated. This denies opportunities to the private sector to compete and offer better outcomes by directly

acquiring the required technology on commercial terms. It could be argued that acquisition of technology by the Government from a private foreign company would be less efficient and economical as compared to such acquisition by a private Indian company which may either be an independent entity or a subsidiary of the provider of technology. The present closed- door policy needs to be opened up so that private sector can also compete for such production. Such a practice has been followed in some cases by the Railways. There could be several ways of engaging the private sector in TOT for defence production. Credible Indian manufacturers, public as well as private, could be short-listed through a stringent pre-qualification process and the pre-qualified bidders may be asked to offer the unit price for a pre-determined supply programme spread over a few years. The lowest offer should be selected as the successful bid. A preferred course would be to specify the product required, such as a gun of a specified quality and capacity, and require the pre-qualified bidders to make offers for setting up a manufacturing facility to supply the guns in accordance with a pre-determined programme. The foreign producers of guns would thus get an opportunity to set up their manufacturing units in India for production of state-of-the-art equipment which they would keep upgrading from time to time. Such an arrangement has been successfully worked out in two cases by the Railways.

12.3.3 Lack of access to cost data

In cases where the goods are procured only from the private sector in India, the Ministry of Defence faces a serious handicap in assessing the reasonableness of the price because it has no access to the cost data of suppliers. In the United States, the Ministry of Defence has this right. In India, under the powers conferred by the Companies Act, the Ministry of Corporate Affairs has so far prescribed 44 Cost Accounting Record Rules for the maintenance of cost records in various industries/ products. The Committee recommends that the Ministry of Corporate Affairs should also notify the products for which Ministry of Defence considers the

cost data as essential.

12.3.4 Off-set policy

The Ministry of Defence has put in place an off-set policy which requires foreign vendors to either invest 30 per cent of the value of their procurement orders of Rs. 300 crore or more in defence production units set up in India, or purchase goods worth this value from the Indian defence production industry. Since foreign companies cannot invest more than 26 per cent in the equity of an Indian firm, they may not be willing to opt for investment in the defence sector in India. Further, since most of the defence production in India is restricted to DPSEs and OFs, foreign suppliers may not be willing to buy their products for meeting the off-set requirements. As a result, foreign suppliers may either opt out of bidding or may add a significant premium to their price. Both these situations are disadvantageous for the Government. These problems are significantly accentuated by the fact that India is one of the largest importers of defence equipment which means that the physical and financial implications of the off-set clause would be very substantial. On the other hand, the production base of defence equipment in India is quite small, and largely restricted to OFs and DPSEs, which means that the off-set clause would become a significant barrier in getting economical offers from foreign suppliers.

The off-set condition is reportedly a part of defence procurement policy in several developed countries. However, in their case, the private sector has been allowed to develop on a large scale. In India, private sector presence in defence production is marginal and until that is addressed, the off-set condition will not achieve its intended benefits. The Committee, therefore, felt that an increase in the FDI limit in defence production would help attract foreign investment and enable effective implementation of the off-set condition in defence procurement. At the same time, enforcement of the off-set policy should be calibrated in a manner that takes into account the time and

enabling environment necessary for allowing foreign suppliers to comply with this condition in a manner that is economic and efficient from the standpoint of defence procurement. The off-set policy and foreign participation in defence production are complementary in nature and enforcing one without liberalising the other may lead to unintended outcomes.

12. 4 Recommendations

12.4.1 The defence procurement policy seems encumbered with some conceptual contradictions; these need to be reviewed and revamped for enabling Indian and foreign companies to engage in the production of hi-tech defence products within India. The policy framework may draw lessons from the other sectors of the economy where investment and latest technology have changed the face of the industry. The objective should be to create a robust defence production industry in India which will enable procurement of hi-tech products produced competitively and efficiently on the Indian soil. This will also help create employment and income opportunities in India, besides transferring a large number of jobs from foreign countries to the Indian soil. While procurement from foreign sources may continue as necessary, augmenting of domestic production would help improve efficiency and reduce costs. Other restrictive practices such as those relating to exclusion of foreign bidders in certain cases, transfer of technology and off-set policy also need to be reviewed and suitably modified. This would not only result in significant savings for the exchequer as well as creation of jobs, it would also strengthen India's defence capability.

12.4.2 It is possible that the above recommendations raise sensitive security issues. The Committee has not been privy to broader security issues and the above recommendations are made purely from the procurement perspective. The Committee appreciates that in the

process of defence procurement, national security considerations would be of paramount concern. As such, the above recommendations and observations of the Committee may be considered by the Government in the context of its overall strategy for defence procurement.

12.5 Dissenting views of Members

Some members of the Committee had dissenting views. Their views are at Annexures-V, VI, IV and VII.

Chapter 13

PUBLIC PRIVATE PARTNERSHIPS

13.1 Introduction

13.1.1 Traditionally, infrastructure and other investments in public services have taken place in the public sector and the Government has evolved elaborate rules for regulating the expenditure, capital as well as revenue. The system is far from perfect, but it is at least a system in which expenditure is governed by well-defined financial rules and delegation of powers. During the past five years, procurement of projects through public private partnership (PPP) is being increasingly relied upon and large volumes of private investment have been made in public projects through the PPP mode. In return, the private sector entity gets a revenue stream which is allowed or enabled by the Government. These are essentially projects that provide public services against public revenues. However, no clear set of rules has been laid down for governing the financial aspects of these projects.

13.2 Role of Government in PPP projects

13.2.1 With the growing reliance on public private partnership (PPP), it will be necessary to find ways of regulating the revenues and expenditures relating to PPP projects. If these were normal private sector projects subject to market outcomes based on competition, there would be no need for any due diligence by Government. However, PPP projects in sectors such as roads, ports, railways and airports typically involve: (a) transfer of public assets, including land; (b) delegation of governmental authority to collect and appropriate user charges levied by force of law; (c) provision of services to users in a monopoly or semi-monopoly situation that imposes an attendant obligation on the Government to ensure service quality for user protection; (d) sharing of risks and contingent liabilities by the Government; and (e) grant of a concession that constitutes valuable property.

13.2.2 In fact, the role of Government becomes more critical in PPP projects because the Government is allowing a private entity to collect revenues by force of law in a monopoly situation where users have little choice or recourse. If the project terms fail to secure value for user charges or impose onerous financial obligations on the Government, there could be legitimate criticism of the Government for providing undue benefit to private entities at public expense. In that sense, PPP projects require greater due diligence from the Government as compared to public sector projects.

13.2.3 Since PPPs are fairly recent in India and are confined to a few sectors, they have not been exposed to much public scrutiny. As awareness increases, the terms of these projects could invite close examination and criticism wherever good value for public money does not appear to have been secured. In addition, disputes arising out of project terms could also lead to significant payout by the Government.

13.3 Value for money

It is sometimes believed that some of the above concerns would be addressed if project sponsors are selected through competitive bidding. In fact, competitive bidding only creates a level playing field for selection of bidders; it may not necessarily secure good value for public money in terms of performance standards, user concerns, public revenues and contingent liabilities. Competitive bidding as well as project terms are equally important and both need to be adequately addressed. In cases where these projects offer a return to the Government, the Government revenues need to be adequately protected.

13.4 Contingent liabilities

PPP projects also involve Government guarantees in different forms. For example, termination payments in the event of an agreement getting terminated imply large contingent liabilities that the

Government may have to bear. These liabilities could be enormous, both under Indian laws as well as under the Bilateral Investment Protection Treaties where foreign investors are involved.

13.5 Need for Rules

13.5.1 While the Finance Ministry has codified rules and delegation of authority for incurring public expenditure, there are no rules in place for approving the terms of a PPP project that may have significant financial implications for the Government. A system is, therefore, required for identifying, evaluating, approving and regulating the expenditure, risks, liabilities and guarantees that these projects may impose on the Government and the public.

13.5.2 Recognising these problems, the Government has evolved Model Concession Agreements (MCAs) for some of the sectors. Such MCAs lay down the standard terms relating to allocation of risks, contingent liabilities and guarantees as well as service quality and performance standards. However, even where the MCAs have been adopted, they will still need to be modified to suit individual circumstances. In sectors where no MCAs have been evolved, stand alone contracts would need to be entered into. The issue therefore arises, what should be the rules and regulations for formulating and approving PPP projects.

13.5.3 Rules for pre-qualification of bidders, evaluation of bids and other matters relating to bidding and award of projects also need to be laid down clearly. Though the Finance Ministry has mandated the use of Model RFQ and Model RFP documents, they are not backed by any statutory rules.

13.6 Sub-optimal terms in PPP projects

13.6.1 In the absence of any codified rules, several departments have awarded PPP projects that have resulted in sub-optimal outcomes. There are projects where flawed pre-qualification intended or otherwise restricted competition and led to undue gains for concessionaires at the expense of users and the public exchequer. There are cases where

quality of service or performance standards have not been laid out or enforced adequately. In sum, several aberrations have occurred in different departments who charted out their course independently in the absence of well-defined policies, rules and practices.

13.6.2 Flawed PPP contracts can lead to large unearned gains for private sector entities at the expense of users and the public exchequer. When controversies break out, the very credibility of PPP as a mode of procurement gets reduced. On the other hand, budgetary constraints make it inevitable that reliance on PPP would have to expand rapidly. It is, therefore, necessary to engage in an in-depth review and build on the substantial work already done in respect of streamlining the documents and processes relating to PPP projects.

13.7 Recommendations

The Committee recommends that the Department of Public Procurement should issue a set of rules for regulating the expenditure, appropriation of revenues, allocation of risks, contingent liabilities etc. in PPP projects. Delegation of powers will also need to be specified.

13.8 Dissenting views of Member:

One member of the Committee had dissenting views on Paragraph 13.6.1.

His views are at Annexure-V.

Chapter 14

DISPUTES RESOLUTION

14.1 Problems in dispute resolution

The provisions for dispute resolution in the procurement for works, goods and services require substantial reforms. In the absence of a satisfactory dispute resolution mechanism, reputed domestic and foreign bidders often refrain from bidding because:

(a) there is no mechanism to contest any aberrations in the procurement procedure; and

(b) dispute resolution during the execution of the contract is very time consuming, costly and inequitable.

The abstention of reputed companies from competitive bidding deprives the Government of the full potential of economical and efficient procurement, besides a possible compromise on quality. Even those who bid would tend to add a risk premium in their bid to account for the costs of dealing with possible disputes. At any rate, the credibility of the Government as a fair and transparent purchaser gets eroded.

14.2 Disputes during the procurement process

During the procurement process, prospective bidders have no way to successfully protest against any arbitrariness in the bid procedure, specifications, eligibility criterion or contract conditions. The introduction of a quick, effective and credible grievance redressal and dispute resolution mechanism during the course of procurement has already been recommended in the chapter on Public Procurement Law as this is considered necessary for assuring the integrity of the procurement process and building public confidence in the system.

14.3 Disputes during contract execution

As noted above, the absence of an effective and time-bound dispute resolution mechanism deters robust suppliers and contractors from participating in public procurement. For example, disputes relating to works contracts are referred to Arbitration Tribunals which are appointed under the Arbitration and Conciliation Act 1996. Though their awards have the force of a decree, the Government offices rarely accept them and contest them in the High Court or the Supreme Court on issues of law and public policy. The High Courts and the Supreme Court hear these cases in due course and several years are lost before a dispute is finally settled.

The B K Chaturvedi Committee on Faster Implementation of National Highways Development Programme (February 2010) has brought out the following status of 406 contracts awarded by NHAI:

Particulars	**No. of disputes**	**Amount (Rs. crore)**
Disputes	1,250	8,509
Arbitration awards	490	657
Awards Accepted by NHAI	68 (14 %)	31 (5 %)
Challenged in courts by NHAI	300 disputes (60%)	470 (72 %)
Challenged in courts by contractors	80 disputes (16 %)	124 (19 %)

The said Report has cited the following major reasons for disputes:

(a) Change in legislation

(b) Deemed export benefits

(c) Delays in handing over encumbrance free site

(d) Shifting of utility not defined in the contract

(e) Valuation of variation in Bill of Quantities beyond permissible limits

(f) Valuation of items not included in the bill of quantities

The existing system of arbitration is ad hoc; it suffers from shortcomings relating to the selection procedures and working ethics of arbitrators; there is absence of well-defined rules for arbitration as well as of a neutral body for administering and supervising arbitration. The Eleventh Five Year Plan has recommended that institutional arbitration should be adopted for overcoming these shortcomings.

14.4 Recommendations

14.4.1 A grievance redressal system should be introduced on the lines recommended in Chapter on Procurement Law with the objective of addressing disputes arising in the course of procurement.

14.4.2 The Conditions of Contract should be reviewed to provide for clarity in the respective obligations of the Government and the contractor. For example, the contract should contain provisions for handing over possession of an encumbrance-free site and also specify the compensation to be paid to the contractor for each day's delay. For other defaults by either party, there should be symmetrical damages for ensuring a fair and balanced contract. Unless the contract conditions are streamlined and standardised, the Government as well as the industry would continue to suffer from a plethora of disputes.

14.4.3 The Conditions of Contract should provide for institutional arbitration. The Ministry of Commerce had helped the setting up of Indian Council of Arbitration, and the Ministry of Law had helped the setting up of International Centre for Alternate Dispute Resolution (ICADR). These institutes have framed rules for the efficient,

economical and time bound conduct of arbitration proceedings which should be adopted by reference in the Conditions of Contract. Adoption of these Rules would curtail the unguided discretion of arbitrators that often leads to delays and higher costs.

14.4.4 The standard Conditions of Contract should provide that a specified proportion of the amount awarded by an arbitration tribunal should be paid by the Government to the contractor against a bank guarantee pending disposal of appeal by the High Court. A similar obligation may also be placed on the contractor.

14.4.5 As a part of legislative reforms, consideration may be given to the possibilities of setting up statutory arbitration tribunals to hear and resolve disputes arising out of contracts where the Government is a party. This would ensure efficient, economical and timely resolution of disputes that would help augment the robustness of public procurement.

Chapter 15

CAPACITY BUILDING

15.1 No matter how sound the legal, policy and institutional framework is, the quality and effectiveness of public procurement would depend nonetheless to a considerable extent on the quality of the people who undertake procurement. This inter alia would depend not only on the basic education and capabilities of these people but equally on their specialised skills in the area of public procurement. In this respect, the Committee observes that there is a skills deficit in public procurement. There are few professionally qualified among the staff that handle the procurement work; most have either been exposed to only brief courses or generally have "learnt on the job". Besides, whatever training is being imparted currently, it is mostly limited to compliance with the extant rules in a mechanical manner. There is little education or training in the basic concepts and nuances of public procurement, for example in writing specifications for procurement, preparing evaluation criteria, comparing bids, formulating contract terms, understanding and implementing different forms of bidding, and so on. The staff may, therefore, be ill-equipped to handle complex cases or new types of procurement or even to deal with sophisticated bidders.

15.2 At present, procurement capacity building initiatives are taken up by individual departments or organisations. The approach to training has been to focus on creating capacity in the national training institutes. This institutional capacity should be upgraded further and substantially expanded to cater to a larger number of trainees. Besides, efforts should be made to develop longer term professional courses in these institutions as well as in academic institutes. Public procurement training should be a regular part of the curriculum of senior staff induction training in the aforesaid institutes as well as the

training institutions for various service cadres of the Central Government.

15.3 The training initiative should encompass vendors as well. Public procurement should be viewed conceptually as a partnership between the procurement entity and the supplying vendors. Therefore, capacity building of the vendor community is as important as the training of the procurement staff.

15.4 Overall, training and capacity building should be the responsibility of the proposed Department of Public Procurement. It should be noted that professional skills training is required at all levels: senior staff at policy making levels, procurement personnel at the operational level and staff who directly deliver the procurement.

15.5 Thus training and capacity building initiatives should:

(a) Develop, promote and support training and professional development of individuals involved in procurement; enhance their procurement competence consistent with their procurement activities;

(b) improve the institutional capacity of the procuring entities; and

(c) attempt vendor capacity building and training to provide quality services to the procuring entities, and other stakeholders.

15.6 The core values to be built into the training and capacity building strategy should include professionalism, integrity, accountability, transparency, team work and efficiency.

15.7 Recommendations:

15.7.1 The Training Need Assessment may be done at the department/ organisation level.

15.7.2 The departments / organisations should draw up specific calendar of training for their procurement officials at different levels.

15.7.3 The broad curricula for training, containing indicative attributes for training, may be prepared by the Department of Public Procurement. Sufficient scope in the curricula may be left for incorporating specific

modules by different departments / organisations.

15.7.4 Training of regular / strategic vendors should also be undertaken to improve communication and mutual understanding between the suppliers and the procuring units.

15.7.5 The training institutes of different services should be encouraged and incentivised to develop professional training courses for procurement entities and vendors. Existing institutions such as the IIMs may also be involved in capacity building. Since public procurement is an emerging field in India, the Department of Public Procurement should engage an existing institute to set up an 'Institute of Public Procurement' as a centre of excellence so that its academic input can add value to this nascent, but vastly important, field.

CHAPTER 16

WAY FORWARD

For accelerating the reform of public procurement, the Committee recommends the following measures to be taken on priority within a period of three months or as specified below:

(1) Declare the public procurement policy with a view to promoting transparency, competition, efficiency, economy and probity while minimising the potential for restrictive and corrupt practices;

(2) set up an institutional framework preferably as the Department of Public Procurement, in conformity with international practice, to build institutional capacity with a view to laying down rules, regulations, processes, procedures, standardised documents etc and to establish an oversight framework for achieving the objectives stated in the Public Procurement Policy. It is clarified that the proposed department would not be directly involved in any procurement;

(3) introduce the Public Procurement Bill in the Parliament during the winter session of 2012 with a view to establishing a legal framework that would ensure transparency, competition, efficiency, economy and probity, besides providing for stringent punishment against those involved in corrupt and fraudulent practices;

(4) mandate that procurement from and by PSEs should be based on competitive bidding and in accordance with the principles enshrined in the Public Procurement Policy so that the large volumes of procurement involving the PSEs are based on best practices;

(5) issue separate and comprehensive procurement rules for goods, services and works respectively before December 31, 2011;

(6) issue standard bidding documents for procurement of different categories of goods and services and mandate their compulsory use by December 31, 2011;

(7) phase out the outdated item-rate construction contracts (except for exempted categories) that typically involve endemic time and cost overruns besides creating potential for corruption, and adopt EPC/ lump sum contracts as the preferred approach in order to transfer the risks of time and cost overruns to the private contractors; issue standard bidding documents for different categories of works and mandate their compulsory use by December 31, 2011;

(8) establish an e-portal for public procurement by December 31, 2011 and lay down a time-frame for adoption of e-procurement by different departments and PSEs; public knowledge of tender processes and procurement prices would raise public awareness and create pressure for efficient and economical procurement;

(9) set up an effective administrative machinery for grievance redressal by December 31, 2011 with a view to improving transparency and providing a method of redressal against malpractices and corruption in procurement;

(10) substitute the present system that confines bidding to registered vendors in the Railways by a system that promotes competition, efficiency and probity by enabling unregistered bidders to bid in case they fulfil the eligibility conditions;

(11) initiate measures for corporatisation of departmental production units of the Railways in order to promote efficiency and economy and to establish an "arms length" relationship between the production units and the Railways;

(12) announce and implement a time-bound programme for attracting the requisite volumes of investment in the railway sector through PPP and other forms of competitive private investment;

(13) discontinue the practice of inspections and payments by DGS&D with a view to ensuring greater delegation, authority and accountability to the procuring departments; and

(14) announce a policy that would help leverage the large volume of defence procurement to establish hi-tech defence production units in India by allowing greater foreign participation that would help substitute goods presently being procured from abroad by domestically produced goods. Government may consider the matter keeping in view security issues and the overall strategy for defence procurement.

The above timelines have been proposed by the Committee to emphasise the urgency of these reforms.

Dissenting views of Member:

One member of the Committee had dissenting views. His views are at Annexure-IV.

Chapter 17

SUMMARY OF RECOMMENDATIONS

17.1 Public Procurement Policy

17.1.1 The Committee recommends the proposed Statement on Public Procurement Policy be issued on the lines suggested in paragraph 2.2 of this Report.

17.2 Public Procurement Law

17.2.1 After reviewing the current legal framework and the practice prevailing in developed as well as developing countries, the Committee concluded that it is necessary to enact a Public Procurement Act in India. The contents of the proposed law have been summarised in paragraph 3.3 of this Report.

17.2.2 The Procurement Act will have to be supplemented by rules to provide for the details of the fundamental principles laid down by the Act. At present, the GFR has only two chapters on procurement of works, goods and services. The Committee recommends comprehensive rules for procurement of (i) works, (ii) goods, and (iii) services respectively.

17.3 Department of Public Procurement

17.3.1 After reviewing the international experience as well as the present institutional structure in India, the Committee believes that it is essential to create a dedicated institutional framework preferably as the Department of Public Procurement under the Ministry of Finance. This will enable the formulation of an efficient and effective public procurement policy, rules, regulations etc. and their enforcement. The functions to be assigned to the proposed department have been summarised in paragraph 4.4 of this Report.

17.4 Public Procurement Portal

17.4.1 The Committee recommends setting up of a Public Procurement

Portal on which all bid invitations should be published compulsorily. The portal should also provide comprehensive information and data relating to public procurement.

17.4.2 The portal should also be used for monitoring delays in the bid process and for enhancing the efficiency and economy in public procurement. It should also be used for posting and tracking complaints relating to any bid process.

17.5 Procurement of Works

17.5.1 The Committee recommends that the outdated system of item-rate contracts responsible for endemic time and cost over-runs should be phased out in a time-bound manner. The EPC (lumpsum/turnkey) contract system should be adopted for all projects other than small or exempted works. The EPC contracts should be awarded by following the two-stage system of pre-qualifying the bidders and requesting the pre-qualified bidders to submit their financial bids. The key elements of the EPC/Turnkey contracts have been summarised in paragraph 6.4.1.

17.5.2 Not enough is done to blacklist corrupt, unethical or non-performing firms. The Government has every right to deal only with ethical firms who should be required to adhere to a code of conduct while dealing with public entities. The Government should lay down clear and transparent rules to permit exclusion of black-listed firms from public contracts for a specified period, depending upon the seriousness of the offence.

17.5.3 In public procurement, the longer the time taken for making a decision during the tender process, the more the problems as well as potential for corruption and manipulation. Delays impose additional costs on the exchequer while robust bidders are discouraged from participating. Those who bid tend to add a premium in their bid price to offset the costs of delay. The Department of Procurement should prescribe time-lines for each stage of bidding and bidders should be compensated for undue delays.

17.5.4 There continues to be a multiplicity of tender and contract documents used by different ministries and PSEs for identical procurements. This causes avoidable confusion, risks, disputes and costs. The proposed Department of Public Procurement should bring out standard EPC bid documents. Other bid documents and processes should also be streamlined and standardised. It should be compulsory for all ministries to use these standard documents.

17.5.5 In cases where land is provided by a public entity to a private entity as part of a procurement contract, such transactions should either follow the rules for procurement of works or the rules for approval of PPP projects.

17.6 Procurement of Goods

17.6.1 The General Financial Rules, 2005 should be thoroughly reviewed as brought out in para 7.2. It should be ensured that the bidding documents conform with the GFR and best practices. For this purpose, standard templates should be prepared for compulsory use by procurement departments.

17.6.2 An effective and uniform system of procurement of pharmaceutical drugs should be laid down with a view to providing quality assurance to users.

17.6.3 The procurement of commercial items should be simplified and enhanced powers may be delegated to the departmental functionaries for procuring such commercial items without following a tender process.

17.7 Procurement of Services

17.7.1 The Government should bring out Procurement Rules for Services which should lay down an efficient and effective method of selection of consultants; disallow hiring of a single consultant for advising on diverse disciplines in which it has no core competence; address potential conflict of interest; eliminate the possibilities of flawed consultancy contracts such as success-fee based assignments; and

provide for adequate delegation of powers for procuring services.

17.7.2 The aforesaid Rules should address procurement/outsourcing of other services referred to in paragraph 8.1.

17.7.3 The Committee also recommends that suitable templates may be developed and published for use in procurement of different types of services which are commonly required by the Government departments.

17.8 Public Sector Enterprises

17.8.1 The Committee recommends that the proposed Public Procurement Act, rules and policy should apply to all public sector enterprises, statutory bodies, commissions and autonomous bodies under the control of Government of India.

17.8.2 Until the Public Procurement Act is enacted, the Government should issue a directive to all the above bodies to revise their procurement policies in conformity with the Public Procurement Policy of the Government.

17.8.3 All procurement by the Government from any PSE should be undertaken through competitive bidding and the practice of nominated or negotiated award of contracts to PSEs should be discontinued in the interests of probity, transparency, efficiency and competition.

17.9 Procurement through DGS&D

17.9.1 The procurement of goods should be undertaken directly by the user departments who should bear the responsibility, authority and accountability for the same. Use of rate contracts should be restricted to costly and sophisticated equipment for which the departments may lack the requisite procurement expertise. Consequently, DGS&D should enter into rate contracts only for products costing more than Rs. 10,000 per unit. Products of a lower unit value can be handled by the procuring departments. GFR (Rule 145) presently allows purchases upto Rs. 15,000 without inviting quotations and upto Rs. one lakh through a Local Purchase Committee. This delegation may

be enhanced.

17.9.2 DGS&D should not enter into rate contracts for bulk commodities such as steel, cement, bitumen, oil etc. as they are not amenable to long-term contracts. Further, DGS&D should not enter into rate contracts for products which may have a likely annual off-take of less than Rs. 25 crore.

17.9.3 DGS&D may enter into rate contracts for equipment which the departments may have difficulty in procuring. The rates should include an annual maintenance contract (AMC) for 3 to 5 years, inclusive of specified spares so as to ensure better product quality and life cycle costs.

17.9.4 Where a product is chosen for rate contract, at least five options from different manufacturers with a fair range of specifications and quality should be provided, as far as possible, so that the user departments have sufficient choice.

17.9.5 DGS&D should increasingly rely on catalogue prices of products sold commercially and negotiate a discount on such prices. Based on such discounts, a Maximum Procurement Price (MPP) may be fixed for a variety of products to enable user departments to procure such goods off-the-shelf without following a tender process. This would enable a much wider inclusion of products and choices. Such an approach is already being followed in the case of automobiles. DGS&D may adopt a similar practice for a wide variety of products and host their specifications, prices etc. on its website in accordance with Rule 147 of GFR.

17.9.6 For all procurements by the user departments, payments should be made directly by such departments to the respective suppliers. Payments should be made within a specified period and delays should attract interest. Where required, inspection and tests may also be undertaken by the procuring departments either directly or through a third party. Payments and inspections by DGS&D should be discontinued.

17.9.7 The expertise of DGS&D should be utilised mainly for performing an advisory role where departments seek its assistance on a voluntary basis and against payment of a fee. DGS&D may also engage in consultancy and research on life cycle costing, technical specifications, performance standards etc.

17.9.8 A simplified regime for procurement of commercial items should be introduced in order to promote efficiency and economy in procurement. DGS&D should develop a new line of activity for fixing the Maximum Procurement Price (MPP) of such goods. For this purpose, DGS&D should engage in cost analysis and price fixation with at least five reputed manufacturers of commonly used goods. For example, in the case of products such as automobiles, air conditioners, photocopiers, office furniture and equipment etc., DGS&D should either fix the MPP or an agreed discount on the catalogue price for each such product and leave it to the procuring agencies to make a choice. MPP could also be fixed for a variety of products that are commonly used by several departments. This will enable the user departments to undertake off-the-shelf purchases without inviting tenders or quotations.

17.9.9 The Railways and Defence Services have a full-fledged and well-structured institutional arrangement for procuring their supplies. DGS&D may not engage in entering into rate contracts for supplies specifically required for Railways or Defence Services.

17.10 Procurement by the Railways

17.10.1 It is recommended that an in-depth review of the procurement practices followed in the Railways may be undertaken on priority.

17.10.2 The Railways should modify its vendor registration programme in its present form as it restricts competition while providing opportunities for cartelisation and corruption. Bidding should be opened up to unregistered bidders who meet the eligibility conditions.

17.10.3 For enhancing competition as well as reduction in bid prices, procurement contracts for products required on a regular basis

should be awarded for a period of three years with price indexation for the second and subsequent years.

17.10.4 Development of vendors should be restricted to products that require significant investments to manufacture and do not have sufficient alternative uses. Contracts for such procurement should be for at least a reasonable period, say 5 years. As far as possible, at least three development vendors should be chosen for a new product and after a period of 5 years, the product should be procured on a normal competitive basis.

17.10.5 The extant practice of single source procurement based on annual bids from a single vendor should be brought to a close.

17.10.6 The rules for leasing/ licensing of land should be codified with the requisite degree of transparency. Where PPP is undertaken, the Cabinet-approved Rules should be strictly followed.

17.10.7 Civil works should normally be procured on the basis of EPC contracts as recommended in the Chapter on Procurement of Works.

17.10.8 Railways should not undertake procurement through PSEs on a nomination basis, nor should PSEs undertake their own procurement on nomination basis. This will be in conformity with the recommendations contained in the Chapter on Procurement by PSEs.

17.10.9 The Railways should announce and implement a time bound programme for attracting the requisite volumes of investment through PPP and other forms of competitive private investment.

17.11 Defence Procurement

17.11.1 The defence procurement policy needs to be reviewed and revamped for enabling Indian and foreign companies to engage in the production of hi-tech defence products within India. The policy framework may draw lessons from the other sectors of the economy where investment and latest technology have changed the face of the industry. The objective should be to create a robust defence

production industry in India which will enable procurement of hi-tech products produced competitively and efficiently on the Indian soil. This will also help create employment and income opportunities in India, besides transferring a large number of jobs from foreign countries to the Indian soil. While procurement from foreign sources may continue as necessary, augmenting of domestic production would help improve efficiency and reduce costs. Other restrictive practices such as those relating to exclusion of foreign bidders in certain cases, transfer of technology and off-set policy also need to be reviewed and suitably modified. This would not only result in significant savings for the exchequer as well as creation of jobs, it would also strengthen India's defence capability.

17.11.2 It is possible that the above recommendations raise security issues. The Committee has not been privy to broader security issues and the above recommendations are made purely from the procurement perspective. The Committee appreciates that in the process of defence procurement, national security considerations would be of paramount concern. As such, the above recommendations and observations of the Committee may be considered by the Government in the context of its overall strategy for defence procurement.

17.12 Public Private Partnerships

The Committee recommends that the Department of Public Procurement should issue a set of rules for regulating the expenditure, appropriation of revenues, allocation of risks, contingent liabilities etc. in PPP projects. Delegation of powers will also need to be specified.

17.13 Disputes Resolution

17.13.1 A grievance redressal system should be introduced on the lines recommended in Chapter on Procurement Law with the objective of addressing disputes arising in the course of procurement.

17.13.2 The Conditions of Contract should be reviewed to provide for clarity in the respective obligations of the Government and the

contractor. Unless the contract conditions are streamlined and standardised, the Government as well as the industry would continue to suffer from a plethora of disputes.

17.13.3 The Conditions of Contract should provide for institutional arbitration. Adoption of these Rules would curtail the unguided discretion of arbitrators that often leads to delays and higher costs.

17.13.4 The standard Conditions of Contract should provide that a specified proportion of the amount awarded by an arbitration tribunal should be paid by the Government to the contractor against a bank guarantee pending disposal of appeal by the High Court. A similar obligation may also be placed on the contractor.

17.13.5 As a part of legislative reforms, consideration may be given to the possibilities of setting up statutory arbitration tribunals to hear and resolve disputes arising out of contracts where the Government is a party. This would ensure efficient, economical and timely resolution of disputes that would help augment the robustness of public procurement.

17.14 Capacity Building

17.14.1 The Training Need Assessment may be done at the department / organisation level. The departments should draw up specific calendar of training for their procurement officials at different levels. The broad curricula for training, containing indicative attributes for training, may be prepared by the Department of Public Procurement.

17.14.2 The training institutes of different services should be encouraged and incentivised to develop professional training courses for procuring entities and vendors. Existing institutions such as the IIMs may also be involved in capacity building. Since public procurement is an emerging field in India, the Department of Public Procurement should engage an existing institute to set up an 'Institute of Public Procurement' as a centre of excellence so that its academic input can add value to this nascent but vastly important

field.

17.15 Way Forward

17.15.1 The Committee views procurement reforms with a sense of urgency. It has, therefore, listed several measures that can be taken within a defined time-frame not only to bring about the much-needed reform in procurement but also to demonstrate Government's commitment to enhance efficiency and economy while minimising the potential for corruption. These measures are summarised in Chapter 16.

17.16 Dissenting views of Member:

Some members of the Committee had dissenting views. Their views are at Annexures- IV, VI and VII.

Annexure-I

CONSTITUTION AND MANDATE OF THE GROUP OF MINISTERS AND THE COMMITTEE ON PUBLIC PROCUREMENT

In the recent past, several steps have been taken by the Government to enhance transparency, efficiency and economy in the functioning of the Government, covering, inter alia, measures to tackle corruption. In order to examine the matter in its entirety, the Government constituted a Group of Ministers (GoM) on January 6, 2011 to suggest further measures in this regard. The terms of reference of the GoM are to consider all measures, including legislative and administrative, to tackle corruption and improve transparency, including the following:-

> 'ensuring full transparency in public procurement and contracts, including enunciation of public procurement standards and a public procurement policy'

1. Committee on Public Procurement

2.1 The Group of Ministers, in its meeting held on 21st January, 2011, decided, inter alia, to constitute a Committee on Public Procurement to look into various issues having an impact on public procurement policy, standards and procedures. Accordingly, the Committee was set up on 31st January, 2011 with the following Terms of Reference (TOR):

(a) to suggest measures necessary to ensure full transparency in Public Procurement and Contracts including enunciation of Public Procurement Standards and Public Procurement Policy, keeping in view the existing legal and regulatory framework and rules and

procedures applicable for Public Procurement and recent initiatives taken in this regard;

(b) to suggest legal, institutional and systemic measures necessary to strengthen Public Procurement practices so as to clearly demarcate the powers and responsibilities of various authorities;

(c) to suggest best domestic and international practices which can be adopted to promote transparency and enhance efficiency and economy in procurement including measures necessary for fair and equitable treatment of suppliers, promotion of competition as well as ethics and probity in Public Procurement;

2.2 The composition of the Committee is as follows:-

Shri Vinod Dhall,
Formerly Secretary, Ministry of Corporate Affairs - Chairman

Smt. Vilasini Ramachandran
Special Secretary, Department of Expenditure - Member

Shri S. Chandrasekhar
Additional Member (Finance), Ministry of Railways - Member

Shri A.K. Mangotra
Director General, Supplies and Disposals - Member

Shri Vivek Rae
Director General (Acquisition), Ministry of Defence - Member

Shri C.S. Prasad
Director General, Central Public Works Department - Member

Shri M P Gupta
Formerly Additional Secretary, Department of Expenditure - Member

Shri S C Sharma
Formerly, Director-General (Roads Development) - Member

Shri Gajendra Haldea
Adviser to Deputy Chairman, Planning Commission - Member

Shri J S Deepak
Joint Secretary, Ministry of Commerce - Member

Smt. Ajanta Dayalan
Joint Secretary, Cabinet Secretariat - Member Secretary

Annexure-II

OECD MATRIX FOR ASSESSMENT OF PROCUREMENT SYSTEMS

The Organisation of Economic Cooperation and Development (OECD) matrix for self-assessment of the public procurement system. The following table is its summarised version:

OECD's Format of Assessment of Country's Procurement System				
Baseline Indicator	**Status**	**Score on a scale of 0 to 3**	**Actions Proposed**	**Priority**
Pillar I – Legislative and Regulatory Framework				
1) The public procurement legislative and regulatory framework				
- Scope of application and coverage of the regulatory framework				
- Procurement methods.				
- Advertising rules and time limits				
- Rules on participation and qualitative selection				
- Tender documentation and technical specifications.				
- Tender evaluation and award criteria				
g)- Submission, receipt and opening of tenders				
h)- Complaints system structure and sequence				
2) Implementing Regulations and Documentation				
a) Implementing regulation that provides defined processes and procedures.				
(b) Model tender documents for goods, works, and services.				
(c) Procedures for prequalification.				

OECD's Format of Assessment of Country's Procurement System				
Baseline Indicator	**Status**	**Score on a scale of 0 to 3**	**Actions Proposed**	**Priority**
d) – Procedures for contracting for services or other requirements in which technical capacity is a key criterion.				
e) – User's guide or manual for contracting entities.				
f) – Existence and coverage of General Conditions of Contracts (GCC) for public sector contracts.				
3) Integration and maintaining of the public procurement system into the public sector governance system.				
– Procurement planning and data on costing are part of the budget formulation and multiyear planning.				
a) – Budget law and financial procedures support timely procurement, contract execution, and payment.				
b) – Procurement actions not initiated without budget appropriations.				
d) – Systematic completion reports are prepared for certification of budget execution and for reconciliation of delivery with budget programming.				
4) Normative and regulatory functions				
a) – Normative/regulatory functions are established and assigned (to one or several agencies) in the legislative and				

OECD's Format of Assessment of Country's Procurement System				
Baseline Indicator	**Status**	**Score on a scale of 0 to 3**	**Actions Proposed**	**Priority**
regulatory framework.				
b)– The responsibilities include at least those required in this sub indicator				
c)– Adequacy of organisation, funding, staffing, and level of independence and authority (formal power) to exercise the duties under (b).				
d)– Separation and clarity so as to avoid conflict of interest and direct involvement in the execution of procurement transactions.				
5. Institutional development capacity.				
a)– System for collecting and disseminating procurement information and accessibility.				
b)– Systems and procedures for collecting and monitoring national procurement statistics.				
c)– Training capacity for procurement				
d)– Quality control standards and staff performance evaluation for capacity development.				
6. Efficiency of procurement operations and practices.				
a)– Adequacy of procurement competence among Government officials.				
b)–Procurement training and information programs				

OECD's Format of Assessment of Country's Procurement System				
Baseline Indicator	**Status**	**Score on a scale of 0 to 3**	**Actions Proposed**	**Priority**
c) – Norms for the safekeeping of records and documents related to transactions and contract management.				
d) – Provisions for delegation of authority.				
7. Functionality of the public procurement market.				
a) – Effective mechanisms for partnerships between the public and private sector				
b) – Private sector institutions are well organised and able to facilitate access to the market.				
c) – Systemic constraints inhibiting the private sector's capacity to access the procurement market.				
d) – Clarity and transparency of rules for determining whether to engage international or national markets.				
8. Existence of contract administration and dispute resolution provisions.				
a) – Procedures are clearly defined for undertaking contract administration responsibilities				
b) – Contracts include adequate dispute resolution procedures.				
c) – Procedures exist to enforce the outcome of the dispute resolution process				
9. Effectiveness of control and audit systems				
a) – Legal framework, organisation, policy, and				

OECD's Format of Assessment of Country's Procurement System				
Baseline Indicator	**Status**	**Score on a scale of 0 to 3**	**Actions Proposed**	**Priority**
procedures for internal and external control and audit of public procurement.				
b)– Enforcement and follow-up on findings and recommendations.				
c)– The internal control system provides timely information on compliance to enable management action.				
d)– The internal control systems are sufficiently defined to allow performance audits to be conducted.				
e)– Auditors are sufficiently informed about procurement requirements.				
10. Efficiency of appeals mechanism.				
a)– Decisions are deliberated on the basis of available information, and the final decision can be reviewed and ruled upon by a body (or authority) with enforcement capacity under the law.				
b)– Capacity of the complaint review system and enforcement of decisions.				
d) – Public access to decisions				
(e) – Independence of the administrative review body.				
11. Accessibility to information.				
Publication and distribution of information.				
12. Ethics and anticorruption policy and measures.				
a) - Legal provisions on corruption, fraud, conflict of interest, and				

OECD's Format of Assessment of Country's Procurement System				
Baseline Indicator	**Status**	**Score on a scale of 0 to 3**	**Actions Proposed**	**Priority**
unethical behaviour.				
b)– Definition in legal system of responsibilities, accountabilities, and penalties for fraudulent or corrupt practices.				
c)– Enforcement of rulings and penalties.				
d)– Effectiveness of the anticorruption measures on public procurement.				
e)– Stakeholders support the creation of a procurement market known for its integrity and ethical behaviours.				
f)– Mechanism for reporting fraudulent, corrupt, or unethical behaviours.				
g)- Codes of Conduct/Codes of Ethics for participant and provision for disclosure for those in decision making positions.				

Annexure- III

DISSENT NOTE by DGS & D

The role of DGS&D is not one of a mere spectator in the whole arena of Public Procurement. DGS&D, with its origin in 1840 in this subject field, has a long institutional memory with legacy, expertise & practical experience in Public Procurement in the country, which is not matched by any other organisation within India. It is an organization which has the privilege of being termed as the Central Procurement Organization of India under the GFR. It has expert professionals in Public Procurement, and has Group–A engineering officers of Indian Supply Service (ISS) and Indian Inspection Service (IIS) cadre of organised services recruited through UPSC, meant solely for handling public procurement. In addition to its present role of finalising Rate Contracts (RC), it is upto the Government to provide additional responsibilities to DGS&D in the field of Public Procurement, with proper infrastructure support and manpower.

2. It is not for the DGS & D to highlight its role in the Government set up. It is a service provider and it is for the user Departments to say whether they find the services of the DGS & D useful or not. However, before taking any decision about the future of the DGS & D, it is felt that views of the myriad users of its services should be taken and especially its biggest clients like the Army, Railways, Central Para Military Forces may be consulted before finalising any course of action on the recommendations of this Committee.

3. As opposed to the drawbacks of the Rate Contract system (which is the predominant activity of the DGS & D at present) highlighted in para 10.4 of the Report, experience of the DGS & D shows that it is the most sought after mode of purchase in the Government. This can be confirmed from any of the regular user Departments. Contrary to what has been stated in the report, the RC system is always demanded by all government departments as well as by Industry for increasing the spread and array of items under RC. There has been more than 90% continuity of the existing Rate Contracts. Increasing drawals on DGS&D Rate Contracts has been recorded over the last 5 years, with growth more than double i.e. Rs 6540 crore in 2009-10 as against Rs 3053 crore in 2005-06. Para 10.2 of the Report itself points out the success and popularity of DGS&D Rate Contracts. The only limitation is that DGS&D has been depleted of staff strength with no intake of ISS & IIS officers for almost a decade, which is proving to be a bottle neck. This needs to be strengthened in order to fully reap the benefit of expertise of DGS&D.

4. Competitive and open bidding process with generalized & broad based latest specifications advertised through the DGS&D website is adopted for concluding the Rate Contracts. There is no compromise on quality, flexibility and value for money as stated. On the contrary, buying selected and branded products often results in paying higher prices and wasteful public expenditure. Yet, all major players in most fields are normally present on DGS&D rate contract at competitive prices for the sake of volumes generated in the Government Sector. Examples of PCs, Laptops and Servers given in the report itself may be seen from the DGS & D website. Products of all major/branded players like HP, Dell, IBM, Acer etc besides others have been/are on the DGS&D Rate Contract at competitive prices with the latest

specifications including the recently launched 'Sandy Bridge' and 'Brazo' processors of Intel and AMD - the processor OEMs . There cannot be any better example of providing latest technology, best available international variety and value for money to the Government than this.

5. Pre-bid Consultative Committee Meetings (CCMs) are held with all stake-holders including Industry, associations, Indentors and OEMs whenvever any new item is to be brought on a Rate Contract. This is to ensure a level playing field for all and to ensure that the Government gets best value for money as also the latest product specifications. More number of Parallel Rate Contracts for the items provide a wider choice to the users. Aspects relating to technical specifications are handled by expert professionals of ISS and IIS officers who are engineers, well qualified and experienced, in addition to having open debates between the competing Industry, their associations, outside experts from BIS, user departments etc.

VIEWS on RECOMMENDATIONS of the COMMITTEE

Under the DGS&D Rate Contract system, users place order directly and independently, on line, on any one of the parallel RC firms of their choice. DGS & D does not do any direct procurement nor does it place any firm at any advantage vis-à-vis its competitors. Recommendations to procure only few select "sophisticated" products through RC system would not be in keeping with effective utilization of capabilities and expertise of DGS&D developed over several decades. No definition has been given to identify such "complex/sophisticated" products. In fact, most products up for sale in the open market undergo complex and capital intensive manufacturing and quality control processes as they operate in a competitive environment. If the RC system itself is not felt to be suitable, there is no logic for going with it at all for any item even for the so called "sophisticated" products where, strictly speaking, competitive bidding would not be feasible for want of generalized specifications of such products.

Recommendation 10.11.1(a) The recommendation of not concluding RC by DGS&D for products costing less that the unit price of Rs. 10,000, are based on an impression that such low cost items are not complex/sophisticated. Linking this amount with GFR delegation of purchase powers of Rs. 15,000 is also without logic. Such GFR delegation is provided for value of total quantity to be purchased each time without bidding, and has nothing to do with reasonability of the unit price of the product. With the GFR permitting buying items upto Rs 15,000 without tendering/bidding, it is all the more necessary to go for RC thus obtaining best competitive price for volumes required across the entire government space thus saving huge public money, for such low cost products. Complexity or sophistication of the products cannot be prudently linked or adjudged with its unit cost being low such as Rs. 10,000 or less. It is the manufacturing and quality control process, which can define the complexity of a product.

Recommendation 10.11.1(b) The aspect of aggregating the nationwide demand of common user items, obtaining bulk discounts and lower prices on account of high volumes required over the entire government space through the present RC system have been completely overlooked by the Committee. This facilitates a buyers' market with the Government commanding the cheapest price all over the country (under the fall clause) for the required quality. This replaces the seller's market demanding premiums which is encountered everywhere else. Purchases through open tenders by each separate department on each occasion would not yield the cheapest/most economical price due to absence of high volumes. The sheer logistics of each Army unit going in for separate tenders all over the country for purchasing PT shoes can be well imagined. Even bulk

commodities like steel, cement, bitumen, oil etc have been successfully operating on RC system for decades saving huge public money and should continue. A move last year to stop RC for POL resulted in a serious impact across the country and had to be withdrawn.

Recommendation 10.11.1(c) The recommendation of DGS&D going for RCs only for items having annual drawal value of more than Rs. 25 crores is without any basis or logic and is with a clear intent to close down the DGS&D, while at the same time suggesting utilization of its expertise in the field of public procurement. Such item categories with an annual off-take over Rs. 25 crores are presently about 30 and would not justify the continuance of DGS&D only for such a meagre number of items. In fact, RC items are chosen on the basis of its common users, repetitive demand and the need for avoiding repetitive tendering thus saving on time and effort by each user besides other concomitant advantages to government users. Moreover, the criticality of an item is not directly related to its value. For example, a small nut and bolt set for the Railways can be a matter of life and death though it may not be costly at all.

Recommendation 10.11.1(f) It is always the attempt of DGS &D to have as many number of suppliers on the RC as possible. For example, there were more than 100 firms on RC for HDPE/PP bags for packaging, located all over the country. But, this is not always in the hand of DGS &D. Where the competition is less or the market has not matured enough, this cannot be ensured.
Recommendation 10.11.1(g) This suggested methodology of negotiating a discount on catalogue pricing for commercial products is based on para 14.6 of the guidelines issued by Ministry of Finance in 2006. DGS&D has been already following the same for RC for automobiles and has extended it to other sectors like IT, under an exhaustive procedure/policy named 'Most favoured Price Agreement (MFPA)'. It is being finalised in consultation with the Department of Commerce. Once approved, this would cater for RCs to be finalised in the segment of specialized, unique, proprietary, branded, market leader products on RC at cheapest price on volume discounting pattern for government sector. This is similar to GSA system prevailing in US and would reap the benefits for government from market leaders/branded products. DGS&D already hosts their RC products, specifications, prices, terms & conditions and all activities on its website, following on-line operations.

Recommendation i) Individual departments normally have no experience of procurement and lack experience of framing generalized specifications, which is a pre-requisite for competitive bidding to fetch a fair price discovery. So also is their expertise in inspecting items they purchase. If the recommendations of the committee to pass on the inspection to the concerned Departments is to be implemented, it would mean setting up inspection units in each of the Ministries and Departments which purchase items through DGS &D.

CCA, responsible for making payments, is a different independent entity under Department of Commerce and is not under DGS&D. CCA makes the payment first to the firms and then claims re-imbursements from concerned government departments of indentors through book adjustment. Prudently, the Paying authority should be different than the order placing authority in order to keep checks and balances. If this activity is entrusted to user departments, it would be more prone to misuse and Govt would weaken this system of checks and balances.

(A K Mangotra)
DGS&D
26.5.2011

Annexure-IV

Parawise dissent note on Chapter 11 (Railways)

11.1.1 This chapter begins with a value judgement on the procurement systems of Railways. It therefore sets the tenor for many generalisations and factual inaccuracies which thereafter follow. This dissent note is meant to provide the correct rational perspective about the procurement process being followed in Railways. This will show that it is incorrect to state that the procurement practices followed in Indian Railways may lack in transparency, competition etc.

Procurement practices in Indian Railways are based on General Financial Rules and guidelines issued by CVC and follow the established principles of public procurement.

11.1.2 It may be fruitful to provide a background of how the concept of vendor approval developed in railways over time:

(A) Historical background - The Qureshi Committee 1973 had called for registration of firms for vital/critical items and use of vendor performance data [1]. Thereafter, one of the recommendations of Railway Reforms Committee 1983, set up by the parliament, was to establish 'a proper system of vendor rating both with regard to quality and contract performance'[2]. Justice Khanna Committee of 1998 had recommended that "RDSO should be entrusted with the task of drawing up such a region-wise vendor list for safety items. This approved list should indicate the production capacity of the firms so that adequate number of vendors is approved. RDSO should also develop a system of getting feedback from the consumers and rate the vendors periodically for retention in the list. ...."[3]. This concept of rating the vendor finally led to the evolution of system of Part I (fully established vendors) and Part II vendors (not fully established vendors) so that vendors after proving their capabilities graduate to Part I source and then are eligible for bulk ordering. For items of general nature, there is no system of RDSO approval. It is limited to vital/critical items where the consequential cost of failure of a component on the railway system is high.

(B) Purchase procedure - Railways use 'Rules for entering into supply contract' (last revised in 2008) as the basic policy document for material procurement. This book and also its updates thereafter are available on the internet (www.indianrailways.gov.in) for wider dissemination and transparency.

For most of its capital items, Indian Railways follow a system of single stage open tender with defined eligibility criteria. Railways invite open tenders for all purchases of more than Rs. 10 lakhs (as against GFR stipulation of Rs 25 lakhs). Therefore, for the components of rolling stock and similar safety/critical items, it follows open tender and the bidding process is not restricted to approved vendors alone. On the contrary the very entry into the approved vendor system of Railways is compulsorily through competitive bidding process with the rider that bulk of the item will be purchased from pre-qualified vendors (called approved Part I and Part II vendors referred above). This is because Railways cannot take the risk of pre-mature failure of an item in terms of its quality. Safety/reliability in Railway operations

cannot be compromised by experimentation and in the hope that a new supplier will certainly succeed in supplying goods of acceptable quality and ensure timely delivery.

For such items, the bulk procurement is restricted from approved vendors. This aspect is clearly mentioned in the web tender notice and paper advertisement of open tender through which all such items are procured. In such open tender, bulk quantity order (upto 75-85%) is given to such bidders who are Part I approved vendors. Part II approved vendors can be ordered upto 25% of the tendered quantity. A new unapproved vendor can quote and get a development order (5% qty) if he is found suitable for the same by the tender committee based on the credentials submitted by the firm in its offer and if his rate is competitive. Based on his satisfactory performance against this development order, the firm can then be upgraded to 'Part II status'. This 'Part II' categorization is considered necessary so as to watch the performance of the new vendor about its ability to supply quality product on a sustained basis. Thereafter, if he successfully fulfils the qualifying criteria of having supplied a minimum quantity and/or minimum duration of field performance as a Part II source, he is then upgraded as a Part I vendor which enables him to get bulk quantity order. This system ensures that the material which railways get is of the requisite quality, the firms who have gone through the drill of vendor approval is assured of the bulk quantity order, yet he is also subject to competitive bidding process which ensures that if he over quotes after getting say Part I status, there is always a new vendor who will get into the system. Similar practice of vendor approval is followed in private and government manufacturing entities. In case of inadequate number of vendors, instruction exists that large quantity order (beyond the limit of 5%) can be given to prospective vendors (e.g. crankshaft in case of DLW) so as to develop new sources. Thus all vendors are free to apply for seeking approval with appropriate agencies subject to fulfilment of technical capability and eligibility criteria specified for the item and following the route of competitive bidding.

How the above procurement strategy has resulted in meeting the twin challenge of 'reduction in total system wise cost and yet maintained the system wise service levels' can be seen from the Table below:

Parameter	2008-09	2009-10
Value of purchase (other than civil engg items)	27495Cr (a1)	27876Cr(a2)
Iron & Steel index	288.4 (c1)	300.6 (c2)
Value of Purchase at constant price of 2008-09 (other than civil engg items)	27495Cr	26750 Cr (c1/c2)*a2
Ratio of total purchase values/(tonne KM + PS Km of train services)	0.0197	0.0185
purchase on single tender basis (including KVIC and AKASH* and excluding BEML)	3% in 2009-10	
Value of import	1150 /27876 = 4.1% (9-10)	

11.1.3 It should be clear from above that it is factually incorrect to say that the bidding process is restricted to 'such registered vendors alone'. Any vendor is free to participate in an open tender and get order subject to fulfilment of eligibility criteria. The very fact that Railways allow the system of open tendering for soliciting offers from those who are interested in supplying a particular item to Railways is indicative of fair play and equity being accorded through a transparent and competitive process. Thus, it does not at all prohibit the new and potential bidders to participate in open competitive tenders. Prior registration of potential bidders with approving agencies is not essential for participation in open tenders and potential bidders are not debarred from participation and therefore question of restricting competition does not arise.

It is also factually incorrect to say that the concept of approved vendors is contrary to the provisions of good procurement practices followed in developed countries or not recommended by UNCITRAL. UNICITRAL (article 7.1) clearly states that

"the procuring entity may engage in pre-qualification proceedings with a view towards identifying, prior to submission of tenders .....suppliers or contractors that are qualified".

Similarly, Federal Acquisition Regulations (FAR) of United States (which deals with public procurement by US Government) has the system of the Qualified Bidder List (QBL) and Qualified Manufacturer List (QML). Further 'such prequalification is done in advance and independently of any specific acquisition action' (para 9.203of FAR). FAR further adds

Para 9.103: (a) - purchases shall be made from and contract shall be awarded to, responsible prospective contractors only. .....(c) the award of a contract to a supplier based on the lowest evaluated price alone can be false economy if there is subsequent default , late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs.

Such a practice is also as per provisions of WTO. Its Agreement on Government Procurement {**Article VIII(d) Qualification of Suppliers**} says 'entities maintaining permanent lists of qualified suppliers shall ensure that suppliers may apply for qualification at any time; and that all qualified suppliers so requesting are included in the lists within a reasonably short time'.

11.2.1 Time period for vendor approval process depends on the complexity of the item and is also dependent on results of field performance.

The sample appears to be biased. The number of vendors approved for a particular item depends on a variety of factors including availability of technology, volume of purchase and degree of competition etc and not due to lack of approval by Indian Railways. For instance, till recently, no indigenous supplier has come forward to undertake manufacture of crankshaft for ALCO locomotives being manufactured in DLW for over four decades for the simple reason that economics does not justify setting up of an indigenous unit for such a small requirement. This is typical of any other industry dealing in low volume.

11.2.2 **(a)** The very first rule of GFR for procurement of goods (Rule 135) stipulates that "detailed instructions relating to procurement of goods may be issued by the procuring departments broadly in conformity with the general rules contained in this chapter." It therefore shows that GFR has not been written with the intent of being an exhaustive repository of procurement process, leave alone vendor approval process. The graduation from development to Pt II to Pt I status is a process for pre-qualification of vendors and is not against the provisions of GFR for the simple reason GFR is not written with this level of detailing. The detailing is left to the respective ministries. As already brought out earlier, even CVC acknowledges buying from approved vendors. CVC (http://cvc.gov.in/CompcirculCTE.pdf) has specifically addressed the aspect of there being a list of approved/registered vendors and said that it can be done, however, there should be publicity through web and all the forms etc for registration/approval should be available on the web. RDSO does give publicity through web and its vendor approval forms are available on its website. Indian Railways follow a non-discriminatory and transparent procedure for vendor approval to provide equality of opportunity to all. Besides, procurement from approved sources is an established system in manufacturing industry. In Ordinance factories of defence too, there is a system of 'registered and established' vendors and 'registered but not established' (Ordinance Factory Manual 2005 chapter 4 para 4.6). While 80% of the quantity is bought through limited tender from 'registered and established' vendors, 20% of quantity is brought through open tender (from April 2011, this quantity percentage has changed to 50% each).

It is repeated that unregistered bidders can bid for the entire tender quantity and in case of inadequate number of sources, instructions exist that Railways can place developmental orders for even up to 100 % requirement and more than 25% quantity on Pt II vendors

(b) Railway is aware of the provisions of The Competition Act 2002 and does not resort to any discriminatory practice in purchase of goods. Railways do not refuse to deal with any enterprise. As indicated earlier, every vendor is free to approach the designated agency for approval. The vendor is considered for approval after a transparent process of evaluation and due diligence. Similarly, in the procurement process too, every bidder is allowed to participate and is eligible for ordering depending on his status and credentials as on the date of bid opening.

(c) Any study has to cover a product range and remarks in a particular case cannot be taken out of context to reinforce a preconceived view and be the basis for decrying the sound system of pre qualification of vendors.

The process at RDSO is not restrictive. A review of vendor approval system at RDSO shows that in line with CVC stipulation referred to in para 11.2.2 (a) above,

(i) RDSO maintains the list of approved vendors on its website which is modified twice in a year.

(ii) RDSO also maintains on-line status of a firm's vendor approval status.

(iii) The vendor approval process is laid out on the RDSO website.

(iv) If the number of approved vendors for an item is less than three, RDSO

proactively seeks approval of more vendors by putting such items on its website and through expression of interest in newspaper.

(v) The time taken in the vendor approval process in RDSO is constrained by the complexity of items, number of items/firms currently under process, RDSO's available resources dedicated to vendor approval process, vendor's ability to fulfill the qualifying requirement in time and in case where field trial is needed, by the constraint of actual fitment on the train and making necessary observation.

(d) There is no linkage of procurement system with formation of cartel. Whenever it is noticed, Railways moves against cartel as per internal guidelines and also by taking up the matter with Competition Commission of India, if considered necessary. However, mere existence of cartels in few cases cannot be used for discarding the entire system of vendor approval which is designed to ensure that items of critical nature are sourced from established sources.

(e) Long term sourcing arrangement can be an alternate system than making annual purchases and this is how large private sector manufacturers such as automobile manufacturers make their purchases. But these procurements are not dependant on price fixation by competitive tenders and most often these are determined by price negotiations. Their system, however, is very restrictive as they do not encourage more number of suppliers for any item who act essentially as their ancillary units. In view of the above, the system followed by private manufacturers would not stand the scrutiny of public procurement as it effectively prohibits entry of any other vendor so long as the private sector manufacturer is satisfied with the performance of its current vendors. Wherever, a need is felt for developing more sources, Railways do follow a system of floating separate developmental tenders for ordering exclusively on new potential bidders. These are distinct from normal annual procurements.

(f) Precisely because of similar safety consideration, bulk of the procurement at DMRC for rolling stock spares is done straight way through single tender from the original equipment manufacturer (OEM), leave alone registered vendors. Open tender is generally followed only for machinery and project items. So the aspect of competitive bidding for rolling stock spares is largely absent there.

11.2.4 **(a)** Railways do allow all potential vendors to compete through advertised tenders. Vendor registration system is transparent and easily accessible through website of RDSO. The aspect of outsourcing of assessment of vendor capability will depend upon the domain knowledge of that institute and is not feasible for wide spectrum of items. Obtaining certificates from IITs etc shall not suffice nor are these institutes meant for such work. Also, association of railways will still be essential for the purpose of field trials.

(b) For the reasons indicated above, it is not possible to discontinue the vendor approval system by Railways.

(c) The underlying assumption in this paragraph is that any vendor can undertake manufacture of any item by making requisite investment on assurance of a guaranteed minimum off-take for certain period. Requisite manufacturing knowhow

and field trials are equally important. Vendor development, therefore, cannot be equated with placement of one time long term supply contract.

11.3, 11.4 Dealt in the body of chapter 11.

11.5 Both the system of procurement of Civil works, i.e EPC contracts and item rate contract have their relative advantages and disadvantages. However, in railways "item rate contracts" are preferred as they are time tested and have following distinct advantages over EPC contracts:

a. Technological changes and upgradations necessitated due to changes in traffic patterns, site conditions etc. are difficult to incorporate once construction starts in an EPC contract.

b. When the designers work for the builder rather than the owner, the tendency is to cut the cost and more often the designers end up in designing the structures making them just safe.

c. If a contractor in an EPC contract fails or the contract is foreclosed due to any reason, the assessment of the quantities executed by him becomes very difficult. Moreover, getting the balance work done also become very difficult as design of the first contractor may not be possible to adopt for the next contractor.

d. The scope of claims and arbitration in an EPC contract is likely to be more because at the time of bidding, the contractor has a tendency to bid very competitively but he tries to demand many items as extra to his scope of EPC contract.

The Railways have a good experience of existing system of "item rate contracts" in Civil Works and this has been quite successful. The scope of various items being well defined has attracted good competition. In fact, we have not seen much variation in quantities/items in contracts or many arbitration cases.

11.6 Dealt in the body of chapter 11.

11.7.1 It has been repeatedly stressed in this report that Railway PUs are an assembly units with very little value addition in house which has been used as an argument to establish that it has low level of technology, screw driver technology etc. As against 80% taken as a material cost in the loco manufacturing factories (ref 9.4.2 of the committee report), in private sector in India, even reputed manufacturing companies like Tata Motors and Maruti-Suzuki have material cost of 80% (source: en.wikipedia.org/wiki/automotive_industry_in_india, http://www.marutisuzuki.com/company-at-a-glance.aspx). Further as a product goes up the complexity chain, its production necessarily entails putting together a number of sub-assemblies. To that extent, if locomotive manufacturing in railways is, on an average, able to do 20% value addition, it is commendable considering that loco manufacturing is more complex and selectively much smaller in volume than say car or truck manufacturing where volume is large and complexity is less.

11.7.2 & 11.7.3 Corporatisation of departmental production units has got nothing to do with procurement practices and hence outside the perview of this committee.

11.8 Please see 11.9.6.

11.9.1 Procurement practices as well as vendor registration programme in Indian Railways are based on General Financial Rules and guidelines issued by other Government functionaries (CVC and parliamentary committees) from time to time. They are followed at all stages from framing of specifications, granting equality of opportunity in vendor approvals, well published and non restrictive bidding and reasoned and well recorded deliberations in evaluation process. The procurement practices are reviewed from time to time and necessary changes are made as considered appropriate.

11.9.2 GFR (para 152) very clearly indicates that two bid system should be for complex items like Plant & Machinery items. It is not understood how on one hand, this report is concluding that the procurement practice of Railways is not in line with GFR, but one the other hand, this report is recommending a method of procurement which is violative of the same GFR! In any case, extension of two bid system for procurement of all the items is neither desirable from the point of view of manufacturing engineering nor it is not feasible to follow single stage two-envelope system for procurement of thousands and thousands of items required by Zonal Railways, PUs on day-to-day basis. However, Railways does follow two bid system for M&P items and large project in line with the provisions of GFR.

11.9.3 This is a good suggestion. However, since procurement is linked to annual budgetary allocations, mechanism for long term contracting will have to be worked out.

11.9.4 Development of vendors is done for Railway specific items. Vendor approval for vital/critical items is necessary considering modern technology demands so that asset reliability and maintainability is ensured & safety is not compromised.

11.9.5 As stated above, tenders are normally global or/advertised so as to attract potential bidders, even when approved vendor base is low. Procurement from single source is resorted to only when there is no option.

11.9.6 Same reply as in 11.3.10 (f) of chapter 11

11.9.7 Dealt with earlier in para 11.5 of this dissent note.

11.9.8 Railway undertake procurement through PSEs on nomination basis only in some specific projects like J&K project, Sevok-Rangpo new line etc.

11.9.9 Same reply as in 11.3.10 (f) of chapter 11

Further, I agree with the dissent notes given by DG/ DGS&D on recommendations in DGS&D chapter, DG/Acquisition on defence matters and Member Secretary in view of the arguments given therein. In line with above dissents, I disagree with the recommendations given in chapter 16 and 17 to the extent they are against the aspects brought out above.

[1] see (p. 73-74) of Qureshi committee report.

[2] see (p.74-75) of Railway reforms committee report

[3] see (p.37) of Justice Khanna committee report

S. Chandrasekaran

Additional Member (Finance)

Ministry of Railway

Annexure-V

Dissent Note of Shri VIVEK RAE, DG(Acquisition), Ministry of Defence regarding the Report of the Committee on Public Procurement

Chapter-3 Public Procurement Law

Comments: Procurement is a complex and system-wide activity across the GOI and its autonomous and statutory bodies and PSEs, with a wide variety of sector/institution specific requirements. Diversity in procurement practices is an integral feature of the vast governmental system in the country. Consequently, at the GOI level, the appropriate course of action would be to outline the fundamental principles of public procurement as has been done in the GFR and leave the detailing to individual departments and agencies. While the fundamental principles of public procurement could be elaborated through a Public Procurement Policy Statement, incorporating these principles into a public procurement law with rules and regulations would create unnecessary rigidity and militate against the diversity and flexibility required by various organizations. The Public Procurement Law would enhance the legislative load on an already overloaded administrative and judicial machinery and result in further expansion of the bureaucracy. The proposal to enact a Public Procurement Law is therefore not supported. A better option would be to review the GFR and incorporate international best practices in public procurement in the GFR as guiding principles.

The policy framework for public procurement processes is provided by the General Financial Rules(GFR) and each department or agency adopts its own procurement procedures, keeping in view the general principles enunciated in the GFR. The institutional and regulatory framework includes oversight mechanisms through the C&AG and CVC, backed by administrative penalties on government servants under CCS(CCA) Rules, and criminal liability under the Prevention of Corruption Act(PCA) and Indian Penal Code(IPC). Deviations from the general principles of GFR are invariably visited with civil or criminal consequences. What is required is effective enforcement of the existing regulatory framework and not fundamental overhaul of public procurement processes.

In so far as dispute resolution at the pre-contract stage is concerned, the mechanisms should be internal to each organization. The proposal to create Public Procurement Tribunals external to the procurement agency is not supported. Any grievances which remain unaddressed through internal mechanisms at the pre-contract stage should be addressed through the existing legal system.

Chapter-12 Defence Procurement

Comments on Paras 12.2.2, 12.2.3: These paras overlook the fact that a significant amount of defence procurement, both in India and abroad, is single source procurement. This is inherent in defence procurement. Because of high design and development costs, long gestation lags, lumpy capital investments as well as uncertainty in flow of orders, the vendor base for major weapons systems and platforms tends to be restricted. Procurements, therefore, often have to be made on single source basis, or on the basis of limited competition. In countries like USA, the cost structure of the OEMs is audited by the Defence Contract Audit Agency and prices negotiated with the OEM thereafter. This modality is adopted because of lack of competition. In this situation, with markets for defence products often characterized by monopolistic and obgopolistic

features, it would not be appropriate to decry the monopoly status of DPSUs and OFs in India. This status is inherent in defence manufacturing. The remedy in such situations is to have a rigorous and independent cost audit while negotiating prices.

With regard to DPSUs and OFs operating primarily as aggregators, outsourcing is today an integral part of modern manufacturing practices and there can be no objection to outsourcing, per se. In the absence of authentic data, it is not clear on what basis a statement has been made that DPSUs and OFs source over 70% of the costs of the products from outside, with just 30% being accounted for by low technology, in-house production, staff costs and profits, etc. It is too sweeping to say that DPSUs and OFs do not have any credible manufacturing capacity. It would be best to avoid such sweeping statements, since they are not based on in-depth study of the manufacturing capability of DPSUs and OFs.

Comments on Paras 12.2.5, 12.2.6, 12.2.7, 12.2.8: Presently, there is a cap of 26% on foreign equity participation in Indian defence manufacturing. However, exceptions can be made on case by case basis. These paras overlook the fact that besides cap on FDI, there are other more potent barriers to transfer of defence technology, particularly technology denial regimes in advanced defence manufacturing countries. Even if the FDI cap is enhanced beyond 26%, there would be no certainty regarding TOT to India, since such decisions are governed by export control laws and political and strategic considerations of the exporting country. A higher cap on foreign equity in Indian defence manufacturing is therefore not a panacea for hi-tech defence production. Further, while low end TOT and knowhow may get transferred, it is unlikely that 'design' and 'development' capability and 'know why' would be transferred to Indian manufacturing entities with higher FDI cap. Design and development capabilities and 'know why' are closely held by foreign companies and are not easily transferred to joint ventures. On the other hand, allowing foreign OEMs a higher FDI cap in defence manufacturing could be a setback for indigenous design and development efforts.

It may be noted that a GOM chaired by the Union Finance Minister is deliberating on the FDI cap for Indian defence production and a number of sensitive and complex issues need to be taken into consideration. Since the Committee on Public Procurement has not been able to go into the matter in-depth, it would be appropriate if recommendations on such complex matters are excluded from the report.

Comments on Para 12.2.12: The example of the Maruti Suzuki venture is not relevant for defence manufacturing. Transfer of defence technology is subject to tight controls which is not the case for TOT in other sectors, including automobiles.

Comments on Para 12.3.1: The observations in para 12.3.1 are based on inadequate appreciation of the logic behind categorization of capital acquisitions under the Defence Procurement Procedure. The categorization of capital acquisitions for Armed Forces is done after careful consideration of various aspects, including capability of Indian manufacturing industry, both in public and private sector, availability of sufficient competition, urgency of the procurement, etc. Capital acquisitions are categorized as under:-

a) Acquisitions covered under the 'Buy' decision: Buy would mean an outright purchase of equipment. Based on the source of procurement, this category would be classified as 'Buy (Indian)' and 'Buy (Global)'. 'Indian' would mean Indian vendors only and 'Global' would mean foreign as well as Indian vendors. 'Buy Indian' must have minimum 30% indigenous content if the systems are being integrated by an Indian vendor.

b) Acquisitions covered under the 'Buy & Make' decision: Acquisitions covered under the 'Buy & Make' decision would mean purchase from a foreign vendor followed by licensed production/indigenous manufacture in the country.

c) Acquisitions covered under the 'Buy & Make (Indian)' decision: Acquisitions covered under the 'Buy & Make (Indian)' decision would mean purchase from an Indian vendor including an Indian company forming joint venture/establishing production arrangement with OEM followed by licensed production/indigenous manufacture in the country. 'Buy & Make (Indian)' must have minimum 50% indigenous content on cost basis.

d) Acquisitions covered under the 'Make' decision: Acquisitions covered under the 'Make' decision would include high technology complex systems to be designed, developed and produced indigenously.

Under the 'Buy (Indian)' and 'Buy and Make(Indian)' categories, only Indian vendors can participate. Under the 'Buy (Global)' category, both the Indian and foreign vendors can participate. The categorization is a well considered decision and foreign companies are not allowed to directly participate in the 'Buy (Indian)' and 'Buy and Make (Indian)' categories. However, foreign vendors can participate indirectly as suppliers to Indian companies under these two categories. The question of providing price preference of 5-10% for domestic vendors under 'Buy (Indian)' and 'Buy and Make (Indian)' categories therefore does not arise. The question of allowing foreign vendors to directly participate in "Buy Indian" and "Buy and Make (Indian)" categories also does not arise by definition.

It may be noted that over the last two years, 'Buy (Global)' cases in which both Indian and foreign vendors can participate, have accounted for 27% of all categorizations approved by Ministry of Defence while 'Buy (Indian)' cases accounted for 29% of all categorizations.

The Defence Procurement Procedure is fully consistent with GFR 135.

Comments on Para 12.3.2: There are several ways in which technologies are acquired under the Defence Procurement Procedure(DPP). In respect of 'Buy & Make' proposals, a Production Agency(PA) is nominated by Department of Defence Production, as the recipient of TOT. The PA can be a DPSU or OF or a private sector company. However, normally, a DPSU or OF is designated as a PA keeping in view the difficulties in nominating a private sector company through a transparent process. The PA needs to be designated prior to issue of RFP and negotiation of the TOT package. In the absence of full details about the product and TOT package, the private sector PA may not be in a position to quote the price on which it would be able to supply the defence product in advance. In the absence of a price bid, it is difficult to select a private company in advance. It is also not feasible to negotiate the TOT package without designating the PA in advance since the PA has a major say in the TOT process. It is for these reasons that it is difficult to designate a private sector company as a PA and recipient of TOT under the 'Buy and Make' category. It may be noted that presently the cost of the TOT is borne by the Government. Further, private sector companies are free to acquire technology and set up joint ventures under the 'Buy and Make (Indian)' category.

Comments on Para 12.3.4: The key objective of the Offset Policy is to leverage buying power to enhance the flow of technology and sourcing of products and services from Indian defence enterprises. The Indian private defence sector has developed rapidly since 2001 and has benefitted

from the Offset Policy introduced in 2005 which has increased sourcing of defence products and services from Indian companies. The Offset Policy benefits Indian companies through several ways including direct sourcing, transfer of knowhow and co-production, both for products and services, and joint ventures. Benefits accrue both through equity participation and also through the non-equity route. Consequently, to conclude that the FDI cap of 26% in Indian defence manufacturing is a major policy constraint for successful implementation of the Offset Policy is incorrect. The purpose of the offset policy is to enhance the defence manufacturing base in India and to conclude that offset stipulations will not work in view of the limited manufacturing base appears to be self-defeating.

Chapter-13 Public Private Partnerships

Comments on Para 13.6.1: The observations in para 13.6.1 have not been substantiated and cannot be accepted at face value.

The undersigned has signed the report of the Committee on Public Procurement, subject to the chapter-wise comments indicated above.

(Vivek Rae)
Director General (Acquisition)
Ministry of Defence

Member, Committee on Public Procurement

June 3, 2011

Dissent Note of Member-Secretary on the Report of the Committee on Public Procurement

In connection with the draft Report of the Committee on Public Procurement and discussions held in various meetings of the Committee, I would like to place my views on certain issues on record. I would like these to be suitably reflected in the report of the Committee. I have also made these views known in various meetings of the Committee.

A. Grievance Redressal System [Paras 3.3(b), 16(9) and 17.2]

2. A proposal has been made to make Grievance Redressal System mandatory under the provisions of the law proposed to be enacted for public procurement. While I generally agree with the idea of having a law on public procurement, I do not support a grievance redressal system. An effective grievance redressal system in public procurement is not possible. Once an order is placed on an entity by a public authority, a contract is already entered into and no redressal of 'grievance' of unsuccessful bidders is, in fact, possible. Any order passed by a grievance redressal forum after placement of order cannot remedy the basic grievance of non-award of contract to the unsuccessful bidders and cannot negate the contract already entered into. In addition, such a system will enhance the administrative work tremendously. Each grievance will need to be responded to such that it is able to withstand detailed scrutiny at a later date. There is also nothing to stop the aggrieved person/ entity from making another representation, citing the contents of the response as the new facts brought to their knowledge, thereby justifying second representation. Considering that for any tender, there will be usually only one successful bidder and all others will be unsuccessful and hence may feel aggrieved, the number of representations and the work generated even for routine procurements will be voluminous. This may derail the whole procurement process in the Government.

3. Further, in case placement of orders itself is withheld till the final decision covering all tiers/ stages of grievance redressal mechanism, there will be substantial delays in placement of orders, receipt of material and continuance of projects/ works. There is also no guarantee that the grievance redressal mechanism will be able to operate within the timelines specified. This will mean substantial delays in placement of orders and generation of tremendous amount of administrative work without commensurate benefits.

4. In case the orders are allowed to be placed while the grievance redressal mechanism is allowed to operate simultaneously, as already stated above, it is not understood as to what really effective redressal can be offered to the aggrieved entities and whether the main grievance for non-placement of orders can at all be redressed when the contracts have already been entered into. As the idea is to give compensation to unsuccessful bidders, questions will arise as to what amount of compensation can be made, what will be the basis for such compensation and who will bear the expenditure. Questions of fixation of responsibility for loss due to payment of compensation will also arise.

These are questions which cannot be easily resolved. These will not only put undue pressure, both administratively and financially, on the government system, but will also make the procurement officers resistant to taking decisions.

5. While an internal grievance redressal system equally suffers from the above limitations, the external grievance redressal system is much more prone to these issues. In view of all above, a public grievance redressal system in public procurements is not supported. In any case, in the present setup not many cases end up in the court. In trying to find a solution to the limitations in the present system through a public grievance redressal system, we may most likely be creating disorder and chaos.

B. EPC Contracts [Paras 6.2, 6.3, 6.4, 16(7) and 17.5.1]

6. EPC contracts are to be made mandatory under the proposed law on public procurement of the Committee. Only a few exceptions are to be allowed. I am of the view that EPC contracts are not the single dose remedy to the limitations of the present system. EPC contracts make the assessment regarding reasonability of rates extremely difficult for the procurement agencies. As the item rates are not indicated, there is no way except from the responses received to the bids to assess reasonability. Information available with the procurement agencies to verify the reasonability of rates is substantially curtailed. If we presume that competition will invariably lead to reasonable rates, this is not borne out in number of cases. The existence of cartelization and malpractices by suppliers cannot be negated, even though prohibited under law. EPC contracts are ideal only where the specifications are pre-determined and not susceptible to change and the rates are well established - such as road construction. These contracts are not a solution where the design needs to be still developed, specifications are susceptible to change or the rates are not well established. In such cases, in an EPC contract, we would not know the base level for a particular item where the changes are required to be made and hence fixation of amounts to be charged for changes of specifications will be rather ad-hoc and discretionary, with procurement agencies having no basis for accepting or negating the claims of the suppliers. EPC contracts are highly risky in projects where there is choice available from number of designs/alternatives and such choices cannot always be pre-determined. The effort of supplier will always be to provide inputs at least cost merely to ensure outputs. In such cases, item rates where the supplier gets what he puts in would definitely be a better choice. Considering the variety in the magnitude, specifications and the sectoral requirements of public procurement, it is best to leave the decision about which type of contract is to be entered into – whether item rate or EPC – to the concerned Ministries/Departments.

7. The logic that item rate contracts result in time and cost overrun is also not justified. To reach a reasonable conclusion in this regard, a greater analysis based on proper sample from data on all contracts cutting across sectors and not merely delayed contracts needs to be made to see whether time and cost overrun have been so substantial as to justify a whole change in setup. In case time and cost overruns are noted in a particular type of project, EPC contracts could be considered for such projects provided these fulfill the basic requirements for EPC contract.

8. It is also incorrect to say that EPC contracts will invariably lead to timely completion within originally estimated cost, as even EPC contract will not cover certain risks like changes in seismic zone structure and force majeure conditions and in such cases delays and cost overruns on these account may need to be borne by the procurer. In any case, the supplier is bound to add on the cost of all risks covered by him in his bid offer, whether in reality these risks materialized or not. To this extent, Government will lose financially. This amount is bound to be very substantial and is most likely to be much more than the amount of cost overruns in the present setup.

9. In view of all above, in my view EPC contracts need not be mandated under law. It should be left to the discretion of Ministries/Departments/ other procurement agencies as to which modality of procurement is best suited to their own specific requirements.

C. Separate Chapters for specific Ministries/Departments and inclusion of specific cases in the Report (Chapters 10, 11 and 12)

10. In my view, the details of procedures being followed by specific Ministries/Departments and the need or otherwise for changes required therein, need not have formed part of the Report of the Committee. I am of the view that recommendations of the Committee should be of generic nature. Presentations by certain Ministries/Departments before the Sub-group formed by the Committee, were organized only to facilitate a better understanding of public procurement and to ensure that general inferences of the Committee are tested on these specific inputs. Also such limited exposure to the procedures and practices of specific Ministries/Departments is not considered adequate to draw general conclusions of vast implications about changes in these procedures and practices. This is more so in view of Dissent Notes of DGS&D, DG (Acquisition), M/o Defence and Additional Member (Finance), M/o Railways to which I generally subscribe.

Similarly, I am of the strong view that specific cases should not have formed part of the Report of the Committee.

11. As regards the specific case of DLW (para 11.3), the facts of the case are strongly contested by Ministry of Railways and the comparison with another offer has been made based on presumptions and ignoring the trends of actual cost in DLW and the price variation clause of the alternate offer, which may result in substantial increase in their price due to inflation. The comparison has been made even when fundamentals of the two cases are widely varying. To me, there seems no logic or reason for this case to form part of the report. This is more so as no other specific cases besides cases relating to Ministry of Railways have been quoted in the whole report.

12. As regards registration of vendor (para 11.2), this is a common practice in many organizations and serves establishing reliable sources of supplies. Placing order with unregistered vendor is fraught with the risk of non-supplies due to low credibility of some unregistered vendors, low quality of goods and delay in supplies, which may jeopardize the progress of the whole project. Further, though individual items may be insignificant and low value items, the same may need to be integrated in the whole system and if these are not of standard quality, these may jeopardize the safety of the

whole equipment which has to be the core objective, especially in sectors like Railways, Civil Aviation, etc.

Hence, there is full justification for restricting the bids to registered vender and limiting the placement of orders to new firms as per practice prevalent in Ministry of Railways.

D. Procurement through DGS&D [Paras 10.11.1(a), 17.9.1]

13. It has been recommended that DGS&D should not enter into rate contracts for products where the unit cost is not more than Rs. 10,000 per unit on the grounds that these low unit- value products are not likely to be complex and can be handled by the user departments through delegation of powers and as part of procurement of commercially available products. In fact, maximum utility of DGS&D rate contracts is for such low-value items of common use. Individual departments do not need to spend time and effort in procurement of such items. Nor will such low-value items always be available commercially. Hence, I am of the view that DGS&D should continue this most useful activity being presently undertaken by them on behalf of other Ministries/Departments. I also strongly support the views given by DGS&D in his Dissent Note.

E. Summary of Recommendations (Chapter 17):

14. The recommendations of the Committee need to be viewed in the light of above observations.

(Ajanta Dayalan)
Member Secretary
Committee on Public Procurement

Date: June 03, 2011

Annexure- VII

Dissent Note of Shri M.P. Gupta, Former Additional Secretary, Ministry of Finance regarding the Report of the Committee on Public Procurement

Tumi ekla chalo, ekla chalo, ekla chalo re
—Rabindra Nath Thakur

1. I write this dissent note in response to the surge in dissent notes. The draft report dated 19th May, 2011 had dissent notes from DG S&D on his department, Additional Member (Finance), Railways on Railways, and DG Acquisitions on his Ministry of Defence. Then, the Joint Secretary, Cabinet Secretariat, joined the Additional Member (Finance) and DG Acquisitions Ministry of Defence to write dissent notes on 9 more chapters in the final report dated 29th May, 2011; and add her weight to the dissent notes on Railways and Defence. Neither the DG Acquisitions Defence nor the Joint Secretary, Cabinet Affairs, had stated that they will give dissent notes on these chapters when these chapters were finalized on 7th May, 2011.

2. Before I state the messages I get from the dissent notes on the chapters on DGS&D, Railways, and Defence, I record some facts which the Committee did not find necessary to cite as evidence to support its recommendations:

(a) A note of mine pointing out several instructions to bidders or contract conditions issued by DGS&D which were in flagrant violations of GFR, 2005 for the procurement of goods. (None in DGS&D had implemented the reforms the GFR 2005 ushered in.)

(b) (i) Chapter on Railways brings out the fact that Railways takes, on average, from 286 to 530 days to register a supplier. The Committee has not recorded the fact that a vendor has to certify that its product does not infringe any patent rights even though the product is to be manufactured in accordance with the specifications and drawings supplied by the Railways. (paragraph 5.1.2.1 of Railways Guidelines for Vendor Approval). (The dissent note does not offer any remedy to the problem of delays in registration of suppliers).

(ii) The study of Diesel Locomotive Works (DLW) draws attention to the fact that only through competition one can judge the reasonableness of the cost of local locomotives, or its fuel efficiency. (The dissent note refrains from this. It dislikes any talk of competition to DLW.)

(c) The dissent note on defence shies away from the reality that the GFR 2005 has done away with the concept of wholly Indian, partly Indian products which governed GFR 1963. Further, the presentation made by the Ministry of Defence did not mention a single reform that removed any shortcomings faced by the public.

3. The *unukta*, the unsaid, messages of the above mentioned dissent notes are:

(a) Competition is not welcome; and
(b) The resistance to reforms from major departments.

4. Therefore, the following are recommended, in addition to all the recommendations made in the Main Report:

(a) Section 418 of Title 41 of the US Code Public Contracts of the United States requires each procuring agency to appoint an advocate for competition to promote competition in public procurement. Further, he has to have necessary staff. His duties and functions include challenging barriers to full and open competition and review the procurement activities to remove any conditions or actions which unnecessarily restrict completion.

Therefore, to encourage competition, Government may appoint an external part time member, with necessary staff, to the Railways Board and the Ordnance Factories Board as Competition Advocate.

(b) To overcome the resistance to reforms, the implementation of the procurement of reforms may be taken up in mission mode.

(M P Gupta)
Member
Former Additional Secretary
Ministry of Finance, Department of Expenditure
31st May, 2011

Flawed constitution of the Committee

This is a very important Report considering the Government's resolve to combat corruption. The Union Cabinet has set up a Group of Ministers (GOM) under the chairmanship of Finance Minister and the recommendations in this Report would be considered by this GOM. It may be recalled that in her address on December 18, 2010, Smt. Sonia Gandhi, chairperson, UPA spoke of the need to "intensify our battle against corruption". She stated that "we must ensure, through legislation and clear procedures, full transparency in public procurement and contracts. It is the duty of the administration to ensure that there is no subversion of due process. And should it come to pass, whistle blowers must be protected". Indeed, it is widely believed that procurement is encumbered by corruption which must be weeded out.

2. In the above context, this Committee set out to evolve its recommendations, but its work was constrained by its very constitution. Four of the eleven members in the Committee represented the four biggest procuring departments of the Government viz. Defence, Railways, DGS&D and CPWD, (hereinafter referred to as "Incumbent Members"). From the interventions made by these Incumbent Members, the undersigned observed the following:

- The Incumbent Members gave no suggestions whatsoever regarding any possible improvement in their respective Departments. Nor did they support the idea of a procurement law or an oversight authority. If their view is to be relied upon, the aforesaid perceptions about corruption in procurement should be treated as unfounded and "all is well".

- Three of the Incumbent Members wrote dissent notes against the recommendations of this Committee relating to reform in their respective Departments. Objections of the fourth Incumbent Member were recorded in the main Report itself.

3. In some cases, the Incumbent Members even supported the cause of one another by formally endorsing the dissent notes of other Incumbent Members – indeed a novel form of cartelisation against reforms!

4. The undersigned would not wish to conclude that the Incumbent Members are personally opposed to reforms. In fact, one member candidly stated that he personally agreed with several recommendations, but his departmental view required him to record a dissent. In the case of Railways, after the entire Report was near final, the immediate superior of the Incumbent Member (i.e. the Financial Commissioner of Railways) met the Chairman and Member Secretary in a bilateral meeting and argued against several parts of the Railway chapter. Following this meeting, the Member Secretary allowed the Incumbent Member a special privilege to add six pages of dissent in the main Report itself, besides writing a full Note of Dissent (Annex-IV). This was a clear demonstration of incumbent pressures at work.

5. It is noteworthy that when individual chapters were being discussed, the Incumbent Members persuaded the Committee to alter or tone down several observations and findings. The other members went along in order to build consensus. Yet in the final stage, the Incumbent Members (excluding DG, CPWD) and the Member Secretary chose to write sweeping Notes of Dissent. Ideally, they should have made their positions known to the Committee during the course

of deliberations. This would have given an opportunity to the other members to respond to their objections in the main report in order to give the reader a wholesome picture. In the case of Railways, in particular, no information or explanations were provided by the Incumbent Member except to state that what the Railways were doing was right.

6. As an old adage goes, no man can be the judge of his own cause, as it involves a patent conflict of interest. It is, therefore, felt that when committees such as the present one are constituted in future, the incumbents may be included as special invitees and not as members.

7. It is noteworthy that the Member Secretary, who is a Joint Secretary in the Cabinet Secretariat, also joined forces with the Incumbent Members. Right from the beginning, she supported their viewpoint that the extant systems were in order. All along, she was also opposed to specific recommendations being made about the aforesaid four departments and ultimately wrote a Note of Dissent to this effect.

8. While the readers would understand the compulsions of Incumbent Members in writing their Notes of Dissent, they may wonder why an ex-officio representative of the Cabinet Secretariat has opposed a large number of recommendations. In the interests of the larger cause, I am constrained to observe that membership of such important committees should not be ex-officio and should be based on individual expertise and experience.

9. In sum, if the Notes of Dissent in this Report are any indication, there would be strong resistance from vested interests against the recommendations in this Report. How this would be overcome remains to be seen.

– Gajendra Haldea
Adviser to Deputy Chairman
Planning Commission
June 9, 2011

Dissent Note of Shri S. C. Sharma, (former, Director General, Road Development) and Shri M. P. Gupta (former Additional Secretary, Ministry of Finance, Department of Expenditure) regarding the Report of the Committee on Public Procurement

Chapter 11 Procurement by the Railways

1. Introduction

1.1 The Committee on Public Procurement (COPP) in its first two meetings decided that the members were to give the free and fair assessment of the present procurement process and the improvements called for and would not resort to obtaining departmental views and record them. We understand that the Additional Member (Finance), COPP member, circulated the draft chapter on railways procurement ("Chapter") to the members of the Railways Board. The Chairman confirmed that the Financial Commissioner met and discussed the Chapter with him and the Member Secretary. Brief history of the Chapter is:

(a) On the 7th May, 2011 COPP discussed the 6th May draft report prepared by the drafting Sub-Group set up by COPP and asked Shri Gajendra Haldea and the Member Secretary to jointly do the final touching up and editorial changes.

(b) The 19th May draft report had the Chapter rewritten by the Member Secretary unilaterally disregarding the views, facts, and findings given in the 6th May report; and on the 24th May, 2011, the COPP disapproved it. It approved the previous version with some changes, and asked Shri Haldea to add a couple of paragraphs to address the points raised in the meeting.

(c) On 26th May, 2011, the Member Secretary circulated a draft Chapter to the Additional Member (Finance) Railways and not to us. Based on his input, she included several pages in the Chapter of the 29th May report. Shri Haldea sent her an amended Chapter on 31st May, 2011 answering some of the points of the Additional Member (Railways).

(d) The chapter in the 6th June Report has two features worth noting:

(i) does not have the clarifications given by Shri Haldea on the points made by the Additional Member (Railways).

(ii) incorporates the revised version of the points made by the Additional Member (Railways).

2. The points made by the Additional Member (Railways) were never discussed in any meeting of COPP. Hence we consider it necessary to record our views on the same as follows:

2.1 ***with respect to paragraph 11.3.1 of the Chapter***

2.1.1 The paragraph 11.3.1 points out that in 1997 the Diesel Locomotive Works, Varanasi (DLW) got from EMD, USA design and transfer of technology (TOT) for 4,000

horsepower diesel locomotives; that in 2009-10, 90 per cent of the of the total production cost related to purchase of sub-systems and components from private suppliers in India and abroad; that 35 per cent was imported from single source; that value addition by DLW was marginal; and that it all indicated that DLW is primarily an assembly plant and not a manufacturing unit.

2.1.2 The Additional Member (Finance) has written about another 3,000 HP locomotive (ALCO) which is based on the technology of the 1960s. This is not relevant to the Chapter. Further, he has adopted provisional figures of the year 2010-11 but he has not disputed the figures of 2009-10. He also states that the single source imports may be seen in proper perspective; and that development orders have not been successful.

We find that development orders cannot be successful under the existing system when the Railways do not assure a vendor any firm commitment to buy a specified quantity for at least five years; and also a new vendor is eligible for only 5 percent of the quantity required in a year.

2.2 ***with respect to paragraph 11.3.2 of the Chapter***

2.2.1 The paragraph 11.3.2 points out that there has been little transfer of technology when 35 percent of the imports come from the entity from whom TOT was bought.

2.2.2 The Additional Member (Finance) claims that DLW has made technological improvement in a decade old design. He refutes the allegation of corruption (which this paragraph does not make) and lack of competition by referring to the cost of production of locomotives in the year 2010-11.

We find that claim of technological improvement does not answer the requirement of their evaluation against improvements elsewhere in the world in diesel locomotives; and that technological up-gradation is also tied to further procurement from EMD to perpetuate its monopoly to supply components etc. We are unable to understand how the cost of a product from a single source can be used to justify the lack of competition.

2. 3 ***with respect to paragraph 11.3.4 of the Chapter***

2.3.1 The paragraph 11.3.4 analyses the reasonableness of the international competitive bid received pursuant to Cabinet approval in 2009. The price comparison is done with reference to the reserve price and the price derived using the actual cost of production of 4000 HP locomotive in 2009-10.

2.3.2 The Additional Member (Finance) contends that the price comparison is flawed and instead would be more appropriate to base it on 2010-11 figures.

His contention is incorrect. There is little justification to base this comparison on provisional figures, as also when the provisional figures relate to a period two years after the bids.

2. 4 ***with respect to paragraph 11.3.5 of the Chapter***

2.4.1 The paragraph 11.3.5 states that the a committee of the Railways estimated a reserve price of Rs. 13.87 crore for a 4,500 HP locomotive and Rs. 16.01 crore for a 6000 HP locomotive; and that the bids first time were received substantially lower than the

estimated reserve price, but the bids were discharged presumably because the Railways did not wish to decide on these large transactions only two months before the general elections of 2009.

2.4.2 The Additional Member (Finance) states "It is not understood why a few committee members are talking about estimated cost data of earlier vintage when actual cost data are available. The disinformation about the so called lower price of the bid received for 4500 HP has already been refuted.

We find that the Chapter has not used any dis-information. The figures are all authentic and provided by the Railways. Additional Member (Finance) has not refuted them. Nor have they been used selectively. It is another matter he considers the actual figures as dis-information. Some of confusion arises because the actual figures of 2009-10 are being suppressed by the Additional Member (Finance) who wishes to rely solely on the provisional figures of 2010-11.

2. 5 ***with respect to paragraph 11.3.6 of the Chapter***

2.5.1 The paragraph 11.3.6 refers to the official government document stating: "...the vested interests of EMD in scuttling the process for setting up of new diesel locomotive factory cannot be ruled out". It also refers to a news report of EMD lobbying to scuttle the bid process for setting up the proposed diesel locomotive factory

2.5.2 The Additional Member (Finance) calls the news report an insinuation, not based on facts. However, he does not question this very assertion made by Member (Mechanical), as reported in OM No. 551/2/2/2009-Cab-III dated 19.02.2009 conveying the minutes of the meeting of Committee of Secretaries in connection with the single bid for Diesel Locomotive Factory in Bihar.

2. 6 ***with respect to paragraph 11.3.7 of the Chapter***

2.6.1 The paragraph 11.3.7 refers to the Cabinet approving the proposal in February, 2010 with a time schedule of six months for finalisation of the bids. And yet, the bid due date was fixed as December 9, 2010 (nine months instead of the six months indicated to the Cabinet); and it is being postponed repeatedly, the latest date being 29 July 2011.

2.6.2 The Additional Member (Finance) cites from the Railway Budget speech the need for due diligence for these projects, and this resulting in delays.

We find that the Cabinet had approved the bid documents and the proposed contract; and that it had also approved the setting up of an inter-ministerial committee to make further improvements, if necessary. Thus, either the due diligence was missing before the Railways Board placed the proposal before the Cabinet; or pressures are working to scuttle the decision one way or another.

2.7 ***with respect to paragraph 11.3.9 of the Chapter***

2.7.1 The paragraph 11.3.9 states the case of DLW clearly suggests that incumbent suppliers have a stranglehold over Railway procurement; that there are no checks and balances; that Railways often oppose external scrutiny and advice; and that the vested interests lead to malpractices, cartelisation and corruption.

2.7.2 The Additional Member (Finance) questions the need to bring out a specific tender to drive a particular point home. About the allegation of malpractices, corruption etc. he points out that the annual increase in cost of production of locos is only 2.5 % a year against the average of 9% of Consumer Price Index.

Prices may fall with technological improvements. The crucial issue is that there are no checks and balances, and established procedures to analyse and evaluate the on-going procurement and production costs with the market prices. This remains un-answered.

2.8 ***with respect to paragraph 11.3.11 of the Chapter***

2.8.1 The 6th June Report reads as follows:

> "After noting the above positions, the Committee was of the view that as this is a specific case and the Committee is to focus on the larger issues of public procurement policy, rules and standards, the matter may be left to the concerned Ministry and the oversight mechanism within the Government"

2.8.2 We disagree with the above formulation for the reason that this report is meant for the Government, and not for Railways or any particular department.

2.9 The wordings discussed in paragraph 2.8 above have appeared also in paragraphs 11.4.5 and 11.6.4. We disagree with them, for the reasons stated in paragraph 2.8.2.

S. C. Sharma

M. P. Gupta

8th June, 2011