DEFENCE CONTRACTS

Lecture - 2

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SCOPE OF PRESENTATION

- Contract is not Common-sense
- Contract Act 1872
- Sale of Goods Act 1930
- Departmental Manuals: DPM, DPP
- Arbitration & Reconciliation Act
- Supreme Court Decisions

SC DECISIONS

- **Equal Opportunity , Non Arbitrariness, Fair**
- **Procedure Established By Law Vs Due Process**
- **Decision Making Process Vs Merits of Decision Making**
- **Till 2G Judgement SC went by Process Compliance (Open Sky Policy not struck down)**
- **2 G Case (2010); First Come First Serve, Loss of Revenue**
- **Coal Block Allocation 2014: Arbitrariness**
- **Chary of Defence Related Cases: Rafael**

PROVISION IN THE CONSTITUTION

- **Article 298: Executive Power of Union and State make contract**
- **Article 299: Contracts in the name of the President and executed by authorised persons**
- **Article 399(2): No Personal Liability**
- **Article 300: Government of India may sue or be sued**

CONTRACT ACT: 1872

- **Essential elements for a valid contract**
- **Agreement: Offer to be definite, meaningful and duly communicated**
- **Acceptance to be absolute, unconditional and duly communicated**
- **Legitimate Consideration: Section 23**
- **Capacity of parties: Minor, mentally unsound, disqualified (S11)**
- **Free Consent, Coercion, Undue Influence, Fraud, Misrepresentation (S20)**
- **Lawful Object**
- **Contract to be Written**
- **Assignment and Contingent contract**

CONTENTS OF BIDDING DOCUMENT

1. **Instruction to Bidders**
2. **Condition of Contract**
3. **Schedule of Requirement**
4. **Specialisation and Technical Details**
5. **Price Schedule**

- **Bid security: EMD except MSMEs**
- **Performance Security: Successful bidder 5-10% of value of contract, DD or FDR**
- **Valid for a period of 60 days beyond completion of all contractual obligation**
- **Advance payment: ≤ 30%**

MODE OF TENDERING

- Publication of TE on CPPP
- National Security Items exempt for e-publication
- Mode of Tendering: LTE: Upto 25 lakh to all registered suppliers, >3 firms
- Unsolicited offers should not be accepted
- Beyond 25 lakh: Demand is urgent, not possible to go for advertised tender
- Sources of supply are definitely known
- Two stage single bid system: High value P& M, complex systems
- Technical bids first , Financial bids of those technically acceptable

TRANSPARENCY, COMPETITION, FAIRNESS AND ELIMINATE OF ARBITRARINESS

- Text of bidding DOC: Self contained and unambitious
- Prior turnover and prior experience to be relaxed for start ups
- Description and spec(s), quality, time and place of delivery
- Criteria for eligibility and minimum experience, technical capability, manufacturing facility and financial position
- Criteria for evaluation of bids
- Essential terms of procurement contract
- Provision for settlement of disputes
- Bids to be opened in public

GENERAL FINANCIAL RULES, 2017

- Standards of Financial Propriety
- Same vigilance as a person of ordinary prudence for his own money
- Not more than occasion demand
- No exercise of power to directly/indirectly benefit
- Not for benefit to a particular person or section of people

GENERAL PRINCIPLES OF CONTRACT: RULE 225

- **Terms must be precise, definitive without any ambiguities**
- **Terms should not involve an uncertain or indefinite liability, except in case of Cost Plus contract or where there is price variation clause**
- **Standard forms of contract should be adopted**
- **Modification with financial and legal advice**
- **If not standard from, obtain legal and financial advice**
- **Cost plus contract to be ordinarily avoided**
- **Price variation clause in long term contract, beyond 18 months**
- **Base year price, Government indices**

STANDARD CONDITION OF CONTRACT

- Application, Law
- Arbitration
- Penalty for Use of under influences
- Agent/Agency commission
- Access to books of account
- Liquidity damages
- Termination

(a) Delayed beyond DP
(b) Bankruptcy
(c) Using agents

PRICE VARIATION CLAUSE: APP II (GFR)

$$P_1 = P_0 \, [F + \alpha \, [M_1/m_0] + \beta \, [L_1/L_0] - P_0$$

- P_0= Contract price at base lend
- F= Fixed element not subject to PV (10-15%)
- A= Material component
- B= Labour component
- L_0, L_1, Wage indices, M_0 & M_1- Material Indices

SINGLE TENDER ENQUIRY

- Emergency/Urgency, a particular source only
- Operational requirement
- To OEMs only
- PAC tendering: Certificate
- Price Reasonableness
- Lack of competition - < 2, cartel formation
- Price quoted unreasonable high wrt RR fixed
- Withdrawal of offer by L_1: Retendering (CVC)

LIQUIDATED DAMAGE

- Penalty Vs Damages: Supreme Court
- Actual/demonstrable monetary loss: Supplier responsible- .5% per Week , Max 5-10%
- Supplier responsible for a part: L/D for which suppliers responsible
- Delay beyond control of supplier: L/D waived
- Token L/D: 10% of . 5% (Minor loss)
- Consequential Damages: Time bound Contracts

REPEAT ORDER, OPTION CLAUSE

- Items delivered successfully
- No downward trend, certified
- Within 6 months from date of completion of supply
- Maximum 50%, if the contract does not include the option clause
- Option Clause : Within Currency of the Contract
- Total quality ; 25-50%
- No downward trend
- Care to be taken in multi vendor contract
- RFI to test the market

DETERRENT CLAUSES

- Agents & Agency Commission
- Undue Influence
- Access to Books of Accounts
- Integrity Pact

RATE CONTACT: DGSD

- Apportionment of Qty – L_1 fully loaded
- Others at L_1's rate for balance qty
- Common use items regularly required in bulk by users
- Prices are likely to be stable
- Economy of scale, cuts down processing time
- With registered firms
- Parallel RC, price differential upto 5%
- Fall clause
- 95% payment against dispatch during
- 5% on account of stages

DESIGN, DEVELOPMENT & CONTRACTS

- TOT has been taken
- Import prices are exorbitant
- Stage Payment: Advance Payment(10-15%), PDR (15%), CDR (35%) , Prototype Trial (25%), Warranty (10%)
- Warranty : Replacement , Repair, Latent Warranty (Design Defect)
- Cost plus contracts: No Previous Reference
- Source development(20%) & Regular Order(80%
- Established Source After two successful Delivery
- Orders on two sources at slightly varying rates: MTU

PRICE NEGOTIATION

- To be generally Avoided
- If poor competition & higher than Bench mark Price: Negotiate with L1(CVC)
- Working out RR
- Cost Details, Access to books of Account
- Relevant Indices, Prowess(CMIE)

WORLD BANK BIDDING DOCUMENTS: GOODS

- Instruction- Right to inspect and test goods without extra cost
- Warranty- No defect arising for design, material or workmanship
- Valid for 12 months under notice
- Repair or replace within reasonable speed
- Assignment- Permission of purchaser
- Sub Contract- Liability with supplier
- L/D- As specified in SCC, 0.5% per week, max 10%
- Force majeure: War or revolution, fine, floods, epidemics, freight, Embargo, Quarantine Restriction
- Arbitration: UNCITRAL Arbitration Rules, ICC, London Court of International Arbitration

WORLD BANK GUIDELINES FOR P&M

- Price of recommended spare part not to be considered
- Award criteria: Substantially responsive and lowest Evaluated bid
- Corrupt Practice: offering, giving, receiving or soliciting
- Fraudulent practice: Misrepresentative of facts to influence a procurement process
- Completion of guarantee
- Applicable rate of L/D: 0.5%, 10% maximum
- Applicable bonus for early completion
- Settlement of Disputes
- UNCITRAL (76), ICC Rules, London Court of Arbitration, Arbitration Institute of Stockholder Chamber of Commerce

WORLD BANK GUIDELINES FOR P&M

- Pre Bid Meeting
- Amendment to bidding Doc(s) before bidding of submission
- Substantially responsive bid: Confirm to all terms and conditions and specification of the bidding doc(s) without material deviation, objection, conditionality or reservation
- Technical Evaluation: Not meeting Minimum Acceptable standard of completeness to be rejected
- Achievement of performance criteria
- Long term availability of mandatory and recommended spare parts
- Commercial evaluation; price of deviations
- Cost of DP extension beyond minimum deliver period

OECD REPORT ON CORRUPTION IN PUBLIC PROCUREMENT

- Transparency of the criteria and process of bid evaluation crucial in bolstering bidders' trust
- Legislation in India does not explicitly require a announcement of tendering results to the unsuccessful bidders.
- Reasons for selection of the winner bidder must be recorded and made available to the bidders.

CORRUPTION IN THE DEFENCE SECTOR/OFFSET CONTRACTS

- Defence sector accounted for 50% of all bribery allegations (94-99)
- Opacity of Offset Contracts
- Obsolete Technology Transferred
- Poor Job Creation Record: Keith Hartley
- No unambiguous economic benefit (Brauer)

Source: Transparency International

MAJOR IRREGULARITIES IN CONTRACT

- Tailor-made specifications
- Resultant single tender: TEC/Field Trial
- Singh Tender
- Arbitrary exercise of repeat order and option clause
- Inspection reports
- Limited tendering
- L/D waiver
- Post contract management
- Phookan Commission: Karghil Procurement
- Coffin Scandal

TRENDS IN GLOBAL DEFENE MANUFACTURING

- Defence is a Merit Good
- Oligopolistic, Monopsony
- Equipment Cost has Increased by 10% in Real Terms
- Trend Towards PPP
- Comparative Advantage of Specialization
- Economies of Scale
- Competitive Tendering : Decrease Cost by 5% - 40%
- Military Malthusiasm

Prof. Keith Hartley : Father of Defence Economics