

No Longer “Heads I Win, Tails You Lose”: Reforming Uncertainties of Payment, Refunds & Recoveries in Government Contracts during CoronaTimes in India

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Introduction

Timeliness in payments to prime- and sub-contractors for work done and for price escalations due; *promptness in refund* of security deposits and performance guarantees; and *fairness in imposition* of liquidated damages have long been recognised as important pillars of *contract administration* reform worldwide. Good *buyer* (read *government*) behaviour not only ensures swift progression of public projects as planned; but may also have important implications for ensuring more competition in future contracts – the *contract formation* stage – when evidence of a *fair paymaster* can be *readily sensed* by the government contractor/ bidder community. Many of these issues surrounding liquidity and timely payments tend to become critically important during times of stress, especially during the current COVID-19 pandemic with its unique labour shortages, movement restrictions and supply chain disruptions – when ensuring liquidity in public projects while tackling

budgetary constraints becomes the key to continued project implementation, and through such project progression, to overall national economic recovery objectives.

Public works in India, on the other hand, have typically contained *one-sided contract clauses* on many of these important aspects – a problem that can worsen in the absence of *fair implementation thereof* and also given *inefficient resolution of contractor disputes*. This short brief accordingly examines some typical evidence, *both anecdotal and case-based* from the State of Rajasthan, particularly in the context of a number of drinking water supply and other EPC (Engineering-Procurement-



Construction) projects in the State.

In fact, most state situations now stand in sharp contrast to smart procurement by the Central Government, particularly with the Government of India having issued path-breaking instructions this Wednesday, directing extension of public contracts without penalties/ liquidated damages as part of an overall “force majeure” strategy kickstarted by them quite early in February this year, as well as issuing instructions for proportionate refund of bank guarantees as public project implementation moves forward.

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Randomised Budget Provisions & Re-appropriations and Excessive Financial Sanctioning

In theory, most States in India have *near-perfect* systems for allocation of budgetary resources to ongoing and greenfield public works: reviews and planning happen regularly through BFCs (Budget Finalisation Committees); the whole show is seemingly *inclusive* with senior-level participation from administrative departments; *ad infinitum ad nauseum*. As a matter of practise, however, participating in the state public finance environment can be highly risky and unpredictable for government contractors for reasons such as: (i) budgetary estimates on likely expenditures are typically based on *unreliable feedback* from the field and can be sought *too much in advance*, while procedures for re-appropriation of funds to faster-moving projects can be *too rigid* – all at the same time; (ii) state governments typically tend to sanction projects far more than that are *financially sustainable* – particularly before the onset of India's *regularly-held elections*; (iii) *last minute revisions and one-sided* budgetary cuts and re-appropriations are frequently witnessed to make space for some high priority project/ scheme of the day; and (iv) last-minute blocking of payments at treasuries can take place merely to avoid an adverse *ways-and-means advances* position of the state government. Cumulatively, this unpredictable payer behaviour creates high uncertainties for contractors regarding budgetary allocations over *a single financial year*, let alone over the three- to ten-year contract duration of a typical infrastructure project.

As a result, contractors may have little or no incentive to progress public

projects *as contracted and planned*, limiting themselves *only to progress commensurate* with what they can *sense* would be *actually be paid for by the State* over a given financial year. Its therefore not surprising that most mid-level contractors tend to conservatively progress projects *even when* faced with imposition of high liquidated damages for failure to progress as per contract. This problem can acquire even more serious overtones on account of other practical reasons as well: (i) contractors may consciously avoid submission of running bills on time, since they become *liable to payment of substantial advance state taxes* on *date of bill-submission* and not the *later date of actual payment by the principal*; (ii) even where contractors regularly submit running bills on time, field officers can *block or avoid certification* for months and years altogether in order to either *ease payment pressures* on themselves, or simply to *avoid taking responsibility for quantum or quality of work done* under a predecessor officer's tenure; and (iii) unlike most advanced jurisdictions, Indian state governments typically do *not allow interest payments on inordinately delayed payments* for work done and measured/ certified.

Lack of Reliable Databases on Progression of Projects

Most states in India do not have *online and reliable databases* on progression of projects, but *only online databases on public expenditure*. As a result, the entire planning and expenditure sequencing exercise can get contaminated with unreliable field estimates – a situation where project implementation agencies can easily *deflate or inflate* status of progression of individual projects – sometimes simply

to benefit *friendly* contractors and to *penalise* others.

The State of Rajasthan, for instance, does not have any public or internal database where *either the quantum or timeliness of running bills* submitted by contractors can be properly monitored; and particularly in times of budgetary squeezes, absence of such a database can hinder fair allocation and prioritisation of financial expenditure across hundreds of constituencies and thousands of public projects vying for funding and for government attention.

Absence of Formal Systems for Recognition of Subcontractors

Most advanced public procurement jurisdictions around the world allow formal recognition of sub-contractors, since *timely payments by a prime to a sub* also usually ensures *timely progression of important sub-contracted parts* in the case of large infrastructure contracts. In contract, most Indian states tend to (rather *mistakenly*) equate *sub-contracting by a prime* with “fake” or “under-the-table” contracting by public procuring officers: the net result being that records of sub-contracts remain either hidden, unavailable or unverified, making it virtually impossible to state governments to ensure timely payments to sub-contractors even upon timely payment by the government to a prime. This usually means *tier-2 implementation* of public works can be left largely unattended and unmonitored in India, adding high uncertainty to proper understanding and progression major sub-contracted chunks of large infrastructure works in the public sector.

To be fair to primes, at least some of the sub-contracting seems to be undertaken by them only to minimise

complaints by numerous *public-spirited* stakeholders on quantity and quality of work done; thus suggesting clever and strategic use of sub-contracts by primes to mitigate their risk of getting entrenched in vicious-endless cycles of inspections and enquiries by India’s quite abundant oversight and anti-corruption fora, a complaint cycle which could otherwise potentially choke a prime’s rightful payments against work actually undertaken and verified.

One-Sided Damages, Unfair Blocking of Refunds, etc etc

Most states in India, including Rajasthan, have issued formal instructions so as to ensure that contractors are not penalised through imposition of high liquidated damages (LD) where hindrances are caused by government inaction and are not attributable to a contractor, extending even to requirements that contracts have to be extended by public authorities from time-to-time as an interim measure to account for such unforeseen or unforeseeable hindrances. In contrast, largely on account of a high degree of risk avoidance by field level officers, most public projects regularly witness mechanical and full imposition of LD essentially just to ensure that no complaints can be made against government officials for allegedly causing any *undue benefit* to contractors.

Quite obviously, such mechanical determinations by government officers typically result in causing *considerable* illiquidity and adversely affect regular fund-flow to otherwise important public projects. The absence of timely and efficient remedies against interim LD impositions, coupled with an equal degree of “corruption risk”-avoidance on part of superior/ appellate

authorities, typically leaves contractors with having to choose *high-risk, high-cost and high time-consuming* dispute resolution fora such as arbitration or writ petitions before higher courts for resolution of their otherwise justified grievances.

To add to the problem, some states like Rajasthan can also have patently unfair contract clauses such as those allowing return/ refund of *performance bank guarantees* (PBGs) to contractors *only when final bills have been paid*, even when a contractor can and should be held responsible *only for timely submission or bills and verification thereof by field officers*. As is obvious, payment of certified bills is an issue with a *payer* (the Government) and not with the *payee* (the contractor); and thus, an anyway high risk of non-payment of certified bills gets compounded manifold with an added but a completely unnecessary risk of non-refund of PBGs in time.

A careful study of important *standardised* procurement rules or contract causes in Rajasthan shows a high incidence of other problematic provisions: for instance, the State does not allow for any *interim price escalation* to paid beyond the originally contracted period *until a final determination of time extension has been approved*, even in the presence of a large number of intervening hindrances not attributable to a contractor (leading to interim time extensions by a procuring entity itself). To make matters worse, as stated earlier, procedures for review or redressal against such unfair initial determinations by field-level officers are either generally absent or remain largely dysfunctional. Some states such as Rajasthan do not even indicate in their procurement rules *specific interest rates to be charged for excess payments already made to contractors*, leaving

implementation of such contract clauses *and* leaving government contractors at the mercy of any bonafide determinations or mischievous whims & fancies of thousands of individual procurement officials.

Conclusions & Recommendations

What makes the aforesaid position interesting from a public policy viewpoint is that while these problems are all well-understood and recognised amongst the government contracting community, there seems to be significant inertia with regard to “who will bell the cat” and “why”. In Rajasthan alone, most of these risks as well as the ways and means to address them, have been identified, catalogued and suggested to the highest levels in the Government repeatedly for at least over the last three years, but no visible consideration let alone resolution has been seen in the intervening period, barring some bursts and fits of *crisis-initiated* procurement reform in the State in 2018. All of this becomes even more interesting when contrasted with the fact that most state governments have themselves already laid down fair risk-allocation contract clauses and procurement rules in the case of externally-funded projects (loan-funded projects not even grants-funded) – meaning thereby that standard templates are available within easy reach but the problems simply remain unaddressed, unattended and ignored.

Of course, much of this inaction needs to be appreciated against the backdrop of the cost of complaining about corruption and causing undue benefit to contractors in India probably being amongst the lowest in the

world – it has been argued that it can most often be as low as the cost of someone finding some A4-size paper and putting one's pen to it. It is thus no wonder that the world's biggest democracy, and probably also the most desirous and committed to accelerated implementation of public works and infrastructure projects anywhere in the world, has chosen to approach public project implementation from a *high-cost, inefficient "anti-corruption" perspective, rather than a much-faster efficiency and fair risk-allocation viewpoint* – even when the latter approach has so much of established research and readily-available procurement solutions gunning for it.

A large number of such contractual solutions are easily implementable, without resorting to harsh systems such as those in the United States and elsewhere holding public officials accountable for sanctioning projects in the absence of adequate budgetary provisions. Much on the lines of the *Nudge* theory, state governments in India can consider allowing nominal interest against overdue payments to contractors, and that small measure alone could prod contractors to submit payment claims in time *and* simultaneously also prod procurement officials who would otherwise not like to be held accountable in audit for additional interest outgoes in case they unduly delay such payments.

Decision-making authority can also be increasingly delegated for cases of time-extension and contract deviations/ variations of quantity, so as to begin holding contract-awarding officers themselves responsible for project completion, rather than continuing with pyramidal decision-making structures requiring higher-level approval in the name of oversight. In the absence of flat decision-making,

field officers in India can become content to merely forward such cases to the next higher level and leaving matters to that for months and years altogether, constantly shuttling files between both sides, raising multiple queries and counter-responses up and down all the time.

Once such inefficiency-inducing clauses and procedures start getting weeded out from public contract drafting in India, it should be possible within our context – where government contractors are unfortunately not really seen as project "partners" but as "unscrupulous businessmen" only out to make a killing – that more open dialogue and trust-building amongst public officials and government contractors can begin, benefitting in the long-run timely project execution and delivery of public services through faster progression of public infrastructure and works.

As mentioned earlier, the Government of India have taken bold yet nuanced steps directing contract extension and proportionate refund of liquidated damages – steps that are clearly path-breaking both in scope and direction, in sharp contrast to risk-averse approaches adopted historically. India's Finance Minister has promised even further reform and innovation in public procurement in her address to the Nation on Wednesday; and the ball is now clearly in the states' courts to follow her glorious example by quickly reforming their own contract administration practices, along the lines of the exemplary vision so clearly spelt out by the Central Government.