Contract Management

Purchase Contract

Communications of obligations to all concerned

- Buyer's obligation
- Seller's obligation
- Product description
- Quality & Quantity
- Terms & conditions
- Payments
- Remedies

Documentation in Public Procurement Process

A vital part of the public procurement process

Inaccuracy or incompleteness of documentation,
Lack of timeliness - Delays public procurement process

In the case of imports, the impact of documents can be severe in clearances, payments, losses, legal actions and fines

Every document should stand test for:

- Authenticity
- Timeliness
- Conformity with requirements of law/tender/contract
- Accuracy & completeness

Tender & the Role

Tender:

Dealing with many and selecting one to result into a compliant & successful contract.

Bid conditions, Rules, procedures, guidelines, policy, law are important

Contracts & the Role

Contracts:

Dealing with chosen one
to result into a complete targeted act.

Your ROLE

Facilitator, enabler, partner
for achieving target

What can you do
to ensure contractor doesn't fail?

Have you done enough?

Complexity of Scale, Process & Interpretation

Scale of stakes involved &

Stage of Procurement matters

The perspective changes with time &

Stage of Process

So called ***Meeting of Minds***

for contracts,

Transforms into

Maximization of Benefits

Important Commercial Terms in Supply Contracts

Contract Management
- Major Commercial Issues

- Contract Performance Guarantee
- Delivery Terms
- DP Extension
- Liquidated Damages
- Denial Clause
- Force Majeure Clause
- Quality Assurance & Inspection
- Quantity Option Clause
- Contract Price Adjustment - Price Variation Clause
- Default and Breach of contract
- Dispute Resolution - Arbitration
- Payment of bills

Contract Management Issues

- Amendments to the contract
  - Admissible or not, conditions
  - No amendment that can lead to a vitiation of the original tender decision or an undue advantage to contractor
- Operation of the option clause
  - Quantity variation
- Handing over materials/ equipment to contractor
  - Security
- Quality assurance
  - QAP, Inspection

- Handling of securities
  - ✓ PBG, WBG
  - ✓ Adequacy, Wording, Validity, Enforcement
- Delays in performance
  - ✓ Extension, Damages
  - ✓ LD, DC, FMC, PVC, SVC
- Breach of contract
  - ✓ Remedies, Forfeiture and termination of contract
- Dispute resolution
  - ✓ Arbitration
- Payment
  - ✓ Milestones
  - ✓ When, How much, Mechanism

Performance Guarantee

- Submitted by Successful Bidder: Guarantee to assure contract successful execution,
- Form & Format: Generally Bank Draft, Fixed Deposits, Bank Guarantee etc as prescribed in tender conditions
- Condition: By Successful bidders irrespective of its Registration Status as per tender conditions
- Value: 5 to 10% of Contract Value
- Validity: 90 to 120 days beyond Completion time of the Contractual Obligations
- Release: On discharge of contractual obligation, generally on receipt of Warranty guarantee

Performance Guarantee

- Return of Bid Guarantee: On receipt of Performance Guarantee
- Bank Guarantee: Most Common Form as per prescribed format (PBG)
- Purchaser's Irrevocable Right: Encashment of PBG on Contractual breach/failure
- Clauses of Bank Guarantee: carefully worded & Legally vetted to avoid Litigation with Bank
- Monitoring System: Required for timely action within validity to extend/encash/discharge
- Future: e-BG in paperless form

Delivery Terms – Price, Time & Risk

- Terms: Ex-works, FOR Stn of despatch, FOR Destination, Door delivery, Incoterms
- Freight: paid/extra, borne/reimbursed
- Insurance: for transit, risk & responsibility
- Mode of transit: Rail/Road/Ship/Air/Hand/Courier
- When the property in goods passes
- Obtaining Over Dimensional Consignment (ODC) Clearances responsibility
- Buyers' obligation: Raw material supply in Fabrication Contracts, Arranging Road Permits etc
- Time-lines for delivery, Installments, Severable, Entire
- Documentation for delivery- Invoice, RR/LR, IC, Packing list
- Delayed delivery, Non-delivery: consequences

Delivery Terms – Price, Time & Risk

For Imports

- Most of GoI contracts are on FOB or CFR basis
- Marine Insurance is by:
  - By Purchaser in FOB or CFR contracts
  - By Supplier in CIF contracts
- Ocean Freight- tenders seek FOB price & Ocean freight, FOB & CIF/CFR (Ministry of Shipping has since withdrawn mandatory requirement of shipping through them)
- On Arrival of Consignment at Indian Port, Clearance, Transportation & Insurance is by Consignee/Purchaser
- Agency commission is permissible for Indian agent, but has to be paid in INR only

Types of Import Contracts

Governed by Incoterms 2010 wef 1.1.2011
(as prescribed by ICC)

- Describe key obligations of sellers, buyers and carriers
- With regard to: Delivery of Goods, Transfer of Risk & Costs

FAS (Free Alongside Ship):

- Responsibility of supplier
  - ceases once he delivers material alongside ship
- Importer to bear all charges of;
  a) Loading into the ship
  b) Freight
  c) Insurance
  d) Can choose vessel for shipping the goods

Types of Import Contracts

(Contd.)

FOB (Free on Board):

- Supplier's responsibility to get the goods loaded into the ship
- Freight & Insurance to be borne by buyer
- Buyer can choose Indian Flag ship

CFR (Cost and Freight):

- Add the element of Freight to FOB Price
- Total price up to the port of destination borne by seller
- Supplier sometimes insists on their choice of vessel

CIF (Cost Insurance Freight):

- Add Insurance to CFR

Types of Import Contracts

(Contd.)

FOR (Free on Rail) or

FOT (Free on Truck): {Not an Incoterm}

- Only when agent handles import
- Agents directly deal with the Principals & Offers submitted by Agent on FOR/FOT basis
- All transactions, including cargo clearance at Indian Port, handled by the Agent

Delivery Period (DP) Extension

- DP expiry means contract stands breached
- Contract can be extended with mutual consent as per terms of the contract
- Concern is attributability of reason for delay
  - Administrative delay –DP is refixed, vendor gets extra time for performance
  - Vendors delay –DP extended with Liquidated Damages (LD) & Denial Clause (DC)
  - In TP order, only higher price is disallowed, no LD
- Caution: a) Confirm the demand/continued requirement of material, b) Any special condition like TP having impact on DP extn decision c) Vendors approval status has not been downgraded, d) Prevailing market rates have not dropped, e) Progress made by supplier

Liquidated Damage (LD) Clause

- Built into the contract as Pre-estimated damage payable by supplier to purchaser for delays in supplies
- Based on quantity due & duration of delay
- Leviable @ 2% per month or part thereof, on value of delayed supply, with a maximum of 10% of Contract Value
- LD to be recovered at the time of Payment
- 'Severable' or 'Entire' Contract
- Waival of LD –as per attributability of delay

Denial Clause (DC)

- Denying the extra cost if any which becomes payable to Supplier during the extended period
  - Upward revision in statutory levies, taxes, duties etc
  - Additional cost due to contracted PVC
- However, the benefits if and due to these changes during the extended period will have to be passed on to purchaser
- In a sense the upper limit of payable price gets frozen as on date of originally stipulated delivery
  - Any extra cost will not be paid by purchaser
  - Any benefit will be availed by the purchaser

Force Majeur Clause (FMC)

- Situation beyond the control of Supplier
- Such Situation may be Natural Calamity, Fire, Floods, Civil Commotion, War, Lock Out etc
- No damage, compensation or Claim by either party
- The Supplier is entitled for DP refixation to complete the Supplies
- Reporting & Documentation of situation is required
- Vetting by Finance and Sanction of Competent Authority may be required

Quality Assurance Plan & Inspection

- Quality Assurance (QA): a way of preventing mistakes or defects in manufactured products by process control
  - Avoids problems when delivering goods or solutions or services to customers
  - Focuses on
    - Providing Confidence
    - Quality requirements will be fulfilled
  - Specifies Standards & Tests in All components contributing to quality of manufacture
  - Organizational structure detailing
    - Each employee's responsibilities and
    - Qualifications an employee needed to fulfill those responsibilities
  - Sub-Suppliers and the materials supplied correspond to the requirements for the product.
  - Has Appropriate Plants & Equipments
  - Specifies adequate product testing at Different Stages
  - System for Feeds back and customer complaints to solve problems and encourage improvements in Quality

Quality Assurance Plan & Inspection

Inspection: Check on incoming material quality

- Time-lines,
- Prototype,
- Stage/Final,
- Pre-despatch /On-receipt,
- WTC based, Third party, consignee,
- Lab tests & detailed procedure for inspection
- Cost of inspection
- Inspection markings,
- Inspection certificate

Why inspect

- Rely on QAP, WTC & be strict on failures
- Save time, money, build trust
- Risk-mitigation measure

Quality Assurance Plan – As a Strategy in Procurement

- Quality Assurance Plan to Specify:
  - Technical Details of Process
  - List of Plant & Equipment
  - Laboratory Test Facilities available
  - Tests Being Performed at each stage of production to ensure Quality
  - Documentation
  - Manufacturer's Test Certificate
- Technical Team Visit to plant to see Quality assurance Facilities

Option Clause to vary Quantity

- Optional Clause: Vary the order quantity, during validity of contract, in High value contracts for regularly required materials
- To be a Clause in Tender document and then in contract
- Clause can be worded to suit requirements: How much, When, What conditions? Existing terms to remain same
- (+/-)30% Quantity Variation Option Clause for meeting Variation in Demand during the currency of the Contract
- Financial Implication of the Clause: May Change the Competency of Approval when operated
- Firm to be given adequate time to deliver enhanced quantity
- Quantity reduction for reduced demand, (also used by some when lower rates are received in next tender)

Quantity Variation

- The Clause has to be operated during the currency of the Contract
- All other terms of contract remain same except quantity & its delivery schedule
- Appropriate Extension in Delivery Period may be required
- No change in rates for additional quantity
- Price Variation Clause will be applicable for additional quantity also
- Caution: a) Confirm the demand, b) Check if vendors approval status has not been downgraded, c) Check the prevailing market rates have not dropped, d) Delivery schedule for supply, e) Approval of CA as per revised value of contract

Price Variation Clause (PVC) - Price Adjustments in Contract

- Payable price is updated to prevailing indexes/ market prices as per arithmatical formula
- For High Value Tenders with long Delivery schedules
- For Items with major input of non-ferrous and other Raw Materials prone to Price Volatility
- To be proactively Incorporated in Tender document itself to avoid bids compaison issues
- In Tender Evaluation this Clause is considered for bringing offers at par for compaison
  - Ensure that all bids are with same price base
  - Ensure that variation formula is same for all

PVC - Price Adjustments in Contract

Need

- To Reduce Speculative bid pricing
- By Reducing future price fluctuation risk for bidders
- For Long drawn contracts, generally more than a year
- In Contracts for items having major input of high price volatility materials eg. Copper, Aluminum, Lead etc

More important

- ✓Helps bidders quote more appropriate price with reduced risk for estimating future input price components
- ✓Purchaser gets more reasonable price with protection from Speculative bidding
- ✓Contractor gets compensated for future Price rise
- ✓Purchaser benefits from drop in input costs, if any
- ✓Less risk of contractors defaulting
- ✓Need not cover all price factors, important ones only

PVC - Price Adjustments in Contract

Types of price adjustments clauses

- Price Variation Clause (PVC)
- Statutory Variation Clause (SVC)
- Foreign Exchange Rate Variation (FEx variation), for import content paid in INR

Contract shall clearly specify price basis with

- Clearly identifiable index/market items for PVC
- Authentic, neutral & fair Source of data
- Prevailing Base price values: index values, market prices, FEx rate, Rates of taxes & duties
- Arithmatical formula for calculation of payable price
- Index/Market data time lag i.e. Dates, in relation to particular supply lot, which will be considered
- Price ceiling applicable both lower & upper, if any
- Documentation required for claiming, Evidence & calculation

PVC Formula Construct

An typical formula construct:

- **Fixed Element** –usually 10 to 15% in respect of Fixed Over Heads, Profit etc
- **Base Indices Values** (Material and Labour) **pertaining to prior Period** Say One Month wrt Date of Tender Opening –values/method to be specified in tender
- **Indices Values for adjustment** –Say 2/3 months **prior to Delivery** as Defined in Contract
- **Suitable Weight** to be **assigned** for Variation of Material and Labour Components to calculate Price Escalation/De-escalation

PVC Formula Construct eg.

$$P_a = P_0 (F + W_L * L_1/L_0 + W_M * M_1/M_0) /100 - P_0$$

- F: Fixed element in price (%)
- W_L and W_M are Appropriate Weights (%)
- L_0 and L_1 are average Consumer Price Index for Industrial Workers Published by Labour Bureau for the base month and 2/3 Months prior to the Delivery respectively.
- M_0 and M_1 are Material Price Indices, Average of the Base month and 2/3 months Prior to the Month in which Date of Delivery Falls respectively
- P_a : Variation and P_0 : Contracted price

PVC Formula – Indices data

Material Indices are Periodically Published by:

- Ministry of Commerce and Industry, DIPP
  - Economic adviser
  - www.eaindustry.nic.in
- IEEMA
- RBI, SBI
- HCL, HZL, SAIL
- London Metal Exchange
- Bombay Metal Exchange
- Economy/Financial News papers
- Any Fair & neutral Source publishing Indices

Application of PVC

- No price increase allowed beyond original delivery unless DP re-fixed or extended with price variation
- Decrease in price is however availed
- All index material prices are basic prices without any taxes, duties etc
- When LD is levied, no upward PVC is allowed
- Price Adjustment may be payable if price Variation is more than a specified Percentage
- Total Price Adjustment may be subject to a Maximum Ceiling

Application of PVC

- No price adjustment is admissible on advances paid to supplier
- For stage payment on staggered supply, initial payment is made as per basic rate
- Price adjustment may be made separately after verifying the calculations & indices
- Particular care has to be taken to obtain price benefit on downward variation of indices

Case Study - PVC

- A Supply Contract awarded during Yr 2009 had PVC Clause based on “Whole Sale Price Index” of 1993-94 Series Published by Economic advisor, Ministry of Commerce
- The Above Series was discontinued from September, 2010 and another Series Issued pertaining to Indices 2004-05 was in place
- There was No Correlation formulae to Switch over from Old Indices to New Ones

Case Study - PVC

- The issue was referred to Economic Advisor, Ministry of Commerce
- They issued “regression equation” for correlation to update price of steel etc as on August, 2010 in new series
- Taking this as base price, the PVC formulae was made applicable up to December, 2011
- They also directed to devise new formulae for new contracts

Other Important Clauses

- Warranty – Protection against manufacturing defects by Manufacturer
  - Warranty has to be claimed
  - Within the contracted warranty period
  - Supported by WBG
- Risk & Cost
  - In case of failure of Supplier to Supply Materials, Purchaser may procure materials from alternate Sources
  - The additional Cost of purchase, if Any, stands recoverable

Default & Termination

- Contractor repudiates the Contract
- Has without valid reason failed to supply as per terms
- Persistently fails to execute the Contract in accordance with the Contract terms without just cause
- Refuses or is unable to execute and complete the contract in the manner specified

Default & Termination

- Supplier/Contractor becomes bankrupt or insolvent or Force Majeure condition
- Supplier assigns or transfers the Contract or any right or interest therein in violation of the contractual provision
- Supplier has engaged in corrupt or fraudulent practices in competing for or in executing the Contract
- Supplier has entered into Unfair Trade Practices

Default & Termination

- In case of default, the incidence has to be dealt with in accordance with the clauses of the contract:
  - Levy LD / Imposing Penalty for delay
  - Forfeiture of security PBG for non-performance
  - Purchase at Risk & cost of defaulter
  - Review of approval/registration status
- Termination to be followed as last option
- Adequate notice pointing out defaults as a matter of Natural Justice before Termination
- In case of Termination, Bank Guarantee Should be Promptly Encashed
- Short Closure of the Contract

Dispute Resolution

- Arbitration & Reconciliation Act, 1996
- Conciliation to Resolve Disputes
- Provision & Procedure to Constitute Arbitration Panel as per Clause in the Contract
- Jurisdiction of High Court to Appoint Arbitrator
- Arbitration Award

Payment to Contractor

- Payment terms to be suitably devised keeping financial safeguards in mind
- Mode Of Payment:
  - Electronic Payments through RTGS is the current preferred mode even by CVC
- Front Loaded Payments to be avoided
- Price Break up of components like Supply, Installation, Commissioning, Trainings etc Is Detailed in the Contract
- Inspection & Submission of Documents Forms Basis for Payment
- Final Payment on Receipt & Acceptance of Materials
- For Regular Suppliers: Advance/ Part Payment Clause (90%, 95%, 98%) based on proof of Inspection & Despatch/Delivery in Depot
- Performance/Warranty obligation supported by financial security
- Budget allotment & Exchequer Check

Incoterms 2010 (wef 1.1.2011)

RULES FOR ANY MODE OR MODES OF TRANSPORT

EXW	Ex works
FCA	Free carrier(Upon delivery of goods to the carrier)
CPT	Carriage paid to
CIP	Carriage and insurance paid to
DAT	Delivered at terminal
DAP	Delivered at place
DDP	Delivered duty paid

RULES FOR SEA AND INLAND WATERWAY TRANSPORT

FAS	Free alongside ship
FOB	Free on board
CFR	Cost and freight
CIF	Cost insurance and freight

Thank you