

187

INFRUCTUOUS AND AVOIDABLE EXTRA  
EXPENDITURE IN THE ACQUISITION OF  
CERTAIN SPECIAL PURPOSE NAVAL  
VESSELS

MINISTRY OF DEFENCE

HUNDRED AND EIGHTY-SEVENTH  
REPORT



LOK SABHA SECRETARIAT  
NEW DELHI

# HUNDRED AND EIGHTY-SEVENTH REPORT

## PUBLIC ACCOUNTS COMMITTEE (1989-90)

(EIGHTH LOK SABHA)

INFRUCTUOUS AND AVOIDABLE EXTRA  
EXPENDITURE IN THE ACQUISITION OF  
CERTAIN SPECIAL PURPOSE NAVAL VESSELS

MINISTRY OF DEFENCE



*Presented to Lok Sabha on 13-10-1989  
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**LOK SABHA SECRETARIAT  
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CORRIGENDA TO 187TH REPORT OF THE  
PUBLIC ACCOUNTS COMMITTEE (8TH LOK SABHA)

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Minutes of the sittings of the Committee held on :

29-11-1988 (FN)

27-12-1988 (FN & AN)

21-4-1989

16-8-1989

12-10-1989

13-10-1989

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\*Not printed (one cyclostyled copy laid on the Table of the House and five copies placed in Parliament Library).

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\*Elected w.e.f. 3-8-1989 *vice* Sarvashri Ch. Vijaykumar Raju, S. Jaipal Reddy and Saifuddin Chowdhary resigned from the Committee.

\*\*Nominated w.e.f. 18-8-89 *vice* Sarvashri Parvathaneni Upendra, Virendra Verma and Jaswant Singh resigned from the Committee.

## INTRODUCTION

1. The Chairman, of the Public Accounts Committee do present on their behalf this Hundred and Eighty-Seventh Report on Paragraph 55 of the Report of the Comptroller and Auditor General of India for the year ended 31 March 1987, Union Government (Defence Services) relating to infructuous and avoidable extra expenditure in the acquisition of certain special purpose naval vessels.

2. The Report of the Comptroller and Auditor General of India for the year ended 31 March 1987, Union Government (Defence Services) was laid on the Table of the House on 13 May, 1988.

3. The Committee have felt that the decision of the Government for supply and indigenous manufacture of SPVs in favour of firm 'B' was a logical one with reference to the facts reported to it from time to time and could not have been otherwise.

4. The Committee have been distressed over a delay of 18 months in the signing of the contract with firm 'B' after approval of the selection of firm 'B' by the CCPA on 30 June 1980, and this resulted in the payment of Rs. 21.33 crores as escalation between the date of the offer and the date of signing of the contract, in addition to a sum of Rs. 5.8 crores, as ex-gratia.

According to the Committee, it is evident from the difficulties that arose in finalising the contract, that, at the initial stages when the offers were obtained, notwithstanding sufficient time having been taken, adequate details were not obtained and the assessment of technical parameters was not as satisfactory as it ought to have been. The Committee have, therefore, emphasized that both Navy and the Ministry should draw appropriate lessons from this and take steps to avoid recurrence of such delays and consequential avoidable expenditure in future.

5. The Committee have found that the whole matter relating to listing and acquisition of B&D spares has been dealt with in a perfunctory and piecemeal manner. The original quotations for

spares of A&B firms, viz. Rs. 19.31 crores and Rs. 5.44 crores respectively were only budgetary or ad hoc figures neither fully reflecting India's spares philosophy nor comparable. In August 1979 itself it was decided to exclude B&D spares for comparative financial evaluation. The Committee have expressed surprise over the fact as to why in the CCPA paper, while making an overall comparison of the total cost of the two offers, the costs of spares was not excluded or shown separately, though the cost of spares was specifically excluded in the comparison of the estimated payments to the foreign yards.

The Committee have regretted that subsequently adequate efforts were not made to ensure that the spares requirements were listed and procured without delay resulting in avoidable cost escalations.

The Committee have emphasized the need to streamline the procedure for assessment and procurement of spares in a more timely and systematic manner in future.

The Committee have also recommended that the Ministry should take note of the lesson learnt from this experience in respect of evaluation and provisioning for spares to ensure better systems and accountability.

6. The Committee have recommended that comprehensive guidelines should be drawn up by Government with regard to the negotiations and implementation of defence contracts, so as to improve efficiency and effectiveness within the specified time frame. In the opinion of the Committee, the organisational structures and systems will have to be improved and streamlined to ensure better results and greater accountability in a world of increasing specialisation, speed and sophistication.

7. The Committee (1988-89) examined Audit Paragraph 55 at their sittings held on 29 November, 1988 (F.N.) and 27 December, 1988 (FN & AN). At their sitting held on 21 April, 1989, the Committee decided to consider the draft Report in the light of the suggestions made by some members at a future sitting. The Committee considered and finalised the Report at their sitting held on 13 October, 1989. Minutes of the sittings from Part II\* of the Report.

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\*Not Printed (one cyclostyled copy laid on the Table of the House and five copies placed in Parliament Library).

8. For facility of reference and convenience, the observations and recommendations of the Committee have been printed in thick type in the body of the Report and have also been reproduced in a consolidated form in Appendix II of the Report.

9. The Committee would like to express their thanks to the Public Accounts Committee (1988-89) for taking evidence on Paragraph 55 and obtaining information thereon.

10. The Committee would also like to express their thanks to the Officers of the Ministry of Defence for the cooperation extended to them in giving information to the Committee.

11. The Committee place on record their appreciation of the assistance rendered to them in the matter by the Office of the Comptroller and Auditor General of India.

NEW DELHI;  
October 13, 1989.  

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Asvina 21, 1911 (Saka)

P. KOLANDAIVELU,  
Public Accounts Committee.  
Public Accounts Committee.

## CHAPTER I

### BACKGROUND

1.1 In the context of the security environment of the country, the Naval Headquarters (NHQ) had first projected in 1968 the need for the acquisition of a certain type of special purpose vessels (SPV) for the Indian Navy. However, several constraints, mainly financial, as well as the need to make good other critical deficiencies of the Navy, inhibited action to make up the shortcoming in this respect. Though a comprehensive review of defence requirements in 1973 recognised the operational need for the SPV, funds could not be provided for the project from within the limited resources then available. The same situation persisted when a review was conducted in 1975.

1.2 Later, the Committee on Defence Planning held a series of meetings on the Defence Plan for 1979-84 and pending submission of recommendations on the totality of the Defence Plan, it recommended the acquisition of the SPV for the Indian Navy which was considered as one of the more urgent items for Defence Plan of 1979-84.

1.3 The Staff requirements (SRs) of SPV were drawn up by the Navy in January 1977. As a result of efforts made to explore sources known to have expertise in the field for competitive collaboration, a delegation of Navy experts visited the shipyards in three countries (i) in June 1977 and by the end of 1977, two more countries also showed interest and offered their proposals. In all, eight proposals were received from these five countries between 1976 and 1978.

1.4 The NHQ conducted detailed technical discussions with the different shipyards on the basis of their offers and made an evaluation, the results of which were given in a comparative statement. The system of evaluation then adopted, was based on awarding marks for two areas into which the technical aspect of the projects was divided namely (i) matrix for best vessel (1000 marks) (ii) matrix for terms of collaboration (1000 marks).

1.5 On the basis of its analysis and scrutiny of the eight offers, the NHQ recommended further consideration of three of the offers for selection of one out of them for possible collaboration for the

acquisition and production of SPVs; the remaining five types were not found suitable for the operational needs of the Navy. A general examination of the offers by the Ministry of Defence indicated that the total outlay for acquiring 2 SPVs abroad and building 2 SPVs in India would be of the order of Rs. 350 crores, involving free foreign exchange to the extent of Rs. 275 crores. This estimation did not, however, include the investment (roughly estimated at Rs. 10 crores) to be made by the selected Indian shipyard. It was then expected that the first SPV from the foreign shipyard would be delivered within 4—5 years and the first SPV indigenously constructed to be available within 6 to 8 years after conclusion of the agreement.

1.6 Based on the above assessments, the Ministry sought and CCPA granted in February 1979 approval (i) in principle for procurement and indigenous construction of the SPVs and (ii) for the setting up of a Project Negotiating Committee (PNC) for examination of all the eight offers and a comparative evaluation of and negotiations on the various competing proposals.

1.7 In the first meeting of the PNC held on 9th March 1979, the representative of the NHQ produced a background paper and explained the basis on which the SRs had been drawn up. The PNC was also informed that the SRs were provided to representatives of the different competing shipyards in the course of their technical discussions with NHQ in the later half of 1977. The evaluations of the offers were explained by the NHQ to the PNC and based on the same, the PNC agreed to shortlist the offers to four and send a delegation to these shipyards only. According to tentative time schedule, considered in the PNC meeting, visits to the foreign shipyards were planned in April—May 1979, final decision and selection in July 1979 and issue of letter of intent in August 1979.

1.8 In the PNC meeting of 16-3-1979, a Public Sector Undertaking (PSU) was selected as the Indian shipyard for construction of the SPVs, (later cleared by the CCPA also). It was also decided that a Naval delegation and a delegation from the PSU would be sent to the various countries for evaluation of their offers. During April—June 1979, a team of Naval experts headed by the then Deputy Chief of Naval Staff (DCNS) as a part of an Inter-Ministerial delegation led by Additional Secretary (Defence) visited the 4 shipyards for making an on-the-spot evaluation of the offers and also for discussions with the top managements of the parties concerned.

and senior officials of the concerned Governments. The evaluation from the collaboration angle was done by the Department of Defence Production in association with the PSU.

1.9 After return of the delegation, the PNC met on 15 June 1979, 28 June 1979, 11 July 1979 and 13 July 1979 to evaluate the offers both from technical and financial angles. The PNC in the meeting held on 11-7-1979 took note of the fact that the financial statement compiled by the Ministry of Finance (Defence) was merely a statement of the quotations received from the various shipyards and that they were not comparable as the shipyards had made different assumptions and also had different understanding/approach to the various points. The PNC hence decided that the most desirable course to be adopted would be to hold discussions with the shipyards so as to obtain "the best offers from them in respect of the variation formula and terms of payment before coming to the details of the price package itself". The discussions with the shipyards were scheduled to be held from 16-7-1979 for which the preparations, questionnaire, etc. were finalised in the meeting of the PNC held on 13-7-1979.

1.10 The results of the discussions with the shipyards and the additional materials obtained from them came up for consideration in the meeting of PNC held on 3-8-1979 and it was decided that the draft CCPA paper would be considered in the next meeting of PNC. In the meeting of PNC held on 4-9-1979 the draft CCPA paper came up for consideration. At the end of the discussions, the PNC decided that the NHQ would prepare the final part of the draft CCPA paper bringing out the views of the PNC and seeking approval of the CCPA for further short-listing of the offers to the technically best two (Firms 'A' and 'B') and for procurement of 4 SPVs in all, one or two to be procured from abroad and balance to be built in India.

1.11 In the meeting of the PNC held on 27 November 1979, the CCPA paper as finalised was decided to be sent by 28-11-1979 to the Cabinet Secretariat. The PNC also decided that on receipt of CCPA's decision, the two shortlisted shipyards would be requested to extend the validity of their offers upto 31 March 1980; the PNC also observed that even though contract stage might take some more time, it did not favour requesting the shipyards to extend the validity of their offers beyond 31 March 1980 at that stage.

1.12 Subject to approval of CCPA to the proposals of PNC, the PNC decided in the meeting held on 25 February 1980 to send a

delegation to the two foreign shipyards for further negotiations and the validity of the offer was also got extended upto June, 1980 by the Ministry.

1.13 On 10th April, 1980, the CCPA gave approval to the proposals for the shortlisting of the offers to two, viz firm A and firm B and for further negotiations for procurement of 4 SPVs in all on the basis of two SPVs to be built in foreign yards, and two to be built in India. Accordingly a delegation led by the then Addl. Secretary, Ministry of Defence and consisting of representatives of Ministries of Defence, Finance and Law, the NHQ and the PSU left for visiting the foreign countries for negotiations on 26 April 1980.

1.14 Subsequent to the departure of the delegation, Firm C of Country Y brought to the notice of the Government of India that on account of its qualitative superiority, another foreign country was entering into a collaboration agreement with it for procurement of SPV and requested that the shipyard of firm C might also be given an opportunity to discuss its offer with the Indian delegation, then on a visit to its country. This proposal was agreed to by CCPA on 1 May 1980 and suitable instructions accordingly given to the delegation.

1.15 After the return of the delegation the reports of the individual members (including a report of the NHQ dated 16 May 1980) were read out in the meeting of the PNC held on 17 May 1980 and discussions held. A CCPA paper was thereafter prepared and submitted on 20 May 1980 to the Cabinet Secretary, incorporating the views expressed by the members of the delegations, the technical evaluation of the three offers, the final offers obtained during the visit of the delegation, etc. Subsequent to the preparation of the CCPA paper, as a result of additional inputs received certain modifications in the evaluations of the offers took place, these modifications were orally reported to the CCPA. In the meeting of the CCPA held on 30 June 1980, firm B of country Y was selected for acquisition of the SPV.

1.16 Two agreements with firm B, one for purchase of 2 SPVs and another for construction of 2 SPVs in India, were finalised in December 1981. The two SPVs to be built abroad were delivered in September 1986 and November 1986, the delay in delivery of the first SPV being 7 months and delay for the second 3 months; for these delays, penalties amounting about Rs. 250 lakhs were levied from firm B. The construction of the 2 SPVs by the PSU, which was to be completed in 1987 and 1988 respectively, is expected to be

completed in 1990 and 1991. The total payments for the two SPVs built abroad amounted to Rs. 173.97 crores (approximately) and upto September 1988, a sum of Rs. 134.90 crores had been paid to firm B for material packages for the 2 SPVs to be built in India.

1.17 Audit has pointed out in paragraph\* 55 of the Report No. 2 of the Comptroller and Auditor General of India for the year ended 31 March 1987 that:

- (i) the price evaluation of the offers of firm A and firm B was defective in as much as abnormal differential in the cost of spares was not analysed and this led to much higher costs being incurred on spares subsequently;
- (ii) the offer of firm A was lower by Rs. 11.41 crores over the offer of firm B;
- (iii) the delays in arriving at a satisfactory memorandum of understanding (MOU) with the foreign Government resulted in an *ex-gratia* payment of Rs. 5.8 crores and extra expenditure of Rs. 21.31 crores due to escalation clause; and
- (iv) the right of rejection in connection with the technical parameter, of "self-noise" was not insisted upon in the agreement with firm B.

1.18 This Report of the Public Accounts Committee is based on the Audit paragraph mentioned above. The second chapter of this Report deals with the selection of firm for procurement of SPVs the third chapter with the contract finalisation, the fourth chapter with spares and the fifth chapter with the construction of SPVs in India.

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\*Appendix I

## CHAPTER II

### SELECTION OF FIRM FOR PROCUREMENT OF SPVs

#### A. Technical evaluation

2.1 Subsequent to the initial technical evaluation done in 1979, the evaluation matrix of the NHQ had been changed by adding an extra aspect of maintenance of logistic support, which was awarded 800 marks; the total marks for best vessel were also raised from 1000 to 2000 and for transfer of technology from 1000 to 1200 marks.

2.2 The comparative position according to the revised matrix formula as assessed by NHQ after return of the delegation in May 1980 in respect of the three firms was as follows:

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Aspect considered	Max. Marks	Firm A	Firm B	Firm C
Best vessel . . . . .	2000	1716	1709	1557
Maintenance and logistic support . . . . .	800	645	695	610
Transfer of technology . . . . .	1200	1060	1130	905
	4000	3421	3534	3072

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2.3 The table above would indicate that, firm B secured 3534 marks, closely followed by firm A with 3421 marks and firm C was far behind with only 3072 marks.

2.4 According to the technical evaluation note of the NHQ dated 16 May 1980, while firm 'B' had become best from the overall technical and operational angle, closely followed by firm 'A',

firm 'C' would be the least suitable from these angles. The NHQ had therefore, recommended that as far as technical and operational evaluations were concerned, offers of both firms 'A' and 'B' were about equal but that the offer of firm 'C' did not meet their requirements. The NHQ also stated that the final choice between the offers of firm 'A' and firm 'B' should be made on the basis of financial consideration and the amount of support given by the respective Governments/Navies.

2.5 According to views expressed by the members in the meeting of the PNC, firm 'B' had a definite edge over the other two shipyards in the matter of designing SPVs because of their association with a reputed design agency and this design agency helped in keeping firm 'B' abreast of the latest development in SPV design technology.

2.6 During the visit to the shipyards in April-May 1980, the representatives of the Ministry and the PSU had further discussed the matter relating to the transfer of technology for the construction of the SPVs in India with reference to certain specific points for further evaluation. From the evaluation so done, it was noticed that all the three shipyards were generally agreeable to the requirements of India in respect of transfer of technology and supply of materials for SPVs to be built in India. On the basis of the assessment made regarding the transfer of building technology, the PSU had stated that it was most to gain from association with firm 'B' due to its long and continued experience in SPV construction and links with a specialised dedicated design agency. In view of the fact that firm 'C' had started construction of SPV for another country, the PSU considered that shipyard to be the next best from the point of view of transfer of technology and firm 'A' was given the third place.

2.7 In the note of the NHQ dated 16 May 1980 (forming part of CCPA paper) it was observed as under:

"Considering the above evaluation, Naval Head-quarters considers that only the SPVs\* of firm 'A' and 'B' meet

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\*Wherever quotations are given in this page and in later pages, words underlined have been substituted to maintain anonymity.

our requirements in all aspects of the SPV and transfer of technology. Offer of firm 'C' does not meet our requirement. Though the offer of firm 'B' had several advantages due to the experience of this yard in building SPVs for several foreign navies as well as building shipyards in foreign countries, the main drawback of the offer is the lack of wholehearted support of the Government and the fact that the ammunitions have not been released to us so far. In the event the ammunition is eventually not released to us, the offer of firm 'B' must be rejected. This also applies to the offer of firm C.

The advantage of the offer of firm 'A' is that India will be the first country buying SPVs from country 'X' and had therefore attracted complete support of the Government and the Navy to the project".

2.8 In their concluding remarks the NHQ observed as under:

"Recommendations—both firm 'A' and firm 'B' are about equal as far as technical evaluation is concerned provided the ammunition is released and the *new engine trial* proves successful. Firm 'C' lags behind by fair margin on this score. The final choice should be made on the basis of the quality of support and cooperation that may be expected from the foreign Government and their Navy and on financial considerations."

The above position on technical evaluation was brought to the notice of the CCPA in the paper finalised on 18/20 May 1980.

2.9 Subsequent to the finalisation of the CCPA paper of 18/20 May 1980, the NHQ made certain changes in technical evaluation through their notes dated 19-6-1980 and 30-6-1980 on the basis of clarifications obtained on certain technical aspects. The combined

effect of the two revisions of the matrices is shown in the table below:

Matrices	Maximum marks	Firm A			Firm B			Margin of difference (Firm B More+) Less (-)		
		CCPA Paper	1st/re- vision dt. 19-6-80	2nd re- vision dt. 30-6-80	CCPA paper	1st re- vision dt. 19-6-80	2nd re- vision dt. 30-6-80	CCPA paper	1st re- vision dt. 19-6-80	2nd re- vision dt. 30-6-80
Best Vessel . . . . .	2000	1716	1716	1732	1709	1558	1558	(-)7	(-)158	(-)174
Maintenance (Logistic support) . . . . .	800	645	645	675	695	695	695	(+)50	(+)50	(+)20
Transfer of Technology . . . . .	1200	1060	1060	1060	1130	1130	1130	(+)70	(+)70	(+)70
	4000	3421	3421	3467	3534	3383	3383	(+)113	(-)38	(-)84

The table above would indicate that as against initial difference of 113 marks in favour of firm B, that final evaluation indicated an overall difference of 84 points in favour of firm A and that whereas under transfer of technology as also maintenance and logistic support, firm B continued to retain more marks, under best vessel firm A scored more marks.

2.10 In the context of the revision in the technical evaluation, the NHQ brought to the notice of Ministry of Defence in its note dated 30.6.80 that the technical comparisons and observations relating thereto, in the CCPA paper dt. 18/20 May 1980 would need to be amended. In another note, also of the same date (30.6.1980), in which the latest revised matrices were conveyed to the Ministry, the NHQ reiterated their earlier observation of 19.6.1980 and stated:

“Naval Headquarters opine that the marginal differences in the overall matrix between *Firm B* and *Firm A* should not be given too great a weightage and either of the SPVs will be suitable to us.”

2.11 In regard to the noise parameter for which 151 marks were deducted from firm B in the first revision of 19-6-80 (as a result of which firm A scored over firm B in the revised technical evaluation), NHQ observed as under (reiterated on 30-6-1980 also):

“However, the noise estimation is a nebulous area and thus cannot be accurately worked out due to absence of proper data. None of the yards has provided the methodology used by them for estimating these as well as hydrological conditions for the figures given and their replies have been vague and guarded on this aspect.”

2.12 According to an official note\* of Addl. Secretary dated 30-6-80 (approved by RRM), the modifications that took place in the evaluations were incorporated in a draft supplementary CCPA paper and contents of this paper as also the changes made subsequent to the preparation of the draft supplementary CCPA paper were brought to the notice of the CCPA orally.

### *B. Collaboration with foreign Government*

2.13 The Governments of the concerned countries were reported to have been sounded in the previous year (1979) for indicating their support and assurance for continued un-interrupted supplies and services relating to the SPV, equipment and technology, to be incorporated in an inter-Governmental MOU. Subsequently, a draft MOU was also forwarded to the concerned Governments, the principal objective of concluding MOU being to seek the assurance of the concerned foreign government to the Government of India

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\*Copy of note given in a subsequent para.

that no restriction or embargo would be placed in successful implementation of the total programme consisting of import of SPV, associated equipment and documents as well as transfer of technology and material packages for construction of SPV in India. This assurance was considered important in view of the long life cycle of the project covering a period of 20 to 25 years. It was indicated that the concerned Governments had shown keen interest in the project and had previously agreed to conclude the MOU with Government of India for this purpose. During the course of the visit of the PNC in April-May 1980 to the two foreign countries, the representatives of both the Governments had given alternative draft MOUs which were discussed at length. At the conclusion of the discussions with the authorities of country 'X' the draft MOU as agreed, provided for continued support as well as un-interrupted supply of SPV, equipment technology, know-how and information relating to the total programme, subject only to unconditional impediments enumerated in one of their laws which provided guidelines for export of war materials from Country 'X'. The impediments were identified in the CCPA paper as undertakings in an international agreement, a resolution of the UN Security Council or rules of international law governing export from a neutral country during war time.

2.14 The draft MOU circulated by the authorities of country Y, was stated to be in the nature of an administrative agreement between the Defence Ministers of the two countries, providing for clearance of export of SPVs and their manufacture with technical collaboration in India; it provided general support of the Government in regard to technical advice, quality assurance, service, training facilities and other related matters. This draft, it was pointed out in the CCPA paper, did not include a specific assurance of the foreign Government for not imposing any prohibition or restriction during the life time of the project. During the course of the discussions, the foreign Government, however, agreed to include the following in the MOU:

"The Government of Y declares that, subject to the constitutional and legal provisions of *Country Y* and in accordance with the political principles governing the export of armaments and related material, any permits necessary during the life of the Project will be granted."

2.15 It was pointed out in the CCPA paper that the authorities of country 'X' had shown a greater degree of appreciation and agreement to the Indian point of view and that the reluctance of

the representatives of country 'Y' in not going as far as Indian Government wanted to, was apparently more out of lack of authority than keenness on their part. The CCPA paper concluded in this regard with the observation that if decision was to go for SPV of country 'Y', the matter would have to be negotiated further with the authorities of country 'Y'.

2.16 Subsequently, before the CCPA took decision on the proposals, Government were informed by the Indian Embassy that the appropriate authority in Country Y had cleared the SPV project, export of ammunition and change to be incorporated in the wording of the MOU. This position was incorporated in the supplementary draft CCPA paper (referred in an earlier paragraph).

### *C. Delivery Schedule*

2.17 The following delivery schedule as offered by the three firms, was indicated in the CCPA paper.

Vessels*	In months		
	Firm A	Firm B	Firm C
1st	57	46	54
2nd	63	52	60
3rd	74	66	70
4th	80	74	76

\*(Vessels 1 and 2 represented SPVs to be built abroad and brought to India. Vessels 3 and 4 represented SPVs to be built in India by the PSU with the help of the material packages).

2.18 This firm B had the more expeditious/construction schedule of vessels. No modifications in the time schedule were offered by any of the firms after the CCPA paper of 18/20 May 1980 was prepared, though firm A stated in a letter dated 29 June, 1980 as under:

“With reference to our shipbuilding contract we are pleased to inform you that after further consideration, we are prepared to state the following :

During negotiations held in Delhi in July 1979 and in country X in May 1980, it became evident that the

Indian Government wishes to have as early a delivery schedule as possible for its new SPVs.

*Firm A* has gradually been able to offer a reduced scheme for delivery and will certainly continue this effort to reach even earlier a time of delivery and very much hope to achieve the same.

In order to express our sincere attitude, we are prepared to delete escalation for that part of the 12 month period preceding contractual delivery which we have not succeeded to catch up with."

#### *D. Financial evaluation*

2.19 In the CCPA paper dated 6 March 1980, it was indicated that all the firms had argued during the negotiations that the prices quoted by them were with reference to then costs of production, quite reasonable and contained no cushions and that except firm A, the other firms did not, during negotiations, offer any price reduction. It was also pointed out that the firms, however, agreed to reconsider and submit their final offers which had since been received and that while firm A had given certain reductions, firm B had given no worthwhile reduction in the price. A financial evaluation without indicating effects of escalation was prepared, based on the revised offers and was appended to the CCPA paper approved on 10 April 1980; this evaluation indicated that the offer of firm A was lower than that of firm B with reference to February 1979 price level.

2.20 During the visits to the foreign countries X and Y in April-May 1980 the firms were reported to have been asked to give the final offers. Thereafter firm A had given a modified offer on 12-5-1980 wherein it mentioned as under:

"It is unfortunately not possible for us to reduce the above price further."

No modified offer was received from firm B.

2.21 Based on the final offers so obtained, comparative total cost including payments in free foreign exchange to be made to the foreign yards for the construction of two SPVs abroad and two

in India was drawn up and the final position which emerged as follows was mentioned in the CCPA paper of 18/20 May 1980:

Firm	Total cost excluding Budgetary quotation for Ashore spares	Payment to foreign yard (including ammunition but excluding budgetary quotation) for Ashore spares*
		(Rs. in crores)
A . . . . .	328.27	274.25
B . . . . .	342.55	286.78
C . . . . .	343.93	285.81

\*The budgetary quotations for ashore (base and depot) spares (B&D Spares) were :

Firm A . . . . .	Rs. 19.31 crores
Firm B . . . . .	Rs. 5.44 crores
Firm C . . . . .	Rs. 5.61 crores

2.22 The above calculations had been made on the basis of the quotations of the shipyards at February 1979 prices and no element of escalation had been included in the above costs. After applying the escalation of 9 per cent, 5 per cent and 5 per cent per annum given by firms A, B, C respectively with reference to February 1979 price level, the payment to foreign yards (excluding ammunition) at February 1980, February 1981 and February 1982 levels was estimated as under:

	(Rs. in crores)			
	Feb. 1979	Feb. 1980	Feb. 1981	Feb. 1982
Firm A . . . . .	212.87	229.57	246.27	262.96
Firm B . . . . .	225.92	236.73	247.54	258.35
Firm C . . . . .	224.95	238.16	251.36	264.57

2.23 After applying the escalation till the completion of the project according to the delivery schedule for all the four SPVs to the Indian Navy, the approximate cost excluding ammunition) was estimated as under:

Firm A . . . . .	Rs. 403 crores
Firm B . . . . .	Rs. 332 crores
Firm C . . . . .	Rs. 377 crores

2.24 With due regard to the above financial evaluation, it was observed in the CCPA paper that from the financial evaluation of the offers made in conjunction with the escalation over the years, the offer of firm 'B' would be considered the cheapest as they had offered the best delivery period and a lower ceiling for escalation (5 per cent by firm B as against 9 per cent by firm A). In regard to the ammunition, it was pointed out that the offer of Government 'Y' was marginally lower than the offer of Government 'X' as at February 1979 prices shown below:

Govt. 'Y' . . . . . Rs. 60.856 crores

Govt. 'X' . . . . . Rs. 61.375 crores

It was also indicated in the CCPA paper that the selection of ammunition should go along with the ultimate selection of the SPV.

2.25 The financial evaluation, as appended to the CCPA, also indicated under "Terms of Payment", the following provisions to govern the payments to be made to firms A, B and C:

(i) *Firm A*

"10 instalment of 10 per cent per SPV. 25 per cent on order,

65 per cent against documents, 10 per cent one month of receipt of material packages."

(The above terms seem to indicate that for SPVs to be built abroad, cost would be paid in 10 equal instalments whereas for SPVs to be built in India, all payments would be completed within one month of receipt of material packages in India).

(ii) *Firm B*

"30 per cent Down 5 instalments of 10 per cent and 4 instalments of 5 per cent."

(According to the above terms, as soon as contract agreement is signed, 30 per cent of total price should be paid and balance to be paid in 9 instalments, to be spread over the entire period of contract).

(iii) *Firm C*

"10 instalments of 10 per cent for SPV."

(Firm C had offered acceptance of total contract payments in 10 equal instalments to be spread over the entire contract paid).

2.26 In the context of the above, the Ministry of Defence recommended to the CCPA that subject to the clearance of ammunition and satisfactory acceptance of the essential features of the MOU by Government 'Y', the SPV of firm 'B' be selected for procurement and manufacture in India in collaboration with firm 'B'.

2.27 After the date of drafting of the CCPA paper viz. 18/20 May 1980, several changes having financial implications on the offer were made by firm 'A' by as many as five letters. By a letter dated 9 June, 1980 the escalation which was earlier stipulated at 9 per cent per annum, yearly compounded from the base period February 1979, was reduced to 8 per cent per annum and thereafter further reduced to 5 per cent per annum (yearly compounded) by a letter dated 16 June 1980; in the same letter of 16 June 1980, the basic price was, however, increased by Rs. 2.96 crores. The above two reductions in escalations and increase in basic price were taken note of in preparing a revised financial evaluation to supplement the Cabinet paper already submitted. Even after taking note of this revision, the estimated cost of firm B's offer was found to be cheaper than that of firm A, *vide* details below:

Escalated cost upto 1984 (excluding B&D spares):

Firm A Rs. 289.23 crores (\*escalated till February 1985)

Firm B Rs. 279.96 crores (escalated till February, 1984).

2.28 Thereafter by a letter dated June 28, 1980 the following clarifications were given by firm 'A':

- (i) The basic price of the ship building contract included cost of training and cost of refit documentation;
- (ii) Know-how contract price (Rs. 25.49 crores) was a fixed price and prices of ship building contract and material packages were subject to escalation.

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\*Firm 'A's' delivery period being longer their offer would have attracted escalation for one more year. However, later on, Firm 'A' agreed not to charge escalation for the last 12 months.

2.29 By a letter dated June 29, 1980 firm 'A' offered 2.5 per cent rebate if the order was placed in a stronger currency, (namely that of country 'B') at the exchange rate prevailing on the date of signing of the contract.

2.30 By a second letter dated June 29, 1980, (copy given in an earlier part) firm 'A' stated that it was prepared to delete escalation clause for "that part of the 12 month period preceding contractual delivery which we have not succeeded to catch up with". (about 11 months as per statement of delivery period given in an earlier paragraph).

2.31 The implications of these changes were incorporated in a third financial evaluation which indicated the following position:

	FIRM 'A' FIRM 'B'	
	(Rs. in crores)	
1. Foreign Exchange Payment Feb. 79 level excluding B&D spares .	210.41	225.92
2. Foreign Exchange Payment Feb. 79 level including B&D spares .	229.72	231.36
3. Escalated upto 1984 (excluding B&D spares) . . . . .	268.55	279.96
4. Escalated upto 1984 (including B&D spares) . . . . .	292.58	286.76
5. Total project cost (Delivery of all 4 vessels excluding ammunition) . . . . .	340.00	332.00

2.32 The various modifications upto 19 June 1980 which were incorporated in the draft supplementary CCPA paper, as also changes made upto 29 June 1980, were brought orally to the notice of CCPA according to the official note recorded in this regard.

2.33 According to the audit paragraph, the offer of firm 'A' became lower by Rs. 11.41 crores over the offer of firm 'B' after taking into account the modifications effected upto 29 June 1980 by firm 'A' (vide item 3 of statement above). Based on a request made to audit on 9th April 1989, the calculations of the last financial evaluation dated 30 June 1980 were subjected to a recheck. Audit pointed out in its letter dated 13 April 1989 that the fixed portion of the price for knowhow contract relating to the offer of firm 'A' (approximately Rs. 25 crores) was wrongly included in the figures to be escalated and that if escalation to this portion is excluded as

per firm 'A' letters dated 29 June, 1980 the offer of firm 'A' would have been cheaper by Rs. 18.25 crores over the offer of firm 'B'.

*E. Reasons for not amending CCPA paper*

2.34 As a comprehensive CCPA paper taking note of all modifications upto 30 June, 1980 was not prepared, the Committee enquired the reasons therefor during evidence. The Defence Secretary stated as under:

"The Hon. Member has suggested that a consolidated note is necessary. But we were on the 30th June. Letters were flowing from these company representatives, sitting in a hotel. There should be a limit upto which we can go on doing it."

2.35 Clarifying further on the issue, the Defence Secretary stated:—

"Developments were rather rapid. You can certainly ask as to why a third paper was not prepared. When repeated changes are made by one or more of the parties, why that can't be done is that there is a set procedure for submitting a paper to the CCPA. Here the date is 30th June, 1980. Therefore, it was necessary to bring it orally and it was recorded in the note."

He also observed:

"A paper which goes to the Cabinet is drafted, cleared and approved by the Minister himself before it is presented. If it comes on the 30th, there is no time to prepare this note and submit the same to the Cabinet on the same day. Therefore, it was presented orally".

2.36 In response to the observation of a Member "I would only be saying that no date is sacrosanct. Such extension was given earlier. Similar extension could have been sought if consideration had been given to those factors", the Defence Secretary responded as under:

"I cannot contest the saying that no date is sacrosanct. This particular matter had been under consideration for seven years already. In one sense, it has been under consideration for 12 years. It is certainly possible that the longer we consider the better it would be. It is also possible that longer the consideration, the greater the disadvant-

ages for the fighting forces as well as for possible escalation. These are the conjectural aspects. I am only submitting that all the facts are with you."

2.37 Asked to state whether the validity period could not have been further extended, the Defence Secretary stated as follows:

"I would submit it is true that in several of these cases, we go on requesting the parties to extend the validity period. But sometimes they agree and sometimes they do not agree. There is a limit to it. When the negotiating team went abroad in May 1980, they had been made sufficiently aware and were reportedly asked, is this the last offer. And they were assured that this was the last offer, the details of which are with the Hon. Committee. There must be finality to the negotiations. I want to submit that at some point of time, Government has to make up its mind to place the orders."

2.38 In response to the observation on the failure of the Government to extract even one concession in the offer of firm 'B', the Defence Secretary observed as under:

"They did not change at all. I would like to submit that under these circumstances one would have to consider the party which is steadfast, as much better party to deal with than the one which goes on repeatedly changing."

2.39 In regard to the overall assessment of the two offers, the Defence Secretary observed as under:

"Technologically, both the SPVs were comparable. The NATO concern was not considered a matter of worry in the political judgement. Financially, it was considered that firm 'B' would be marginally cheaper for the country. Firm 'B' already supplied identical models, while firm 'A' had not yet supplied these SPVs. Then, the delivery of firm 'B' was substantially earlier by about one year. It was an important point."

2.40 Asked to indicate whether all the letters and all the financial inputs etc. were incorporated in the CCPA note, the Defence Secretary clarified that they were incorporated in the decision making process, that they were orally reported to the Cabinet and that what was reported orally had been placed on record in a note which reads as follows:

"Our proposal regarding SPV collaboration project came up for consideration of the Cabinet Committee on Political affairs today. Defence Secretary and I were in attendance.

2. Apart from the salient features of the proposal contained in the Cabinet Note dated 18|20 May 1980 the position about three items covered by the Supplementary Note was also explained. This Note had earlier been seen by R.R.M. and PM's Sectt.
3. Cabinet was also apprised about the points obtained by firms 'A' and 'B' in the matrix relating to technical and operational evaluation carried out by the Naval Headquarters. It was stated by me that as per our Cabinet Paper of 18th|20th May, 1980 firm 'B' was ahead of firm 'A' by 113 points in the overall matrix. On a further clarification obtained about the noise level of firm 'B' vessel, the position underwent some change and firm 'A' took a marginal lead of 38 points. The position had further changed as per note of the Naval Headquarters dated 30th June, 1980 whereby the lead of firm 'A' increased i.e. from 38 to 84 points. It was also pointed out that according to Naval Headquarters assessment both the vessels of firms 'A' and 'B' are broadly on the same footing both technically and operationally and meet their staff requirements. The vessel of firm 'C' however, does not suit the Naval requirements. The possible implications of NATO connection of country 'Y' were also pointed out.
4. The financial implication as a result of the modified offers made by firm 'A' vide their letters dated 16th June, 1980, 28th June, 1980 and 29th June 1980, were also intimated to the Cabinet Committee.
5. After the Cabinet meeting, Defence Secretary and I were informed by the Cabinet Secretary that the proposal of MOD has been accepted. Being the last day of the validity of existing quotations, it was suggested that we may intimate the position to firm 'B' so as to cover the legal position. After consulting Defence Secretary and RRM, a cable as at Encl. 27-A\* was issued. Shri S. K. Banerjee Solicitor and Addl. Secy. Ministry of Law, was also consulted about the draft of the cable. Copies of the cable

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\*Not appended to this Report.

were sent to Secy. to P.M. and Cabinet Secretary for information.

6. Minister may also like to see.”

The above note was seen by RRM.

*Evidence of the Ex-Chief of Naval Staff*

2.41 The Committee took the evidence of Admiral Pereira (Retd.) who was the Chief of Naval Staff (CNS) during the period of finalisation of contract for acquisition of SPVs. He told the Committee that as this had happened about 8 years back, many details could not be recollected but that the general points and aspects of the SPV deal were still fresh in his mind. In his evidence he initially summarised the entire deal leading to the submission as under:

“The findings of the valuation team which in my opinion was a very fine and professional team, were that the SPV of firm ‘A’ were by far the best.”

“The crux of the issue was that we were not only looking for SPVs but more importantly for transfer of technology... our view was that firm ‘A’ was extremely open-minded. They were in fact, bending over backwards to please us.....”

“Firm ‘B’ was, in my personal view, not half as open..... They also left us with an impression that they always tried to cloud the transfer of technology in legal words. In fact, I often remember that the evaluation team and the NHQ were not very sure of what firm ‘B’ were trying exactly to give us.”

“As far as technical evaluations of both were concerned, there was not a great deal of difference. We still preferred firm ‘A’ as I was most concerned with the transfer of technology which was the nub of the whole problem and their offer was loud and clear on this aspect”.

2.42 The evaluation notes compiled by NHQ upto the date of decision by CCPA had, however, indicated that firm ‘B’ was better qualified in transfer of technology as compared to firm ‘A’ and better marks had also been scored by firm ‘B’ (1130 marks to firm ‘B’ as against 1060 to firm ‘A’). Confronted with this data, which was in conflict with his evidence, Shri Pereira changed his observations at this stage and stated:

"In the transfer of technology, *firm 'B'* came one up. But in the totality of the project *firm 'A'* were higher. In did not totally trust *firm 'B'...*"

2.43. Asked to state whether his opinion of firm 'B' was subjective, he said, "It is right".

2.44 Asked to specify objective facts, he observed:

"In my opinion, in the transfer of technology, *firm 'B'* were slightly superior but they were not superior in the totality of the deal."

In regard to the financial evaluation, Shri Peroira observed:

"We ultimately had to face the Ministry of Finance, who had eventually boiled the whole issue down to rupees and naya paise. *Firm 'B'* as I remember, kept dropping the prices and *firm 'A'* were somewhat higher. There was an escalation clause that kept putting one upon the other, and ultimately, I was faced with a problem that looked as if *firm 'B'* were cheaper."

2.45. He was not however, questioned on the correctness of his observation though it was firm 'A' and not firm 'B' that kept dropping the prices.

2.46. On the technical aspect relating to noise level, Adm. Peroira observed:

"But noise levels in SPV are very difficult to ascertain. It is very difficult to get an objective and precise view on this. It is necessary that they have got to be noise ranged and no one likes to be told that the noise level of his SPV is more than the other. Merely being informed of the noise levels without statistical data that can be mathematically checked, is a subjective assessment."

**2.47 The Committee note from the CCPA paper dated 20 May 1980 that 4 factors, viz. (i) technical evaluation, (ii) delivery schedule, (iii) extent of cooperation from the Government concerned and (iv) financial evaluation were considered relevant for selection of the firm for supply of the SPVs.**

**2.48 The technical evaluation factor was sub-divided into three categories viz. (a) best vessel, (b) maintenance and logistic support and (c) transfer of technology. The Committee note that whereas firm 'B' was throughout considered superior both by the NHQ and the PSU on categories (b) and (c), the difference in favour of firm 'A' in respect of category (a) was 7 marks as on 20 May 1980 out**

of a total of 2000 marks and this increased to 174 marks as on 30 June 1980, mainly because marks of firm 'B' under this category was reduced by 151 marks from 1709 to 1558 as given in the table on a previous page\*. The Committee also note that while reducing the marks in June 1980 from the marks given earlier to firm 'B' in May 1980, the NHQ had qualified its reduction with the observation that the noise factor for which reduction was made as "a nebulous area and thus cannot be accurately worked out due to absence of proper data". In this connection the Committee note that the offer of firm 'A' as it turned out after the final revision as late as 30 June 1980, was only marginally in excess of the evaluation marks that were awarded to firm 'B' considering the fact that the maximum marks were 4000 and the net difference between the offers was only 84. The Committee feel that the difference is marginal and not decisive, particularly when the NHQ had stated both on 19.6.1980 and on 30.6.1980 that the marginal differences in the overall matrix between firm 'A' and firm 'B' should not be given too great a weightage and that either of the SPVs would be suitable to them. The Committee also note that firm 'A' had not supplied any SPV to any outside country whereas firm 'B' had actually supplied SPVs to several countries and had an established reputation in the international market.

2.49. In respect of category (c) viz. transfer of technology the Committee note that firm 'B' had throughout maintained a lead. In this connection the PSU which was vitally concerned with this evaluation was categorical in its observation that in view of the past experience of firm 'B' in building SPVs for other countries as also the association of firm 'B' with a reputed design agency, their preference for collaboration was for firm 'B'.

2.50 With regard to the important factor of delivery schedule, the Committee note that firm 'B' always had a shorter delivery period than firm 'A' by about 11 months. The Committee also note that even as late as 29 June 1980, firm 'A' had specifically accepted that it had not succeeded in catching up with the delivery period offered by firm 'B'. The Committee are of the view that the delivery period is an overriding consideration especially in defence matters. Even with regard to transfer of technology, which is of paramount importance, firm 'B' was always considered distinctly better than firm 'A'.

2.51 Though the NHQ had, at one stage, stated that better co-operation could be expected from country 'X', as that country would be supplying SPV for the first time outside their country, the Committee are of the view that the extent of cooperation that could be expected from the concerned Government over the long cycle of the project, is largely a matter of political judgement of the Government.

2.52 With regard to the factor, financial evaluation, the Committee note that even before the departure of a delegation to countries 'X' and 'Y' in April 1980 the firms had given what was stated to be their final offers based on which the evaluations were done for the CCPA paper dated 8 March 1980. The Committee also note that despite this position, another revised offer had been received on 12 May 1980 from firm 'A' in the context of the discussion held during the visit of the Indian delegation in April-May 1980 and that firm 'A' had categorically expressed therein its inability to reduce the price further. The Committee conclude from these observations that by the middle of May, 1980 the Ministry had received the final offers from all the firms for evaluation and that there was no necessity for the Ministry to entertain any further communication on the financial terms after the CCPA paper was prepared. Notwithstanding this, the Committee note that the Ministry did project as many as 7 modifications offered by firm 'A' between 9 and 29 June, 1980 and brought to the notice of the CCPA orally the effect of the changes made. The Ministry did not take the stand that once the final offers were received such unilateral changes ought not be normally entertained without also giving the other party a chance to revise its offer.

2.53 The Committee note that the evaluation done at the time of a supplementary CCPA paper in the middle of June 1980 also indicated that the offer of firm 'B' continued to be financially better than that of firm 'A'. The Committee, however, find that the financial evaluation tilted in favour of firm 'A' only when the last unilateral modification was offered on 29 June 1980 by firm 'A' for foregoing escalation for a period of about 11 months, by which it was falling short of the delivery period offered by firm 'B'. It is interesting to note that this modification had been proposed on the ground that the Indian Government was interested in early delivery as indicated during discussions in July, 1979 and in April-May 1980. Since the intention of Government was known long back, the Committee feel that any reduction on this score ought to

have been offered when the firm gave its offer on 12 May 1980. Having regard to the circumstances and the manner in which the revisions in terms of offer were made by firm 'A' alone, it is obvious that firm 'A' sensed that in the evaluation done by the Ministry of Defence the rates offered by it worked out to be more than that offered by firm 'B' and, with a view to off-set this financial effect; firm 'A' started making one concession after another. Under these circumstances there was no justification for entertaining any of the unilateral concessions offered by firm 'A' after 12 May 1980, particularly on 29 June, 1980 when the last day for acceptance was 30 June, 1980.

2.54 Even with regard to the financial evaluation as done, the Committee are concerned to note that comprehensive data on timings of payments of various instalments was not obtained in respect of any of the offers. As a result a proper discounted cash flow statement was not prepared so as to indicate correctly the effects of escalation and interest on the payments made from time to time. In the absence of such an assessment of financial commitment, any other method of evaluation can be only an approximation and would not indicate a clear picture of the financial effect. The Committee recommend that the financial effects may invariably be assessed in accordance with sound commercial principles and, if guidelines do not exist at present, they may be drawn up in consultation with Audit for future compliance.

2.55 From the manner in which the financial evaluation has been done in this case, the Committee note that the final cost estimated in the case of firm 'A' was Rs. 268 crores (vide item 3 in the table in paragraph 2.31) and about four-fifth of this amount (about Rs. 214 crores) would have remained locked up with firm 'A' for one year because the delivery schedule was more by 11 months in the case of firm 'A' as compared to firm 'B' (vide table given in paragraph 2.17). So even if interest of 10 per cent is calculated on this locked up amount for 11 months, the Committee note that the interest of about Rs. 19 crores would have more than offset the difference between the two offers. The Committee are, therefore, of the view that the concessions offered were themselves not adequate to tilt the financial evaluation in favour of firm 'A' even as on 30 June 1980.

2.56 Having regard to the results of the various factors analysed, the Committee feel that the decision of the CCPA in favour of firm 'B' was a logical one with reference to the facts reported to it from time to time and could not have been otherwise.

2.57 The Committee consider it unfortunate that a responsible retired officer, who was in overall command of the Navy at the relevant time, should have given contradictory and subjective evidence that is contrary to the facts as reported consistently in written documents submitted by his own office till the last date of consideration of the case by the CCPA.

2.58 With regard to the difficulties in the preparation of a supplementary or revised CCPA paper in a case of this type, the Committee do appreciate the problems explained by the Defence Secretary during his evidence. Notwithstanding the same, the Committee wish to emphasise the need for taking decisions on the basis of a formal note incorporating all relevant parameters and evaluations, avoiding the contingency of oral submissions modifying the contents of the formal note.

## **CHAPTER III**

### **DELAY IN FINALISATION OF THE CONTRACT**

3.1 Subsequent to the acceptance of the offer of firm 'B' by the CCPA on 30 June 1980, the PNC met on 5 July 1980 to consider the future course of action in relation to the finalisation of the contract for purchase|procurement of SPVs and ammunition, apart from the signing of MOU with the Government of country 'Y'. The representative of the NHQ observed in the meeting that the draft contracts for the SPVs and ammunition did not contain the detailed specifications for examination. that this process was time consuming and would take quite sometime, say at least a month and that the firm should be requested to send the supplementary documents to the contract containing detailed specifications immediately.

3.2 In regard to the finalisation of the MOU, after ascertaining the availability of officials of Government of 'Y' for discussions, the PNC decided that further discussions would be held in August 1980.

3.3 In a subsequent meeting of the PNC held on 16 October, 1980, certain problems on the technical parameters and specifications that arose during scrutiny of the terms of contract, were examined and the stand of the Indian Government decided for further negotiations with firm 'B'. In respect of the MOU, the results of talks held with the foreign Government were considered and the wordings of the MOU examined for further talks with the Government of 'Y'.

3.4 During the period taken to finalise the MOU with the country 'Y' the then Chief of Naval Staff sent two notes on February 3 and February 25, 1981 to RRM stating that since the dialogue was opened with the Government of country 'Y' in May 1980 on the MOU, there had virtually been no progress and further. that it was essential that the vessels in question should be inducted into the Navy at the earliest to counter the already existing threat to the country. It further stated that each day's delay was costing the Government approximately Rs. 4 lakhs by way of escalation and that during the period of 9 months when negotiations were proceeding, there had been no tangible progress in regard to obtaining the assurance of the Government of country 'Y' on vital aspects.

3.5 The negotiations with firm 'B' and the Government of 'Y' took nearly one year. On 10 June 1981 the problems that arose during negotiations with firm 'B' and Government of country 'Y' were brought to the notice of the CCPA and appropriate orders taken. In July 1981 a stage of finality for signing of the contract and the understanding with the Government of 'Y' were reached.

3.6 Asked to indicate the reasons for the delay in finalising the contract, the Secretary, Defence stated during evidence as under:

"It took considerable time to complete the contract negotiations with firm 'B'. It is also true that the parallel amount of time was taken in finalising the "Note Verbale" and other connected documents to be obtained from the Government of country 'Y'.

3.7 Asked to indicate how much time the negotiations took with firm 'B' and when the Note Verbale was obtained, the witness stated:

"It took one years' time. We got it in July 1981".

3.8 On the contributory causes for the delay, the Secretary stated: "These contract negotiations are tough and difficult. There are certain difficulties in getting the various items".

3.9 Clarifying further on the aspect of delay in finalisation of contract, the Secretary observed:

"The approval to go ahead with firm 'B' was given at the meeting of 30 June 1980, we had to discuss the entire building specifications subsequently. Further two SPVs were proposed to be built in India... Discussions were going on. What took a year or more so was the building specifications. You may certainly say that it should not have taken one year. We will certainly try to improve ourselves. At that time, building specifications were not available".

3.10 Thereafter, two contracts were signed in December 1981 one for building two SPVs abroad and one for material packages for two SPVs to be built in India. Audit has pointed out that the delay of 18 months in finalising the contract resulted in an additional liability of Rs. 21.33 crores due to operation of the normal escalation clause and in addition an ex-gratia payment of Rs. 5.80 crores which had to be made as a one time payment to firm 'B'. This additional sum was claimed by firm 'B' due to revision of quotations by the sub-contractors of firm 'B', notwithstanding the fact that the ex-gratia

payment did not fall within the terms of offer as accepted by the CCPA on 30 June 1980.

3.11 In this connection, the Ministry have stated that during the course of the negotiations with firm 'B' for finalisation of the contract, it became clear that firm 'B' was under pressure from its sub-contractors to increase prices due to the long time that had elapsed since their original offers were made in February 1979. According to the Ministry, the request was not accepted by them but later the Ministry had to finally agree to this demand when firm 'B' was not agreeable to go ahead with the contract without ensuring payment of this additional claim. In the circumstances Government stated that this one time payment of Rs. 5.8 crores was made with the sanction of the CCPA.

3.12 As the Finance Ministry had objected to the payment of the said sum, the Committee inquired as to why the ex-gratia payment was made in spite of Finance Ministry's objection. In reply, the Ministry of Defence have stated that the approval of CCPA was obtained to the payment after bringing the objections of the Finance Ministry to the notice of the CCPA.

3.13 Audit has pointed out that instead of signing an MOU, with the Government of country 'Y', a "Technical Assistance Agreement" was signed on 10 July 1981 and a "Note Verbale" was exchanged on 11th December 1981. Government have stated that as a result of subsequent negotiations with the Government of country 'Y', it became clear that they were not agreeable to a detailed MOU but would agree to a brief 'Note Verbale' recording an understanding between the two Governments relating to this project. In the CCPA paper submitted for obtaining approval of the CCPA, the Ministry brought to notice that the difficulties for MOU arose due to the following factors:

1. The Government of 'Y', though keen to lend support to the project, wanted to do so within the ambit of their constitutional and legal provisions.
2. Although SPVs had been exported to many other foreign countries from country 'Y' in the past, never before any such understanding had been concluded by the Government of 'Y' with other foreign Governments.
3. Unlike other neighbouring countries, the approach of Government of 'Y' to its sale of ammunitions was different, in that the defence sales should be settled between the commercial firms and the purchaser with the minimum of Government interference and involvement.

3.14 In the context of the above the Ministry stated that the CCPA's approval was sought for the exchange of a 'Note Verbale' and an Agreement on Technical Assistance between concerned Ministries of the two Governments, instead of a MOU. This was agreed to by the CCPA.

3.15 According to the NHQ self-noise is a very important parameter forming part of the building specifications. The effect of high self-noise is that the equipment fitted in the vessel to locate other vessels would have to overcome self-noise to be effective. In other words, self-noise in excess of that specified will affect the vessel's ability to receive signals from enemy vessels operating in the area and, thereby prejudice its operational role. Audit has pointed out that while Naval Headquarters had wanted to include a clause of "right of rejection" in case the parameter was exceeded, firm 'B' was unwilling to accept such a clause but it was willing to accept a penalty in case of a shortfall in the specified value of self-noise.

3.16 When this issue came up for consideration in the meeting of the PNC held on 4, 5 November, 1980, the PNC took note that firm 'B' was willing to guarantee that the operational range would be the same or better as compared to those proven for its SPVs then in operation and that no effective figures were quoted as it could not release this till the signing of the security arrangement.

3.17 After further negotiations and discussions the compromise brought about by the PNC with firm 'B' was brought to the notice of the CCPA on 28-11-1981 as under:

"While firm 'B' are willing to accept penalties for shortfalls in specified values of "self noise", they are not prepared to give a right of rejection to us even if the required values are not met. Their reluctance emanates mainly from the lack of measured data, and the amorphous nature of the self-noise. its measurement and interpretation. After detailed technical consideration of the matter and taking into account the experience, the technical competence and reputation of the shipyard, NHQ have agreed to accept the stand of firm 'B' with the proviso that if the self-noise parameters are exceeded, firm 'B' must analyse the reasons for this and take timely action to rectify it before paying penalties".

The above proposal was agreed by the CCPA.

3.18 In the meetings of the PNC held on 4-11-1980, 5-11-1980 and 25-11-1980 VCNS had stated that there had been changes in certain technical parameters of the vessel of firm 'B' and on fresh evaluation made on the basis of the revised figures, the marks awarded to it in the matrix went down against 1773 points awarded to the vessel of firm 'A'. As firm 'B' had indicated its inability to make any improvements in the parameters which had since been revised by it the VCNS suggested reopening of dialogue with firm 'A'.

3.19 Additional Secretary (Defence) who was also Chairman of the PNC, however, observed that the question of re-opening of dialogue with firm 'A' needed to be considered very carefully because it would have many repercussions and could cause embarrassment all round. He further stated that there was no certainty that after detailed discussion with firm 'A' also the position now obtaining in regard to the technical specifications of the vessel would not be revised. Since the offer of firm 'A' was also based on drawing board design, it was not considered certain that in detailed negotiations the technical parameters would not also change. In the circumstances, the PNC decided not to reopen the issue of a fresh dialogue with the firm 'A'.

3.20 On the progress made in the delivery of SPVs to be built abroad under the contract, the Ministry have stated that the two SPVs due to be built abroad and delivered by February and August, 1986 were actually delivered in September and November 1986. For the delay in supply liquidated damages are reported to have been recovered to the extent of Rs. 250 lakhs according to the terms of contract.

3.21 The Committee regret to note that there was a delay of 18 months in the signing of the contract with firm 'B' after approval of the selection of firm 'B' by the CCPA on 30 June 1980, and this resulted in the payment of Rs. 21.33 crores as escalation between the date of the offer and the date of signing of the contract, in addition to a sum of Rs. 5.8 crores, as ex-gratia.

3.22 It is evident from the difficulties that arose in finalising the contract, that, at the initial stages when the offers were obtained, notwithstanding sufficient time having been taken, adequate details were not obtained and the assessment of technical parameters was not as satisfactory as it ought to have been. It is, therefore, imperative that both the Navy and the Ministry should draw appropriate lessons from this and take steps to avoid recurrence of such delays and consequential avoidable expenditure in future.

3.23 The Committee would like to know why all aspects relating to self-noise, including right of rejection, could not be settled satisfactorily earlier starting from the initial stages of negotiation. Now that the SPVs to be built abroad have been delivered, the Committee would like to know the actual level of performance in relation to the expected level and steps taken, if any, to achieve the same.

## CHAPTER IV

### BASE AND DEPOT SPARES

4.1 Indian Navy's inventory of spares is governed by a philosophy which is different from that of the Navies of the more advanced countries and the list of inventories of spares is rather large. In accordance with the norms accepted by the Government for provisioning of spares for the Indian Navy for all new construction of ships, the limit applied was stated to be 15 per cent of the cost of the ships.

4.2 From 1979 onwards, discussions were reported to have been held and communications exchanged between firms A and B and the Ministry/NHQ on the spares philosophy of the Indian Navy. During discussions with the firms A and B in April-May 1980, the Indian delegation explained the philosophy of spares which included provisioning requirements on specified areas. Firm A in its letter dated 11 May 1980 stated that it had compared Indian Navy's spares philosophy to the spares philosophy of firm A and had found that the recommended stock (estimated at Rs. 19.31 crores) should cover Indian Navy's requirements. Firm B had initially given in May 1979 a quotation towards cost of five year B & D spares at Rs. 5.44 crores with the observations that the requirements depended on the spares philosophy of the Indian Navy and intended dislocation and that the quotation was based on the general experience of firm B with its various customers. The discussions in May 1980 between firm B and the Indian delegation which were minuted, indicated in regard to B & D spares as under :

"Indian side will indicate the ranging and scaling, so firm B can use it as a yardstick for demanding the requisite spares".

4.3 Thus no firm figure of quotation for B & D spares was available from either of the firms at the time the financial evaluation was done for inclusion in the CCPA paper of 20 May 1980; both quotations were budgetary according to their respective philosophies and were dependent on a further analysis of range to the understanding of and compliance with the spares' philosophy of the Indian Navy by the foreign shipyards for the purpose of quoting for B & D spares. It had

been decided as early as August 1979, in a meeting of the PNC that the quotation for B & D spares would be regarded as budgetary figures i.e. cost of spares as quoted by the respective firms were not to be included in the financial evaluation for the purpose of making a comparison between the two competing offers. The budgetary quotations were actually taken into account to arrive at the total cost of the project in the financial evaluation incorporated in the CCPA paper of 18/20 May 1980. But for estimated amount payable to the foreign yard, this was not included for purpose of comparison.

4.4 Audit has pointed out that in respect of the B & D spares, the Ministry did not enquire into the abnormal variation in the price of spares (355 percent) quoted by the two firms although the spares philosophy was made known to both the firms and that the point was crucial for financial evaluation as borne out by subsequent events because the price of spares relating to firm B increased by Rs. 26.56 crores to Rs. 32 crores (as compared to Rs. 19.31 crores offered by firm A) when the contract was to be concluded with firm B.

4.5 Asked to state why the abnormal variation in the prices of spares was not enquired into, the Ministry gave extract of a decision in the meeting of the PNC held on 3-8-1979 according to which B & D spares were identified as one of the items for which only budgetary figures had been quoted for mention as such in the note to the CCFA.

4.6 During the negotiations that were held subsequent to the acceptance of the offer of firm B for formalising the agreement, it was realised by the Ministry that firm B had not given any specific quotation on the basis of Indian Navy's spares philosophy. The PNC thereafter decided in the meeting held on 10 December 1980 that as according to accepted norms, cost of the B&D spares amounted to about 15 per cent of the cost of the ships, the Navy would be allowed to obtain spares, at a later date if necessary, upto 15 per cent of the cost of the ships. In view of the uncertainty on the extent and value of spares to be acquired, an agreement on price of spares could not be arrived at and it was decided by the Government in November 1981 not to include the price of spares in the contract but to procure them separately on a commitment from firm B that it would supply the spares at fair and reasonable prices. On this basis an *ad hoc* provision of Rs. 32 crores was made in the contract agreement.

4.7 As per provision of the contract, firm B was to progressively submit a list of B&D spares between 11 December 1982 and 11 December 1983. The first list was received in March 1983 and till 30 November 1983, only about 30 percent of the lists had been received.

Despite the best efforts by the Ministry to have the matter expedited the firm B could supply a complete list of B & D spares only in December 1984.

4.8 The Committee were informed that ranging and scaling of B & D spares was done by an Initial Provisioning Committee deputed to country Y from June to December 1985. The requirement of various items as assessed by this Committee and accepted by the Naval Headquarters was as follows:

- 
- |   |  |
|---|--|
| (a) Total number of items . . . . .     | Approx 40,000 comprising 19,500 items of equipment spares and 20,500 items of system and items of outfitting |
| (b) Total number of suppliers . . . . . | Approx 87 (as of September, 1988)  |
| (c) Total cost . . . . .                | Approx DM 108.00 million (at Feb 1986 price level)   |
- 

4.9 According to the Ministry of Defence, the cost of B&D spares has since been further revised to DM 111.2 million at 1988 prices level. Out of the 81 suppliers identified so far, contracts have been concluded with 65 of them at a total cost of DM 69.44 million in different currencies like DM, FF, US dollars, Pound Sterling, etc.

4.10 The estimated cost of the spares yet to be contracted for is stated to be about DM 42 million (equivalent to Rs. 33.6 crores). Asked to explain the reason for such a large variation between the original estimate and the actual cost of spares, the Defence Secretary stated that in India significantly larger amount of spares are stocked than would be done in any western country where a person could lift a telephone and place orders on suppliers. The Secretary gave three specific reasons for making the inventory of spares large viz. (i) lack of delegation of powers, (ii) lack of availability of foreign exchange at all time and (iii) amount of time one took to get the supply. He further added that since defence has no experience of running a vessel like this it would play the issue cautiously. He added that in all major purchases, Government ran into the same problem and that the Indian purchaser was always different as he might run out of stock at critical time.

4.11 The Committee are of the view that the whole matter relating to listing and acquisition of B&D spares has been dealt with in a perfunctory and piecemeal manner. The original quotations for

spares of A&B firms, viz. Rs. 19.31 crores and Rs. 5.44 crores respectively, were only budgetary or ad hoc figures neither fully reflecting India's spares philosophy nor comparable. In August 1979 itself it was decided to exclude B&D spares for comparative financial evaluation. The Committee wonder why in the CCPA paper, while making an overall comparison of the total cost of the two offers, the cost of spares was not excluded or shown separately, though the cost of spares was specifically excluded in the comparison of the estimated payments to the foreign yards.

4.12 It is also regrettable that subsequently adequate efforts were not made to ensure that the spares requirement were listed and procured without delay resulting in avoidable cost escalations. In the agreement with firm 'B' a suitable clause could have been provided that firm 'B' would also be liable for any additional cost that Government might incur as a result of its delay in supplying full list of spares by the prescribed date.

4.13 All these clearly indicate the need to streamline the procedure for assessment and procurement of spares in a more timely and systematic manner in future.

The Committee recommend that the Ministry should take note of the lesson learnt from this experience in respect of evaluation and provisioning for spares to ensure better systems and accountability

## CHAPTER V

### CONSTRUCTION OF 2 SPVs IN INDIA

5.1 The contract signed in December 1981 provided that the construction of two SPVs in India with the material packages to be imported from firm B would be completed in 1987 and 1988. The construction of the first SPV in India commenced on 12-1-1984 and the second on 24-9-1984.

5.2 Audit has pointed out that these two SPVs are expected to be completed only by 1990 and 1991 and that as a result of the abnormal delay in the construction of the vessels by the PSU, the Navy will not be able to avail of the warranty of 30 months provided for the equipment ordered in the material packages.

5.3 Asked to indicate the reasons for this delay, the Ministry stated in a written note to the Committee as under:

#### "Phase I

- (i) *Delay in facilities:* Though the civil works for the workshops A & B were ready in January 1984, the services of these shops were ready only in September 1984.
- (ii) *Welding:* The automatic welding stations could not be commissioned in time due to damage in transit and theft of electronic parts in transit. Specialists had to be called from *Country Y* for undertaking repairs. The welding parameters given by *firm B* were not suitable for the tropical climate of Bombay and had to be modified in consultation with *another PSU in India*. During this period, the welding of automatic machines had to be stopped.
- (iii) *Training:* The training imparted by *firm B* was not **satisfactory** and the PSU personnel had to learn 'on job' **training during construction of SPV in India**. The activities pertaining to construction were thus delayed.
- (iv) *Miscellaneous:* There have been other factors like riots and communal violence around the yard in May|June

1984 and officers' work-to-rule agitation in end 84 for 2 and a half months and for one month in 1985.

*Phase II*

- (i) *Quality Control*: To maintain a high standard of quality, extra inter stage checks were introduced both by the yard and the Indian Navy which resulted in additional time between subsequent activities. Besides, a new work culture had to be evolved to achieve stringent quality requirement.
- (ii) *Indigenous manufacture of items*: A large number of items which were supplied as semi-finished by firm B had to be manufactured indigenously by locating suitable sources. This necessitated a large amount of effort and time in developing suitable sub-contractors, inspection and acceptance of the items by the Navy. Most of the items which have been sub-contracted have been considerably delayed and have directly caused delay in the construction of the SPVs."

5.4 According to the Ministry, as on 30-9-1988, the first vessel had been completed to the extent of 77.67 per cent with the expected commissioning date as 30.9.1990 and the second vessel, to the extent of 51.29 per cent with the expected date of commissioning as 30.6.1991. Asked to indicate the impact of this delay on the Navy in operational terms, the Ministry stated that there had been no adverse impact and that the force level planned for 1985-90 would be achieved.

5.5 During the visit of the Study Group I of the Public Accounts Committee to the Indian Shipyard, they were informed in regard to training at the foreign yard that under the contract, production of SPV in the foreign yard was to have precedence over the training requirements, that firm 'B' did not allow the PSU's operatives numbering 76 to work on the job with their hands and that the non-operatives numbering 76 received adequate training. Clarifying the issue relating to training, the Ministry stated in a written note as under:

"It was always anticipated that on the job training will be provided barring in exceptional cases where firm B feared delays in their own production. However, this was belied. It is pertinent to mention that the major sufferers have been production operators, 76 of whom had been

sent for training. The rest of the personnel (namely those concerned with non-production, design, planning, quality control, inventory management, etc. who also totalled 76) did not suffer from any drawback in training”.

5.6 Asked to indicate the extent to which inadequate training contributed to delay in construction and increase in cost of construction, the Ministry stated:

“It is difficult to assess this accurately. There was a total delay of 8 months in the construction schedule on account of a number of factors such as:

- (a) Non-availability of dust free environment
- (b) inadequate on job training
- (c) 100 percent quality control inspection instituted by the Navy. Of the delay of 8 months perhaps 2 months delay could be laid at the door of inadequate training”.

5.7 In regard to receipt of several items in semi-finished condition, the Secretary, Department of Defence Production and Supplies informed the Committee during evidence that these items should have come to the PSU in the same condition in which they had been used in the foreign shipyard, that when these items came in semi-finished condition, the matter was taken up by the PSU a number of times specifically by a delegation in 1985, and that the firm said that this was the condition in which it received these items at its yards and that further work should be done by the PSU. The secretary further stated that they did not precipitate any action on this because they wanted to tie up everything else first and after this process, the matter would be placed before the Project Management Board and whatever decision was taken by the Project Management Board, action would be taken on these lines.

5.8 According to the Ministry of Defence, items costing Rs. 46.44 lakhs were supplied by firm ‘B’ in semi-finished condition and the cost of machining/assembly of these items in India was Rs. 62.88 lakhs. About the delay consequent on the supply of semi-finished items and their assembly in India, the Secretary, Department of Defence Production and Supplies stated during evidence that delay had not occurred because of receipt of these items in semi-finished

condition but that the Indian sub-contractors had delayed the supplies. This delay on the part of Indian sub-contractors, the Ministry stated, ranged between 2 months to 26 months.

5.9 Apart from the delayed supply of list of R & D spares and supply of semi-finished items supplied by firm B, according to the Ministry of Defence, the following problems were faced in the operation of the contract since its signing in December 1981:

- (i) Article 19 of the Contract provided for warranty of items, which was valid for either 18 months from the time equipment was put in operation or for 30 months from delivery FOB, whichever was earlier. Due to revision of construction schedule, the warranties of all the items had expired except the main batteries. The extension of the warranty of the items was taken up with firm 'B', in August 1985 and was further discussed by the Deptt. of Defence Production's Delegation to firm 'B' in September 1985. During the discussions, firm 'B' indicated that the cost of extension of warranties would be prohibitive and, in certain cases, more than the cost of the original equipment. It was decided not to seek the extension of the warranties.
- (ii) According to the contract, the seller's representatives were to be deputed to the PSU for a period of 56 months extendable by another 8 months due to late delivery of material package items, i.e. for a maximum period of 64 months and this period expired on 30-9-1988. Negotiations, were, therefore, undertaken with firm 'B' and the quoted figure brought down considerably. Subsequently, firm 'B' did not reduce the amount any further but agreed to accept a portion of the fees in Indian Rupees. This position is reported to have been agreed to by the Government.
- (iii) Initially the PSU had, on the advice of firm 'B' projected a requirement of 200 manmonths of specialists' services. As the construction of the SPV progressed, it became apparent that the estimation was inadequate. The revised requirement of the specialists services was 362 manmonths, of which 224 manmonths had been availed of in terms of the original contract and the remaining 138 manmonths were to be covered by the agreement entered with firm 'B' for the period beyond 30-9-1988.

The Ministry also clarified that this additional requirement of manmonths was not necessitated by delayed delivery of the material packages.

- (iv) According to the contract, firm 'B' was to provide services of sub-contractors' specialists to provide advice and guidance. Firm 'B' did not, however, provide sub-contractors' specialists for "setting to work, HATs and and SATs", stating that they would render only advice but would not be working with their hands. The matter was taken up with the firm but it did not change their stand. A decision was, therefore, taken to deal directly with the various sub-contractors for their services for setting to work the various equipments. The cost for this work had also been negotiated and settled. According to the Ministry, HATs|SATs have not yet commenced and according to the direct negotiations with the sub-contractors, it has been estimated that 190 man-months of sub-contractors|specialists would be required at a cost of Rs. 6.02 crores".

*Expenditure on building 2 SPVs in India*

5.10 While computing the cost of the vessels initially in March 1982, Rs. 63 crores was earmarked towards yard effort by the PSU. The total cost of the two SPVs is now expected to be Rs. 307.11 crores, of which yard effort by PSU would account for Rs. 152.00 crores. The main reasons for the upward revision in the cost of the SPVs were stated to be:

- (i) the revision in the construction schedule from the original 42 months to 81 months;
- (ii) increase in labour cost from Rs. 40/- per day to Rs. 112/- per day;
- (iii) change in labour overheads from Rs. 130.40 per day to Rs. 600/- per day.
- (iv) increase in amortisation cost.

5.11 The Committee note that the construction of the two SPVs by the PSU which was originally estimated to be completed in 1987 and 1988 respectively, is now expected to be completed by 1990 and 1991. The Committee hope that there would be no further slippages from the revised schedule for the construction of both the SPVs at the PSU.

5.12 Unfortunately due to revision of construction schedule, the warranties of all the items except the main batteries have since expired. The Committee feel that the contract could have provided for extension of guarantee period, subject to certain conditions and ceilings, if the time schedule was not maintained.

5.13 The Committee consider it unfortunate that a large number of items which were supplied in semi-finished conditions by firm 'B' had to be processed further indigenously incurring additional expenditure and resulting in loss of time. The contract perhaps could have been worded more precisely to take care of this difficulty. The Committee also consider it unfortunate that firm 'B' did not impart on-the-job training to the 76 operative personnel of the PSU deputed to the foreign shipyard for this purpose, contrary to the main intention and spirit of the contract in this regard.

5.14 The Committee are surprised to be informed that one of the causes for delay was in commissioning automatic welding stations to damage in transit and theft of electronic parts in transit. The Committee wonder how in import of defence equipment such damages and thefts could have taken place. The Committee consider this a serious matter and would like to be informed of the results of inquiry as to how the damages took place and how thefts could take place despite the expected level of high security arrangements in handling the equipment.

5.15 The Committee recommend that comprehensive guidelines should be drawn up by Government with regard to the negotiations and implementation of defence contracts, so as to improve efficiency and effectiveness within the specified time frame. The organisational structures and systems will have to be improved and streamlined to ensure better results and greater accountability in a world of increasing specialisation, speed and sophistication.

NEW DELHI;  
October 13, 1989  
Asvina 21, 1911 (Saka)

P. KOLANDAIVELU,  
Chairman  
Public Accounts Committee.

## APPENDIX-I

(Vide Para 1.18)

*Paragraph 55 of the Report of the Comptroller and Auditor General of India for the year ended 31 March, 1987, No. 2 of 1988, Union Government (Defence Services).*

*Infructuous and avoidable extra expenditure in the acquisition of certain special purpose vessels.*

0.1 In the context of the security environment of the country, the Naval Headquarters (HQ) had expressed the need for acquiring certain special purpose vessels. Between 1976 and 1978, offers for the supply of the vessels were received from six shipyards in foreign countries. In February 1979 the Government set up a Price Negotiating Committee (PNC) for examining the offers in detail.

0.2 The offers were evaluated on the basis of specified Naval Staff Requirement by various agencies including the Naval HQ. Based on the recommendations of the PNC, Government approved short listing of the offers of firm 'A' of country 'X' and firm 'B' of country 'Y' in April 1980. A Public Sector Undertaking (PSU) was also selected for the indigenous construction of the vessels.

0.3 The Naval HQ had also emphasised that the selection of ammunition 'Z' required for arming the vessels was a pre-requisite to the selection of the vessels. However, the release of ammunition 'Z' offered by firm 'D' of country 'Y' for use with the vessels of firm 'B' was subject to clearance by their Government.

0.4 According to the technical evaluation by the Naval HQ, the offer of firm 'A' was superior to the offer of firm 'B' by 174 points as the "best vessel" and by 84 points in the overall analysis.

0.5 According to the financial evaluation, the offer of firm 'A' for two vessels with two materials packages (excluding spares) was cheaper by Rs. 11.41 crores.

0.6 The Ministry of Defence (Ministry), while confirming the above facts stated in September 1987 that it was only in the vessels performance that firm 'B' was found below firm 'A' and in the case

of transfer of technology and maintenance support the offer of firm 'A' was found below firm 'B'. The Ministry also mentioned that the financial evaluation indicated above was based on an unilateral offer of firm 'A' for a further reduction after the submission of the papers to the Government and that firm 'B' could not be given an opportunity to review their offer.

0.7 However, the offer of firm 'B' was superior by only 90 points regarding transfer of technology and maintenance support whereas the offer of firm 'A' was superior by 174 points as the "best vessel" for which criteria 50 per cent of the total points were allocated in the evaluation. The offer of firm 'A' was also superior by 84 points in overall assessment. In regard to the financial evaluation, it was known to the Government that firm A's offer excluding Base and Deport spares was cheaper. Instead of closing the option in favour of firm 'B', which Government knew was not the lowest, efforts could have been made to obtain revised offers.

0.8 In so far as the procurement of spares was concerned, the Ministry did not enquire into the abnormal variation in the prices of spares (355 per cent) quoted by the two firms although the spares philosophy of the Indian Navy was confirmed as understood by both the firms. The Ministry stated in September 1987 that the financial effect of the comparative cost of spares was only considered in passing. This point was crucial as borne out by subsequent events when firm 'B' increased the price of spares by Rs. 26.56 crores (compared to Rs. 19.31 crores offered by firm 'A') when the contract was to be concluded with firm 'B'.

0.9 Before entering into a contract with either of the two firms, the Government wanted to have a Memorandum of Understanding (MOU) which was intended to be a declaration of co-operative support between the two Governments and a pre-requisite for signing the contract. While the Government of country 'X' agreed wholly in May 1980 to the draft MOU without conditions, no such agreement had been reached with the Government of country 'Y' till 30th June 1980.

010 The Government approved (30th June 1980) the offer of firm 'B' of country 'Y' for procurement and indigenous construction of four vessels subject to the clearance of ammunition 'Z' to be supplied by firm 'D' and satisfactory acceptance of the essential features of the MOU by the Government of country 'Y' even though the offer of firm 'A' had emerged as the best techno-economic option and there was complete agreement with country 'X' on the MOU.

0.11 The Government of country 'Y' gave the clearance for sale of ammunition 'Z' of firm 'D' only in July 1980. However, instead of signing a satisfactory and acceptable MOU with the Government of country 'Y' a "Technical Assistance Agreement" was signed on 10th July 1981 and a Note Verbale was exchanged on 11th December 1981. The Ministry stated in September 1987 that while the administrative agreement proposed by country 'Y' originally was considered inadequate and did not meet the Government's own specified requirement, the final arrangement arrived at by exchange of a Note Verbale did cover this shortcoming. The provisions of the Note Verbale were subject to the constitutional and legal provisions of country 'Y' governing the export of armament and related material. In contrast, the draft MOU accepted by country 'X' did not contain such conditions.

0.12 The finalisation of Technical Assistance Agreement and Note Verbale with the Government of country 'Y' took eighteen months. Since the normal escalation clause operated during this period of eighteen months. Government was committed to an additional liability of Rs. 21.33 crores. Firm 'B', in the meantime, revised its prices upwards which necessitated further negotiations in August 1981. The increase in price (Rs. 101.55 crores) *inter alia* included.

Rs. 5.80 crores as an ex-gratia one time payment due to revision of quotations by sub-contractors of firm 'B'.

Rs. 27.20 crores (budgetary cost) for an increase in the cost of spares.

0.13 Since an agreement on the price of spares could not arrived at, it was decided by the Government in November 1981 not to include the supply of spares in the contract but to procure them separately on a commitment from firm 'B' that it would supply the spares at fair and reasonable prices. Therefore, an *ad hoc* provision of Rs. 32 crores was made. Ultimately, the spares originally quoted by firm 'B' at Rs. 5.44 crores and for which Government had provided Rs. 32 crores were being procured at a cost of approximately Rs. 60 crores. Of this, an amount of Rs. 16 crores had been paid upto September 1987. Had the abnormal variation in prices for spares quoted by the two firms prior to 30th June 1980 been analysed, the decision to exclude the spares from the main contract could have been taken earlier when the offer of firm 'A' was also available. This would have also resulted in the offer of

firm 'A' being lower by Rs. 11.41 crores. Further, since the provision of Rs. 32 crores was 470 per cent higher than the estimate given by firm 'B' in June 1980 and was one of the factors which had tilted the scales in favour of firm 'B' during the comparative evaluation in June 1980 prior to the final selection of firm 'B' it is possible that firm 'B' had intentionally quoted a lower figure on spares though the spares philosophy of the Navy had been duly explained to the firm. Against a background of significant increase in the prices of spares and difficulties in negotiating an acceptable MOU, the Ministry did not explore the possibility of falling back on firm 'A' whose terms were advantageous. The Ministry stated in September 1987 that the negotiating committee did consider this option but did not pursue it further for the following reasons:

firm 'B' had offered a better delivery schedule; and

similar problems could also arise in case negotiations were opened at that late state with firm 'A'.

0.14 The Ministry's reply is not plausible on account of the following:

To work out a satisfactory MOU (which, in the event, was not so satisfactory) the Government had laboured for a period of nearly 18 months. Had the earlier delivery schedule been a prime factor, the contract could have been concluded in June 1980 itself.

The fact that firm 'A' had made an extension of their original offer made in May-June 1980 in February 1986 based on an enquiry of Government reveals that the Ministry's concern on "similar problems" arising in case negotiations were opened at that late stage with firm 'A' were groundless.

0.15 During negotiations in August 1981, it was argued by firm 'B' that after submitting their original offer in February 1979, their sub-contractors were no longer willing to maintain the same base price and the amount of escalation which firm 'B' had to pay to its sub-contractors was much more than the ceilings on escalation agreed to Firm 'B', therefore, asked for Rs. 5.8 crores as an ex-gratia, one time payment to absorb these additional costs. This was accepted by Government. The claim of firm 'B' was not proved correct subsequently when the Naval authorities contracted a number of sub-contractors/suppliers of equipment to firm 'B' directly for the

supply of a complete unit and spares. The quotations obtained were found considerably lower than the claims preferred by firm 'B'.

0.16 An important technical parameter of the vessel was "self-noise". The parameter was important enough to make Naval HQ insist on a "right of rejection" in the draft contract if the parameter was exceeded. Although firm 'B' was willing to accept penalties for a shortfall in the specified value of "self-noise", it was not prepared to give a "right of rejection" to Government of India. The Naval HQ finally agreed to the position taken by firm 'B' in October 1981 with the stipulation that if the "self-noise" parameters were exceeded, firm 'B' would analyse the reasons and take timely action was rectification before paying penalties. It was seen from papers made available to Audit, that an exacting technical requirement was not insisted upon on account of Government's apprehension that negotiations would break on this issue.

The Government's approval was obtained in November 1981 for the project at a cost of Rs. 359.59 crores.

0.17 Contracts were signed in December 1981 with firm 'B' for the procurement of 2 vessels and 2 material packages. Another contract was signed in December 1981 with firm 'D' for the supply of ammunition 'Z'. The vessels which were due for delivery in February and August 1986 were actually delivered in September and November 1986 after a delay of 3 to 7 months. The Ministry stated that a sum of Rs. 25 lakhs approximately has been recovered from firm 'B' as penalty for this delay.

0.18 The construction of 2 vessels by the PSU with the material packages contacted with firm 'B' which was to be completed in 1987 and 1988 respectively is expected to be completed only by 1990 and 1991. As a result of the abnormal delay in the completion of the vessels by the PSU the Navy will not be able to avail of the warranty of 30 months provided for the equipment ordered in the material packages. This is apart from the cost over-runs that are likely to occur and the impact which the delay will have on the operational commitments of the Navy.

0.19 The review, based on records made available to Audit by the Ministry, reveals the following:

The price evaluation was defective in as much as the abnormal differential in the cost of spares was not analysed

which led to much higher costs being incurred on spares subsequently;

although a decision was taken in November 1981 to exclude the spares from the contract Government did not consider the fact that the offer of firm 'A' was lower by Rs. 11.41 crores;

although the Government had approved in June 1980 the procurement of the vessel subject to a satisfactory acceptance of a MOU by the Government of country 'Y' only a conditional "Technical Assistance Agreement" was signed after a year and a half. This delay also resulted in delayed signing of the contract due to which firm 'B' sought a higher price as a one time, ex-gratia payment of Rs. 5.8 crores and extra expenditure of Rs. 21.33 crores on account of escalation in cost over one year arising out of delay in concluding the contract with firm 'B', and an important technical parameter viz. "self-noise", was not insisted upon in terms of the provision which did not allow the Naval HQ an unfettered right of rejection but merely left to the supplier to analyse the cause for excessive noise to remedy matters before paying any penalties. Clearly, the payment of penalties would be no compensation for an unacceptable noise level.

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## APPENDIX II

### Conclusions and Recommendations

Sl. No.	Para No.	Ministry concerned	Conclusion/Recommendation
1	2	3	4
1	2.47	Defence	The Committee note from the CCPA paper dated 20 May 1980 that 4 factors, viz. (i) technical evaluation, (ii) delivery schedule, (iii) extent of cooperation from the Government concerned, and (iv) financial evaluation were considered relevant for selection of the firm for supply of the SPVs.
2	2.48	Do	The technical evaluation factor was sub-divided into three categories viz. (a) best vessel, (b) maintenance and logistic support and (c) transfer of technology. The Committee note that whereas firm 'B' was throughout considered superior both by the NHQ and the PSU on categories (b) and (c), the difference in favour of firm 'A' in respect of category (a) was 7 marks as on 20 May 1980 out of a total of 2000 marks and this increased to 174 marks as on 30 June 1980, mainly because marks of firm 'B' under this category was reduced by 151 marks from 1709 to 1558 as given in the table on a previous page.* The Committee also note that while reducing the marks in June 1980 from the marks given earlier to firm 'B' in May 1980,

the NHQ had qualified its reduction with the observation that the noise factor for which reduction was made as "a nebulous area and thus cannot be accurately worked out due to absence of proper data". In this connection, the Committee note that the offer of firm 'A' as it turned out after the final revision as late as 30 June 1980, was only marginally in excess of the evaluation marks that were awarded to firm 'B' considering the fact that the maximum marks were 4000 and the net difference between the offers was only 84. The Committee feel that the difference is marginal and not decisive, particularly when the NHQ had stated both on 19-6-1980 and on 30-6-1980 that the marginal differences in the overall matrix between firm 'A' and firm 'B' should not be given too great a weightage and that either of the SPVs would be suitable to them. The Committee also note that firm 'A' had not supplied any SPV to any outside country whereas firm 'B' had actually supplied SPVs to several countries and had an established reputation in the international market.

In respect of category (c) viz. transfer of technology the Committee note that firm 'B' had throughout maintained a lead. In this connection the PSU which was vitally concerned with this evaluation was categorical in its observation that in view of the past experience of firm 'B' in building SPVs for other countries as also the association of firm 'B' with a reputed design agency, their preference for collaboration was for firm 'B'.

4            2.50            Do

With regard to the important factor of delivery schedule, the Committee note that firm 'B' always had a shorter delivery period than firm 'A' by about 11 months. The Committee also note that even as late as 29 June 1980, firm 'A' had specifically accepted that it had not succeeded in catching up with the delivery period offered by firm 'B'. The Committee are of the view that the delivery period is an overriding consideration especially in defence matters. Even with regard to transfer of technology, which is of paramount importance, firm 'B' was always considered distinctly better than firm 'A'.

5            2.51            Do

Though the NHQ had, at one stage, stated that better cooperation could be expected from country 'X', as that country would be supplying SPV for the first time outside their country, the Committee are of the view that the extent of cooperation that could be expected from the concerned Government over the long cycle of the project, is largely a matter of political judgement of the Government.

6            2.52            Do

With regard to the factor, financial evaluation, the Committee note that even before the departure of a delegation to countries 'X' and 'Y' in April 1980 the firms had given what was stated to be their final offers based on which the evaluations were done for the CCPA paper dated 8 March 1980. The Committee also note that despite this position, another revised offer had been received on 12 May 1980 from firm 'A' in the context of the discussion held during the visit of the Indian delegation in April-May 1980 and that firm 'A' had categorically expressed therein its inability to reduce the price further. The Committee conclude from these observations that by the

middle of May, 1980 the Ministry had received the final offers from all the firms for evaluation and that there was no necessity for the Ministry to entertain any further communication on the financial terms after the CCPA paper was prepared. Notwithstanding this, the Committee note that the Ministry did project as many as 7 modifications offered by firm 'A' between 9 and 29 June, 1980 and brought to the notice of the CCPA orally the effect of the changes made. The Ministry did not take the stand that once the final offers were received such unilateral changes ought not be normally entertained without also giving the other party a chance to revise its offer.

The Committee note that the evaluation done at the time of a supplementary CCPA paper in the middle of June 1980 also indicated that the offer of firm 'B' continued to be financially better than that of firm 'A'. The Committee, however, find that the financial evaluation tilted in favour of firm 'A' only when the last unilateral modification was offered on 29 June 1980 by firm 'A' for foregoing escalation for a period of about 11 months, by which it was falling short of the delivery period offered by firm 'B'. It is interesting to note that this modification had been proposed on the ground that the Indian Government was interested in early delivery as indicated during discussions in July 1979 and in April-May 1980. Since the intention of Government was known long back, the Committee feel that any reduction on this score ought to have been offered when the firm gave its offer on 12 May 1980. Having regard to the circumstances

and the manner in which the revisions in terms of offer were made by firm 'A' alone, it is obvious that firm 'A' sensed that in the evaluation done by the Ministry of Defence the rates offered by it worked out to be more than that offered by firm 'B' and, with a view to offset this financial effect, firm 'A' started making one concession after another. Under these circumstances there was no justification for entertaining any of the unilateral concessions offered by firm 'A' after 12 May 1980, particularly on 29 June, 1980, when the last day for acceptance was 30 June, 1980.

8            2.54            —do—

Even with regard to the financial evaluation as done, the Committee are concerned to note that comprehensive data on timings of payments of various instalments was not obtained in respect of any of the offers. As a result a proper discounted cash flow statement was not prepared so as to indicate correctly the effects of escalation and interest on the payments made from time to time. In the absence of such an assessment of financial commitment, any other method of evaluation can be only an approximation and would not indicate a clear picture of the financial effect. The Committee recommend that the financial effects may invariably be assessed in accordance with sound commercial principles and, if guidelines do not exist at present, they may be drawn up in consultation with Audit for future compliance.

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9            255            —do—

From the manner in which the financial evaluation has been done in this case, the Committee note that the final cost estimated in the case of firm 'A' was Rs. 268 crores (vide item 3 in the table in para-

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graph 2.31) and about four-fifth of this amount (about Rs. 214 crores) would have remained locked up with firm 'A' for one year because the delivery schedule was more by 11 months in the case of firm 'A' as compared to firm 'B' (vide table given in paragraph 2.17). So even if interest of 10 per cent is calculated on this locked up amount for 11 months, the Committee note that the interest of about Rs. 19 crores would have more than offset the difference between the two offers. The Committee are, therefore, of the view that the concessions offered were themselves not adequate to tilt the financial evaluation in favour of firm 'A' even as on 30 June 1980.

10      2.56      Defence

Having regard to the results of the various factors analysed, the Committee feel that the decision of the CCPA in favour of firm 'B' was a logical one with reference to the facts reported to it from time to time and could not have been otherwise.

11      2.57      —do—

The Committee consider it unfortunate that a responsible retired officer, who was in overall command of the Navy at the relevant time, should have given contradictory and subjective evidence that is contrary to the facts as reported consistently in written documents submitted by his own office till the last date of consideration of the case by the CCPA.

12      2.58      —do—

With regard to the difficulties in the preparation of a supplementary or revised CCPA paper in a case of this type, the Committee do

appreciate the problems explained by the Defence Secretary during his evidence. Notwithstanding the same, the Committee wish to emphasise the need for taking decisions on the basis of a formal note incorporating all relevant parameters and evaluations, avoiding the contingency of oral submissions modifying the contents of the formal note.

13      3.21      —do—

The Committee regret to note that there was a delay of 18 months in the signing of the contract with firm 'B' after approval of the selection of firm 'B' by the CCPA on 20 June 1980, and this resulted in the payment of Rs. 21.33 crores as escalation between the date of the offer and the date of signing of the contract, in addition to a sum of Rs. 5.8 crores, as ex-gratia.

14      3.22      —do—

It is evident from the difficulties that arose in finalising the contract, that, at the initial stages when the offers were obtained, notwithstanding sufficient time having been taken, adequate details were not obtained and the assessment of technical parameters was not as satisfactory as it ought to have been. It is, therefore, imperative that both the Navy and the Ministry should draw appropriate lessons from this and take steps to avoid recurrence of such delays and consequential avoidable expenditure in future.

15      3.23      —do—

The Committee would like to know why all aspects relating to self-noise, including right of rejection, could not be settled satisfactorily earlier starting from the initial stages of negotiation. Now that the SPVs to be built abroad have been delivered, the Committee

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would like to know the actual level of performance in relation to the expected level and steps taken, if any, to achieve the same.

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4.11

Defence

The Committee are of the view that the whole matter relating to listing and acquisition of B & D spares has been dealt with in a perfunctory and piecemeal manner. The original quotations for spares of A & B firms, viz. Rs. 19.31 crores and Rs. 5.44 crores respectively, were only budgetary or *ad hoc* figures neither fully reflecting India's spares philosophy nor comparable. In August 1979 itself it was decided to exclude B & D spares for comparative financial evaluation. The Committee wonder why in the CCPA paper, while making an overall comparison of the total cost of the two offers, the cost of spares was not excluded or shown separately, though the cost of spares was specifically excluded in the comparison of the estimated payments to the foreign yards.

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4.12

—do—

It is also regrettable that subsequently adequate efforts were not made to ensure that the spares requirements were listed and procured without delay resulting in avoidable cost escalations. In the agreement with firm 'B' a suitable clause could have been provided that firm 'B' would also be liable for any additional cost that Government might incur as a result of its delay in supplying full list of spares by the prescribed date.

- 18      4.13      —Do.—
- All these clearly indicate the need to streamline the procedure for assessment and procurement of spares in a more timely and systematic manner in future.
- The Committee recommend that the Ministry should take note of the lesson learnt from this experience in respect of evaluation and provisioning for spares to ensure better systems and accountability.
- 19      5.11      —Do—
- The Committee note that the construction of the two SPVs by the PSU which was originally estimated to be completed in 1987 and 1988 respectively is now expected to be completed by 1990 and 1991. The Committee hope that there would be no further slippages from the revised schedule for the construction of both the SPVs at the PSU.
- 20      5.12      —Do—
- Unfortunately due to revision of construction schedule, the warranties of all the items except the main batteries have since expired. The Committee feel that the contract could have provided for extension of guarantee period, subject to certain conditions and ceilings, if the time schedule was not maintained.
- 21      5.13      —Do—
- The Committee consider it unfortunate that a large number of items which were supplied in semi-finished condition by firm 'B' had to be processed further indigenously incurring additional expenditure and resulting in loss of time. The contract perhaps could have been worded more precisely to take care of this difficulty. The
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Committee also consider it unfortunate that firm 'B' did not impart on-the-job training to the 76 operative personnel of the PSU deputed to the foreign shipyard for this purpose, contrary to the main intention and spirit of the contract in this regard.

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5.14

Defence

The Committee are surprised to be informed that one of the causes for delay was in commissioning automatic welding stations to damage in transit and theft of electronic parts in transit. The Committee wonder how in import of defence equipment such damages and thefts could have taken place. The Committee consider this a serious matter and would like to be informed of the results of inquiry as to how the damages took place and how thefts could take place despite the expected level of high security arrangements in handling the equipment.

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5.15

—Do—

The Committee recommend that comprehensive guidelines should be drawn up by Government with regard to the negotiations and implementation of defence contracts, so as to improve efficiency and effectiveness within the specified time frame. The organisational structures and systems will have to be improved and streamlined to ensure better results and greater accountability in a world of increasing specialisation, speed and sophistication.

