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**UNDUE FAVOUR TO VENDOR IN ACQUISITION
OF SUBMARINES**

[Action taken by the Government on the Observations
Recommendations of the Committee contained in their
Tenth Report (Fifteenth Lok Sabha)]

MINISTRY OF DEFENCE

**PUBLIC ACCOUNTS COMMITTEE
2010-2011**

TWENTY NINTH REPORT

FIFTEENTH LOK SABHA



**LOK SABHA SECRETARIAT
NEW DELHI**

TWENTY-NINTH REPORT
PUBLIC ACCOUNTS COMMITTEE
(2010-2011)
(FIFTEENTH LOK SABHA)

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SUBMARINES

[Action Taken by the Government on the Observations/Recommendations of the
Committee contained in their Tenth Report (Fifteenth Lok Sabha)]

MINISTRY OF DEFENCE



*Presented to Lok Sabha on 24th February, 2011
Laid in Rajya Sabha on 24th February, 2011*

LOK SABHA SECRETARIAT
NEW DELHI

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COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE (2010-11)

Dr. Murli Manohar Joshi — *Chairman*

MEMBERS

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Dr. Baliram
4. Shri Ramen Deka
5. Shri Naveen Jindal
6. Shri Satpal Maharaj
7. Shri Bhartruhari Mahtab
8. Dr. K. Sambasiva Rao
9. Shri Yashwant Sinha
10. Shri Jitendra Singh (Alwar)
11. Kunwar Rewati Raman Singh
12. Shri K. Sudhakaran
13. Dr. M. Thambidurai
14. Shri D. Venugopal
15. Shri Aruna Kumar Vundavalli

Rajya Sabha

- *16. Vacant
17. Shri N. Balaganga
18. Shri Prasanta Chatterjee
19. Shri Kalraj Mishra
20. Shri N.K. Singh
21. Shri Tiruchi Siva
22. Prof. Saif-ud-Din Soz

SECRETARIAT

- | | | |
|------------------------|---|-------------------------|
| 1. Shri Devender Singh | — | <i>Joint Secretary</i> |
| 2. Shri D.R. Mohanty | — | <i>Deputy Secretary</i> |

* Vacancy occurred *vice* Shri Ashwani Kumar has been appointed as Minister of State *w.e.f.* 19th January, 2011.

INTRODUCTION

I, the Chairman, Public Accounts Committee (2010-11), having been authorised by the Committee, do present this Twenty-ninth Report (fifteenth Lok Sabha) on Action Taken by the Government on the Observations/Recommendations of the Committee contained in their Tenth Report (Fifteenth Lok Sabha) on '**Undue Favour to Vendor in Acquisition of Submarines**' based on Para 2.2, Chapter - II of the C&AG Report No. CA-18 of 2008-09 (Defence Services— Air Force and Navy).

2. The Tenth Report was presented to Lok Sabha on 11th March, 2010. The Tenth Report was laid in Rajya Sabha a day earlier *i.e.* on 10th March, 2010. Replies of the Government to the Observations/Recommendations contained in the Report were received on 10th December, 2010. The Public Accounts Committee took up consideration of the Twenty-ninth Report on 3rd February, 2011, but the adoption of the Report was deferred as the Committee desired to have some additional inputs on the Report. After the needful was done, the Committee considered and adopted the Twenty-ninth Report at their sitting held on 15th February, 2011. Minutes of the sittings are given at *Appendices I & II*.

3. 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.

4. 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.

5. An analysis of the Action Taken by the Government on the Observations/Recommendations contained in the Tenth Report (Fifteenth Lok Sabha) is given at *Appendix-III*.

NEW DELHI;
21 February, 2011

02 Phalgun, 1932 (*Saka*)

DR. MURLI MANOHAR JOSHI,
Chairman,
Public Accounts Committee.

CHAPTER I

REPORT

This Report of the Public Accounts Committee deals with the Action Taken by the Government on the Observations/Recommendations of the Committee contained in their Tenth Report (Fifteenth Lok Sabha) on 'Undue Favour to Vendor in Acquisition of Submarines' based on Para 2.2, Chapter - II of the Report No. CA-18 of 2008-09 (Defence Services—Air Force and Navy) of the C&AG of India.

2. The Tenth Report (Fifteenth Lok Sabha) was presented to Lok Sabha on 11th March, 2010 and laid in Rajya Sabha on 10th March, 2010. It contained 16 Observations/Recommendations. Action Taken Notes in respect of all the Observations/Recommendations have been received from the Ministry of Defence and categorized as under:

- (i) Observations/Recommendations of the Committee which have been accepted by the Government:

Para Nos. 1, 3-10, and 13-16

Total :13

Chapter - II

- (ii) Observations/Recommendations which the Committee do not desire to pursue in view of the replies received from the Government:

Para No. 2

Total : 1

Chapter-III

- (iii) Observations/Recommendations in respect of which replies of the Government have not been accepted by the Committee and which require reiteration:

Para No. 11 and 12

Total : 2

Chapter-IV

- (iv) Observations/Recommendations in respect of which the Government have furnished interim replies:

-NIL-

Total: 0

Chapter-V

3. The Tenth Report of the Committee was based on the Audit review of the process of acquisition and indigenous construction of state-of-the-art Submarines for the Indian Navy. The detailed examination of the subject by the Committee had revealed serious shortcomings/lapses on the part of Ministry of Defence which *inter alia* included faulty process of selection of vendor, delay in the construction/delivery of Submarines adversely impacting the operational preparedness of the Indian Navy and resulting in huge financial losses, flaws in the monitoring mechanism adopted by the Ministry of Defence to oversee the Defence procurement procedure, etc. The Committee had accordingly given their Observations/Recommendations in the Tenth Report.

Gist of the Committee's Observations/Recommendations

4. Some of the important Observations/Recommendations made by the Committee in their Tenth Report are as under:—

- Finding that the French Company TCSF was selected by the Government despite the Company's reluctance to give a clear cut commitment of the release of the TCM Exocet SM 39 for the two Type 1500 (HDW) Submarines until and unless Project-75 was linked with long term naval cooperation with France, the Committee disapproved the way the Ministry surrendered to the terms and conditions of their French counterpart and desired that the Ministry of Defence should not succumb to such pressure tactics in crucial defence deals and should put across their points firmly in any future negotiations with any country before awarding contracts for induction of force level.
- Having observed that systemic deficiencies had played a major role in abnormally delaying the acquisition of Submarines by the Indian Navy whereas the Augusta 90 B Submarines were acquired at a much faster rate by Pakistan from the same French firm, the Committee impressed upon the Ministry to review the entire system so as to ensure strict adherence to the prescribed time frame for each of the Defence procurement processes for facilitation of the acquisition according to plan.
- Observing inordinate delays in the procurement procedure of acquisition of Submarines despite oversight at various levels and finding that even after a second Defence Procurement Procedure was promulgated in the year 2002, following the observations of the GoM in a detailed review of the Defence Procurement system subsequent to the Kargil War the shortcomings could not be overcome, the Committee had desired that the Ministry should take corrective action and improve and streamline the Defence acquisition and procurement system.
- Taking note of huge financial losses due to delay in finalization of the contract for Submarines and deprecating the inability expressed by the Ministry of Defence to quantify the exact financial loss on account of the delayed finalization of contract, the Committee asked for an explanation from the Ministry in this regard.

5. The Action Taken Notes furnished by the Ministry of Defence to each of the Observations/Recommendations of the Committee contained in their Tenth Report have been reproduced in the relevant chapters of this Report. The Committee will now deal with the action taken by the Government on some of their Observations/Recommendations which either need reiteration or merit comments.

A. Inadequate Monitoring System and Delay in Defence Procurement Process

(Recommendation Para No. 11)

6. In their Tenth Report the Committee had observed that despite a three tier monitoring system reportedly evolved to oversee the Defence Procurement Process which included a review by the Secretary, Defence Production at the Ministry level, the Controller of Warship Production and Acquisition at the Navy level, and the Chairman and Managing Director, MDL, at the Company level, the acquisition of Submarines got delayed inordinately. The Committee expressed their surprise over the fact that despite the Group of Minister's observations of several inadequacies in the procurement procedure, post Kargil War, the same shortcomings persisted in the acquisition of Submarines for the Indian Navy. The Committee had, therefore, impressed upon the Ministry to take corrective action, wherever warranted, to improve and streamline the procedure of Defence acquisitions.

7. The Ministry of Defence in their Action Taken Notes have stated as under:—

"The Defence Procurement Procedure (DPP) is reviewed from time to time. Various lessons learnt during processing of procurement cases as well as their subsequent execution are being incorporated in the DPP. The DPP 2008 has been amended and is effective from 1st November, 2009. The amendment for the current year is under discussion."

8. The Committee are not satisfied with the reply of the Ministry. Their claim that the Defence Procurement Procedure (DPP) is reviewed from time to time and various lessons learnt are being incorporated in the DPP, does not impress the Committee. Had the DPP been properly reviewed, taking into account the lessons learnt, the post-Kargil Observations of the Group of Ministers regarding the shortcomings existing in the acquisition process would have been given due weightage and the impediments in the acquisition of Submarines for Indian Navy could have been avoided. Now that the amendment of the DPP for the current year is under discussion of the Ministry, the Committee recommend that the shortcomings pointed out by the Group of Ministers be taken into account with all the seriousness and urgency that they deserve so that an integrated planning and coordinated approach towards future defence procurements on time is ensured.

B. Time and Cost overrun of the Project

(Recommendation Para No. 12)

9. The Committee in their Tenth Report had observed that there was an escalation in the price of Submarines by more than Rs. 2,800 crore and an additional Euro 27.05 million commitment on procurement of missiles due to delay in the finalization of the

contract for as long as three years *i.e.* from 2002 to 2005. Deprecating the Ministry's inability to quantify the exact financial loss on account of the delayed finalization of the contract and prolonged delivery of the Submarines, the Committee demanded an explanation in this regard from the Ministry.

10. In their Action Taken Notes, the Ministry of Defence have stated as under:—

"The instant case being a highly complex one, it took considerable time to resolve all relevant issues in consultation with stakeholders. Extensive scrutiny of the proposal before seeking approval and concluding the contract also took time. It is further submitted that escalation in price during examination and scrutiny of acquisition proposals is difficult to quantify."

11. The Committee outrightly reject the reply of the Ministry for delayed finalization of the contract and subsequent delay in the delivery of Submarines. Highly complex nature of the procurement and extensive scrutiny of the proposal are no valid excuses for delayed finalization of the contract for as long as three years. Defence procurements are usually technical and complex in nature and every proposal ought to be scrutinized extensively before placement of orders as the interest of the Nation is involved therein. The Ministry's reply, being far from tenable, is not acceptable. The Committee, therefore, impress upon the Ministry to discard their tendency of putting across lame excuses and take necessary corrective action to ensure that contracts are finalized within a specific time frame and defence procurements are made according to plan so as to avoid time and cost overrun. The Committee deplore the unwarranted stubbornness on the part of the Ministry of Defence not to quantify the exact loss in terms of money due to delayed procurement of Submarines for obvious reasons. The Committee, therefore, reiterate the need for quantification of financial losses accrued due to delayed procurement of equipment and desire the Ministry to apprise them accordingly indicating *inter alia* the exact losses caused and action taken by the Ministry to recover the losses and fix responsibility with a view to checking recurrence of such incidents.

CHAPTER II

OBSERVATIONS/RECOMMENDATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

Observation/Recommendation No. 1

The process of acquisition and indigenous construction of state-of-the art Submarines for the Indian Navy was given serious thought three decades ago when the Government mooted a proposal in 1980 for induction of Shishumar Class (SSK) Submarines in the Indian Navy. Accordingly, in March 1982 a decision was taken and sanction accorded for procurement of four Submarines out of which two were to be bought from HDW, West Germany and two to be indigenously built at Mazagaon Dock Limited (MDL). The two Submarines that were bought from HDW were commissioned in the year 1986 and out of the two indigenously built SSK Submarines, one was commissioned in 1992 and the other was delivered in 1994. In between, a proposal which was considered in 1935 to procure the fifth and sixth Submarines had to be deferred by the Government in the wake of allegations about payment of commissions by HDW. In 1997, a decision was taken by the Government for construction of two indigenous SSK Submarines of Type 1500 at MDL as well as for enlisting the collaboration of an expert foreign agency to validate the design and development by the Submarine Design Group (SDG) of the Indian Navy. Pursuant to that, the Letter of Intent (LOI) listing the names of four firms *i.e.* Thomson—CSF (France), VSEL (UK), Kockums (Sweden) and Roosvoorouzheine (Russia) was issued by the Naval Headquarters to MDL which in turn tendered inquiries to all the four firms. But response was received only from TCSF, France who were willing to participate in the Project on the condition that their Combat Suite was selected for the Submarines. Amid a series of development, the Government approved in 1999 the plan for the 'Project for Series Construction of Submarines for the Indian Navy and Acquisition of National Competence in Submarine Building'. As per the approval a fixed number of Submarine were to be built over a certain period. The programme was to be implemented in two phases *viz.* Phase I and Phase II. In Phase I some Submarines were to be built at MDL under Project—75 and some more at another production line to be created by absorbing technology. In Phase II some additional Submarines were to be built which will be completely indigenous. Two options emerged to carry out of the Submarine construction at MDL. Option I envisaged construction of some Submarines, which would be Type (HDW) design with Combat suite of TCSF and the remaining on the Scorpene design suitably modified to meet the Naval requirements. Option II envisaged construction of certain number of Submarines all based on the Scorpene design. An indigenous construction of Submarines at MDL under Porject—75 would involve Scorpene design at one stage or the other, Naval Headquarters carried out the evaluation of Scorpene Class submarines and ultimately Option II was preferred mainly because of the elimination of HDW, the more advanced nature of the Scorpene Submarine than

that of the Type 1500 HDW design amortization of the Transfer of Technology (TOT) cost over six platforms direct receipt of TOT by MDL from the designers etc. In October 2000, a Request for Proposal (RFP) was forwarded to TCSF, France seeking their technical and budgetary proposal for the Submarines under Project-75. The construction of the Submarines could commence only between December, 2006 and July, 2009 and resultantly the delivery of the Submarines have been delayed badly. The Committee's in depth examination of the subject has revealed certain disquieting aspects that led to such an inordinate delay grossly undermining the imperatives involved, as has been pointed out in the succeeding paragraphs.

[Para 1 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

Paragraph 1 brings out the background that led to selection of the Scorpene Submarine. The Committee has touched upon the process followed for the induction of SSK (Shishumar Class) Submarines and accord of the Government approval for the 'Project for Series Construction of Submarines for the Indian Navy and the Acquisition of National Competence in Submarine Building'. Based on various options available, the circumstances under which the selection of the Scorpene Design was made have also been brought out.

[Ministry of Defence O.M. No. 4(5)/2010/D/(N-I) dated 6th September, 2010]

Observation/Recommendation No. 3

As per Defence Procurement Procedure 2002, Submarine should be trial evaluated in Indian waters or the design should be validated through Computer simulations and model testing before accepting the proposal for Submarine. Such evaluation is intended to enable to gauge the performance of the Submarine with reference to the Naval Staff Qualitative Requirement (NSQR). According to the Ministry, the Scorpene design incorporated incremental improvements and underwent state-of-the-art validations by the French. The Ministry have further contended that Scorpene Submarines have already been commissioned by the Chilean and the Royal Malaysian Navy. The Committee also find that a delegation of Indian Navy and Joint Delegation of Indian Navy and MDL visited France and Spain and even sailed-on-board Chilean Scorpene in Chilean waters besides visiting Malaysian Scorpene at Kochi at different times to conduct physical verification of the Scorpene Submarines in order to satisfy themselves with the Sea Acceptance Trial (SAT) and Harbour Acceptance Trial (HAT). The Committee are, however, concerned to observe that the Ministry accepted the unproven design of the Scorpene Submarine based on the validation of the design through computer simulation despite the fact that the design of the Scorpene Submarine had not proved its efficacy in other Navies. In such a scenario, deviations in respect of the prescribed parameters such as stability, speed, endurance, noise levels, maneuvering performances etc. of the Submarine cannot be ruled out. The Ministry have, however, inserted specific provisions in the contract regarding corrective actions in case the main performance parameters are not met. The Committee feel that the measures taken by the Ministry are in the right direction and these should be persisted with more so when the design of the Scorpene Submarine has yet to prove its efficacy elsewhere, so

as to compel the vendor to take corrective action whenever slightest deviations from the original parameters are noticed. Such measures appear to be more imperative to maintain the requisite Defence preparedness.

[Para 3 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The observations takes note of the action taken in the right direction by the Ministry. If there is any deviation in agreed performance parameters, it would be checked during Harbour Acceptance Trials (HATs)/Sea Acceptance Trials (SATs) and the vendor would be made to take corrective actions before acceptance of the Submarines.

[Ministry of Defence O.M. No.4(5)/2010/D/(N-I) dated 6th September, 2010]

Observation/Recommendation No. 4

The Committee further desire that the Military should ensure transparency and accountability by being absolutely clear in the Defence requirement as they play a greater role and have more responsibility in Defence procurement and as most importantly frequent deviations from Quality Requirement (QR) may lead to an uncalled for compromise on National Security.

[Para 4 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The Staff Qualitative Requirements (SQRs) are approved by the Service Headquarters. The DPP 2008 has been revised in 2009 and it has now been made mandatory that prior to formulation of the SQRs, the Service Headquarters would follow the procedure of 'Request for Information' (RFI) to be uploaded on the MoD website. Subsequent to the receipt of information from capable vendors, the SQRs are formulated so as to ensure maximum participation. Once the SQRs are promulgated and issued as part of the Request for Proposal (RFP), no waiver of parameters is be granted.

[Ministry of Defence O.M. No.4(5)/2010/D/(N-I) dated 6th September, 2010]

Observation/Recommendation No. 5

The Committee note that pursuant to the approval of the Government in April 2001 to have negotiations with TCSF and Armaris on their Scorpene offer for construction of Submarines at MDL under Project 75 as envisaged in the Ministry in the plan of series construction of Submarines, the first round of the Price Negotiation Committee (PNC) meeting was held from November 2001 to June 2002. But astonishingly the Contract Negotiating Committee (CNC) could be held only in February, 2005 after a gap of three years and subsequently the third one in August 2005. Reasons for such abnormal delay between holding the PNC and CNC meeting have been attributed to forwarding of the CCS note to the Ministry of Finance for examination, reference to Central Vigilance Commission in accordance with the observations of the Ministry of Finance followed by several rounds of examination, extensive deliberations and vetting

by all concerned. Needless to say, the process is too cumbersome particularly the reference of Defence proposals to CVC for such a matter relating to national security. Notwithstanding the statement of the Defence Secretary that only in specific cases, if recommended, the Defence procurement decisions are sent to the CVC, the Committee feel the system of pre-audit of the procurement decisions of the Ministry of Defence by the Central Vigilance Commission should be dispensed with as it is unnecessary and totally uncalled for and resultantly leads to unacceptable delays, as has happened in the instant case.

[Para 5 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

There is no system to pre-audit of the procurement proposals by the Central Vigilance Commission. However, based on the observations of MoF during processing of the case, the case was referred to CVC for examination from vigilance angle.

[Ministry of Defence O.M. No.4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 6

The Committee are given to understand that there are three categories in the Defence acquisition process. One is the 'Buy' category which is a straight acquisition. The second one is the 'Make' category where Defence try to develop the technology of complex systems within the country which they cannot source from outside or there are other impediments in getting it. The last category is 'Buy and Make' wherein some systems are directly bought from the foreign vendors and the balance through Transfer of Technology (TOT) in order to enable the Defence to build those systems indigenously within the country. And in the acquisition of Submarines, the 'Buy and Make' method was given precedence over the other two categories as the concern of the Government has always been to develop the indigenous capability and build the Submarines. This concern of the Government is well founded as in many situations in the past; the Defence have experienced that during war situation indigenous capability is an essential requirement for maintenance of spare parts and other equally important things. The Committee feel that while the objective of hundred percent indigenization is laudable, the capabilities and capacities available in the country have to be assessed realistically. That is because even if basic infrastructure is available, the requirement of associated essentials such as equipment, technical expertise and capacity building would still take time. Moreover, while trying to achieve long term objective of self reliance in Defence acquisition, there is a need to achieve a realistic balance between the existing capacity in the country, including that of the private sector with the urgency/timelines involved in the planned acquisition. The Committee therefore, recommend that based on a case to case urgency, a rational and flexible approach towards 'Buy', 'Make' and 'Buy and Make' theories have to be adopted with a view to meeting any contingencies.

[Para 6 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The categorisation for procurement under the category "Buy", "Buy and Make" and "Make" is being undertaken on case to case basis (on the merits of the proposal) whilst according Acceptance of Necessity (AoN).

[Ministry of Defence O.M. No. 4(5)/2010/D(N-1) dated 6th September, 2010]

Observation/Recommendation No. 7

The Committee are constrained to observe that the progress of the construction of the Submarines at MDL has been very slow as on 30 September, 2009 and resultantly the delivery of the Submarines would be delayed significantly. That the Mazagon Dock Limited is attempting to reduce the gap between the scheduled delivery of the Submarines by having commenced the construction of another batch of Submarines ahead of schedule is no consolation to the Committee. According to the Ministry, the progress on the construction of Submarines has been slow on account of some teething problems, time taken for absorption of technology, delays in augmentation of industrial infrastructure and procurement of MDL Purchased Material (MPM) items. The Committee are of the view that care should have been taken to foresee such problems before awarding the contract and going for indigenisation. They are particularly concerned to note that there was problem in transference and absorption of technology which adversely impacted Project-75. However, now that the problems of Transfer of Technology (ToT) have been reportedly fully addressed as per a mutually agreed action plan between MDL and *Armaris*, the Committee hope that the problem would not resurface so that the Project progresses satisfactorily and Submarines are delivered within the stipulated time line.

[Para 7 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

Various measures (including close monitoring) have been taken to ensure that the project progresses without any difficulty so as to meet the revised delivery schedule.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-1) dated 6th September, 2010]

Observation/Recommendation No. 8

The Committee are happy to note that MDL has been taking a number of measures to avoid delays in the construction of Scorpene design Submarine. Such initiatives include opening up of parallel work fronts, revival of three new bays for use of structural fabrication work, development of a new work shop, vigorous pursuance of outsourcing etc. It is equally encouraging to notice that the Ministry have taken up a massive modernization programme of the three shipyards with particular emphasis on MDL. The Committee are of the opinion that efforts on the part of MDL itself for augmentation of infrastructures and that of the Ministry for embarking upon massive modernization programme of the PSUs that are engaged in modern technology, high value and strategic importance fabrication of weapon

system are steps in right direction and the momentum should be maintained uninterrupted as a national strategic imperative.

[Para 8 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

Various measures taken by MDL to avoid further delays in the construction of the Scorpene Submarines are being closely monitored through Progress Review Meetings held at various levels to obviate any further slippages.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 9

What concerns the Committee more is that systemic deficiencies played a greater role than any other cause that delayed the acquisition of submarines existence of such failings was corroborated by the Defence Secretary himself when he admitted before the Committee that there are problems in the system, mindset and in the whole process. The Committee acknowledge that Defence procurement is a complex process which starts with the services qualitative requirement, proceeds through the Defence Acquisition Council, Request For Proposals, Field Evaluation Staff, Technical Evaluation Committee and Contract Negotiation Committee and culminates with the approval of the Competent Finance Authority. But the Committee fail to understand the reasons for inordinate delay in the Defence procurement when a definite time frame has been laid down for each of the activities involved in the process. In this context, the Committee find that Pakistan has acquired the Augusta 90 B submarines from the same French firm at a much faster rate than their Indian counterparts. The Defence Secretary has made an effort to defend the delay on their part on the plea of focus on transparency in the Indian system. The Committee are well aware that transparency is and should be the essence of Governance, particularly matters relating to the National security. But in the name of transparency, things should not be allowed to linger on for an indefinite period which would ultimately prove detrimental to the interest of the Nation. Prudence, therefore, requires that an introspection be made to usher in a paradigm shift in the entire system and the mindset of the decision makers that would ensure strict adherence to the prescribed time frame for each of the Defence procurement processes which in turn would facilitate the acquisition according to plan.

[Para 9 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The Defence Procurement Procedure (DPP) is reviewed by the MoD from time to time. Various lessons learnt during processing of procurement cases as well as their subsequent execution are being incorporated in the DPP. DPP 2008 has been amended with effect from 1st November, 2009. The DPP-2008 (Amendment 2009) is being further reviewed. Delay in acquisition cases is being given a focussed attention during the review.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 10

In this context, the Committee would also like to point out that due to the very nature of the long term plans/programmes of the Defence procurement, the Competent authority approving the procurements may not be always fully aware of the implications of the delay and its consequential impact on the operational preparedness. Further, since the Defence procurements, by their very nature of a long lead time, greatly impact the country's Military preparedness as a whole, the Committee feel that it is absolutely necessary to put in place a long term perspective plan with the approval of an Empowered Committee of Ministers, which would certainly make the decision making process faster and more transparent at every level.

[Para 10 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

A (15-year) Long Term Integrated Perspective Plan (LTIPP) is already in place. The Headquarters Integrated Defence Staff (HQ IDS), in consultation with the Services Headquarters (SHQs), formulates the LTIPP, 5-year Defence Plans and the Annual Acquisition Plans (AAPs). Long term and medium term modernization plans prepared with due consideration to our security concerns, defence capabilities and equipment profile are prioritized and approved by the Defence Acquisition Council in the light of operational exigencies.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 13

The Committee observed that in order to compensate slippages in the delivery of contracted items on the part of the vendor due to unforeseen circumstances, a Liquidated Damage (LD) clause has been incorporated in the contract as per the provisions of DPP. The Committee also note that an 'Integrity Pact' in lieu of 'Agency Commission' Clause has also been incorporated in the contract to avoid all forms of corruption by ensuring free, fair, transparent and unprejudiced dealings before, during and after the currency of the contract. While acknowledging the incorporation of the Liquidated Damage Clause and the 'Integrity Pact' in the contracts, the Committee would simultaneously like to prevail upon the Ministry to ensure that the Liquidated Damages are invariably realized in all cases of slippages and the Integrity Pact is followed in letter and spirit.

[Para 13 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The Ministry closely monitors procurement programmes/delivery schedules to ensure adherence to the laid down timelines as per the contract. Further, wherever necessary, the Ministry invokes the Liquidated Damages (LD) clause as stipulated in the relevant contracts. Moreover, the Integrity Pact is a binding agreement between the agency and bidders for specific contracts and any violation of the pact can be looked into by independent monitors.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 14

According to Audit, separate Performance Bank Guarantees are to be provided for performance and warranty. But the vendor has provided a combined Guarantee and thus avoided providing a warranty of 58.20 million Euros. Clarifying the position, the Ministry of Defence have apprised the Committee that at the time of the signing of the contract, the Ministry considered that if the deliveries are made as per the contractual terms and conditions, one per cent of the Bank guarantee would be sufficient to cover both performance and warranty liabilities. In this content, the Committee would like the Ministry to consider obtaining separate Bank Guarantees in case the vendors at any point of time deviate from the contractual obligations.

[Para 14 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The current Defence Procurement Procedure-2008 (Amendment-2009) has made it imperative the separate Bank Guarantees are provided for performance and Warranty. The same is being followed and included in the Request for Proposal (RFP).

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 15

The Committee note that the issue of missile delivery/extension of warranty, when delays were expected in the construction of the first submarine, was taken up with the OEM *i.e.* MBDA France. The OEM has extended warranty of the first batch of submarines for a period of 24 months at no extra cost. As regards the extension of the warranty of other batches of the missile, the Committee has been informed that, a meeting is being arranged with MBDA where the issue would be taken up. The Committee desire that in the scheduled meeting, the Ministry should impress upon the firm to extend warranty to other batches of missiles also as they propose to possess adequate number of missiles in the inventory.

[Para 15 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The requirement of extension of warranty of all batches of missiles at no extra cost was taken up by the Naval Headquarters with Original Equipment Manufacturer (OEM) during the meeting in New Delhi on 28th April, 2010. During the ongoing discussions, the OEM has agreed to effectively extend the warranty at no extra cost for all the four batches of missiles by 36, 30, 24 and 18 months respectively.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Observation/Recommendation No. 16

To sum up, the Committee find that successive Governments have planned the procurement of submarines in their Maritime Perspective Plans. This has been going on since ages and there have been inordinate and unacceptable delays on the part of several Governments in deciding about the essential fleet strength; total requirements

and thereafter on the type of Submarine to be inducted. The question whether it should be indigenously fabricated or a new type procured; plus the source of procurement has always intrigued the decision makers. Such indecisiveness on the part of the decision makers and the systemic flaws in the procurement of Submarines have led to time and cost overrun and undue favour to the vendor besides adversely impacting the operational preparedness of the Indian Navy. The Committee, therefore, urge upon the Ministry to take action in accordance with their above Observations/ Recommendations.

[Para 16 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

Action taken on the observations/recommendations of the PAC have been indicated under each observation/recommendation as above.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

CHAPTER III

OBSERVATIONS/RECOMMENDATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN VIEW OF THE REPLIES RECEIVED FROM THE GOVERNMENT

Observation/Recommendation No. 2

The Committee note that a limited tender was floated as the number of companies which can manufacture conventional Submarines like Russia, Germany, France and Spain, as reported by the Ministry of Defence. Only one company *i.e.* TCSF from France responded to the tender inquires and according to the Ministry, the best decision was taken to award the contract to TCSF, keeping in view the situation and time. Here, the Committee would like to point out that TCSF was selected for Scorpene Class of Submarines despite the Company's reluctance to give a clear cut commitment on the release of the Tube Launch Missiles (TLM) Exocet SM 39 for two Type 1500 (HDW) Submarines until and unless Project 75 is linked with long term Naval Cooperation with France. The Committee acknowledge the fact that the US 'Harpoon' missile was not available at that point of time and Russian 'Klub' missile was not compatible with the Tubes of either HDW or Scorpene design Submarines. Without disputing the contention of the Ministry that due to limited choice, preference was given to the French Submarine and Missiles, the Committee would however, like to express their displeasure over the manner in which the Indian side succumbed to the conditions impose by their French counterparts in the implementation of Project-75. Since such pressure tactics do not gel well between two Sovereign Nations, the Committee would like the Ministry of Defence to put across their points firmly in any future negotiations with any country before awarding contracts for induction of force level.

[Para 2 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

Contracts for defence acquisitions are concluded in accordance with the provisions laid down in Defence Procurement Procedures as amended from time to time. Denial regimes and limited choices sometimes circumscribe decisions.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

CHAPTER IV

OBSERVATIONS/ECOMMENDATIONS IN RESPECT OF WHICH REPLIES OF GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE AND WHICH REQUIRE REITERATION

Observation/Recommendation No. 11

The Committee note that a three tier monitoring system has been evolved to oversee the Defence procurement process. This includes a review by the Secretary, Defence Production at the Ministry level, the Controller of Warship Production and Acquisition at the Navy level and the Chairman & Managing Director MDL at the Company level. The Committee are surprised that despite oversight at each level, the acquisition of Submarines got delayed inordinately. In this context, the Committee would like to point out that pursuant to the Recommendation made in their 187th Report (Eighth Lok Sabha), the Defence Procurement Procedure was promulgated to streamline the process. However, subsequent to the Kargil war, a Group of Ministers took a detailed review of the Defence procurement system and observed a number of shortcomings like lack of integrated planning, cumbersome administrative, technical and evaluation procedures and absence of dedicated professionally equipped procedure within the Ministry of Defence. Much to the consternation of the Committee, although a second Defence Procurement Procedure was promulgated in the year 2002 following the above observations of the GoM, yet the same bottlenecks in the Defence procurement system appear to have resurfaced in the acquisition of Submarines for the Indian Navy. As the Defence Secretary has candidly admitted before the Committee that there is still lot of scope for improvement in the procurement system, the Committee would like to impress upon the Ministry to take corrective action, wherever warranted to improve and streamline the procedure so that Defence acquisitions do not suffer.

[Para 11 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The Defence Procurement Procedure (DPP) is reviewed from time to time. Various lessons learnt during processing of procurement cases as well as their subsequent execution are being incorporated in the DPP. The DPP 2008 has been amended and is effective from 1st November, 2009. The amendment for the current year is under discussion.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-I) dated 6th September, 2010]

Comments of the Committee**Observation/Recommendation No. 12**

The Committee note that due to delay in the finalization of the contract for as long as three years i.e. 2002 to 2005, there has been an escalation in the price of Submarines by more than Rs. 2,800 crore and an additional Euro 27.05 million commitment on the procurement of missiles. The increase in the cost of Submarine has been primarily due to escalations of Exchange Rate Variations (ERVs) and increase in the cost of Missiles despite a discount of 1.03 per cent by the vendor, as has been pointed out in detail by the Audit. But astonishingly the Ministry of Defence have expressed their inability to quantify the exact financial loss on account of the delayed finalization of the contract and prolonged delivery of the Submarines. As it is an established fact that time overrun in finalization of contracts and completion of planned projects certainly leads to cost escalation, the Ministry owe an explanation in this regard.

[Para 12 of the Tenth Report of the Public Accounts Committee (15th Lok Sabha)]

Action Taken by the Government

The instant case being a highly complex one, it took considerable time to resolve all relevant issues in consultation with stakeholders. Extensive scrutiny of the proposal before seeking approval and concluding the contract also took time. It is further submitted that escalation in price during examination and scrutiny of acquisition proposals is difficult to quantify.

[Ministry of Defence O.M. No. 4(5)/2010/D(N-1) dated 6th September, 2010]

Comments of the Committee

Comments of the Committee Please *see* Paragraph No. 11 of Chapter-I.

CHAPTER V
OBSERVATIONS/RECOMMENDATIONS IN RESPECT OF WHICH
GOVERNMENT HAVE FURNISHED INTERIM REPLIES

—NIL—

NEW DELHI;
21 February, 2011
02 Phalguna, 1932 (Saka)

DR. MURLI MANOHAR JOSHI,
Chairman,
Public Accounts Committee.

APPENDIX I

MINUTES OF THE TWENTY FIRST SITTING OF THE PUBLIC ACCOUNTS COMMITTEE (2010-11) HELD ON 3RD FEBRUARY, 2011

The Committee sat on Thursday, the 3rd February, 2011 from 1130 hrs. to 1250 hrs.
in Room No. '62', First Floor, Parliament House, New Delhi.

PRESENT

Dr. Murli Manohar Joshi—*Chairman*

MEMBERS

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Shri Ramen Deka
4. Shri Naveen Jindal
5. Shri Bhartruhari Mahtab
6. Shri Yashwant Sinha
7. Shri Jitendra Singh (Alwar)
8. Kunwar Rewati Raman Singh
9. Shri K. Sudhakaran
10. Dr. M. Thambidurai
11. Shri Aruna Kumar Vundavalli

Rajya Sabha

12. Shri N. Balaganga
13. Shri Prasanta Chatterjee
14. Shri Kalraj Mishra
15. Shri N.K. Singh
16. Prof. Saif-ud-Din Soz

SECRETARIAT

- | | | |
|--------------------------|---|----------------------------|
| 1. Shri Devender Singh | — | <i>Joint Secretary</i> |
| 2. Shri M.K. Madhusudhan | — | <i>Additional Director</i> |
| 3. Shri Sanjeev Sharma | — | <i>Deputy Secretary</i> |
| 4. Shri D.R. Mohanty | — | <i>Deputy Secretary</i> |

Representatives of the Office of the Comptroller and Auditor General of India

1. Shri R.S. Mathrani — Director General of Audit (Central Expenditure)
2. Shri C.M. Sane — Pr. Director of Audit (Air Force & Navy)
3. Ms. Ahladini — Director (Central Expenditure)
4. Shri Bhawani Shankar — Director (Economic Service & Ministries)

2. At the outset, the Chairman welcomed the Members and the representatives of the Office of the C&AG to the sitting of the Committee. The Chairman, then, apprised that the meeting was convened to consider six Draft Reports of the Committee. Accordingly, the Committee took up the following Draft Reports for consideration:

- (i) *****
- (ii) *****
- (iii) *****
- (iv) *****
- (v) *****
- (vi) Draft Report on Action Taken by the Government on the Observations/ Recommendations of the Committee contained in their Tenth Report (Fifteenth Lok Sabha) on "**Undue Favour to Vendor in Acquisition of Submarines**" (Ministry of Defence).

3. *****

4. As the Members desired to have some additional inputs on the Draft Report mentioned at Sl. No. (vi), the consideration of that Report was deferred.

5. The Committee authorized the Chairman to finalise the five Reports adopted by them, in light of their suggestions and the factual verifications received from the Audit and present the same to the House on a date convenient to him.

6. The Chairman thanked the Members for their valuable suggestions on the consideration of the Draft Reports.

The Committee then adjourned.

APPENDIX II

MINUTES OF THE TWENTY THIRD SITTING OF THE PUBLIC ACCOUNTS COMMITTEE (2010-11) HELD ON 15TH FEBRUARY, 2011

The Committee sat on Tuesday, the 15th February, 2011 from 1130 hrs. to 1230 hrs. in Room No. '62', First Floor, Parliament House, New Delhi.

PRESENT

Dr. Murli Manohar Joshi — *Chairman*

MEMBERS

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Shri Ramen Deka
4. Shri Naveen Jindal
5. Shri Bhartruhari Mahtab
6. Dr. K. Sambasiva Rao
7. Dr. M. Thambidurai
8. Shri Aruna Kumar Vundavalli

Rajya Sabha

9. Shri Prasanta Chatterjee
10. Shri N.K. Singh
11. Prof. Saif-ud-Din Soz

SECRETARIAT

1. Shri Devender Singh — *Joint Secretary*
2. Shri Sanjeev Sharma — *Deputy Secretary*
3. Shri D.R. Mohanty — *Deputy Secretary*
4. Smt. A. Jyothirmayi — *Under Secretary*

Representatives of the Office of the Comptroller and Auditor General of India

1. Shri K.R. Sriram — *Principal Director of Audit (ESM)*
2. Shri Subir Mallick — *Principal Director (Indirect Taxes)*
3. Shri C.M. Sane — *Principal Director of Audit
(Air Force & Navy)*

2. At the outset, the Chairman welcomed the Members and the representatives of the Office of the C&AG of India to the Committee. The Chairman then apprised the Members that the meeting had been convened to consider and adopt three Draft Reports viz. two Original Reports and the one Action Taken Report which was deferred adoption in the last sitting held on 3rd February, 2011. **** **** ****

3. **** **** ****

4. The Committee, thereafter, took up the following Draft Reports for consideration:

(i) Revised Draft Report on Action Taken by the Government on the Observations/Recommendations of the Committee contained in their Tenth Report (Fifteenth Lok Sabha) on "**Undue Favour to Vendor in Acquisition of Submarines**" (Ministry of Defence);

(ii) **** **** ****

(iii) **** **** ****

5. After going through the Draft Reports one by one, the Committee adopted the Draft Reports with some modifications/amendments. The Committee, then, authorised the Chairman to finalise the above mentioned Reports adopted by them, in light of their suggestions and the factual verifications received from the Audit and present the same to the House on a date convenient to him.

6. The Chairman thanked the Members for their valuable suggestions on the consideration of the Draft Reports.

The Committee then adjourned.

APPENDIX III

(Vide para 5 of Introduction)

ANALYSIS OF THE ACTION TAKEN BY THE GOVERNMENT ON THE OBSERVATIONS/RECOMMENDATIONS OF THE PUBLIC ACCOUNTS COMMITTEE CONTAINED IN THEIR TENTH REPORT (FIFTEENTH LOK SABHA)

(i) Total No. of Observations/Recommendations	-	16
(ii) Observations/Recommendations of the Committee which have been accepted by the Government: Para Nos. 1, 3-10, and 13-16	-	Total: 13 Percentage—81.25%
(iii) Observations/Recommendations which the Committee do not desire to pursue in view of the replies received from the Government: Para No. 2	-	Total: 1 Percentage—6.25%
(iv) Observations/Recommendations in respect of which replies of Government have not been accepted by the Committee and which require reiteration: Para Nos. 11 and 12	-	Total: 2 Percentage—12.50%
(v) Observations/Recommendations in respect of which Government have furnished interim replies:	-	Total: 0 Percentage—0% -NIL-