CHAPTER XIII: MINISTRY OF PETROLEUM AND NATURAL GAS

Balmer Lawrie and Company Limited

13.1.1 Loss of Rs.2.61 crore

Balmer Lawrie and Company Limited stood guarantor for a loan taken by Balmer Lawrie Freight Containers Limited and suffered a loss of Rs.2.61 crore in addition to being burdened with an undischarged liability of Rs.19.32 crore.

Balmer Lawrie Freight Containers Limited. (BLFC), a joint venture company of Balmer Lawrie and Company Limited (BL) was incorporated in November 1994, started commercial production in September 1995 and was incurring losses since inception. The net worth of BLFC was totally eroded during the year 1998-99 and it was declared a 'Sick Industrial Company' by BIFR in October 2000. The Management attributed the financial non-performance to the progressively difficult business environment and declining demand for the Company's main product. The position was not likely to improve in the near future.

In March 2000, BLFC applied for a soft loan of Rs.45 crore from the Oil Industry Development Board (OIDB) for design and development of new products and retirement of costly loans including loans from BL. OIDB sanctioned the loan, subject to the condition that the assets of the BLFC should be *pari passu* hypothecated (first charge basis) in favour of OIDB and BL would stand guarantor for timely repayment of loan/interest till the hypothecation was done. BL stood guarantee (April 2000) for the loan.

BLFC drew Rs.27.05 crore (April 2000) from OIDB. The loan was mainly utilised in repayment of loan of Rs.16.94 crore due to BL and Rs.8.87 crore in development of new products. The name of BLFC was changed to Indian Marine Freight Containers Manufacturing Limited (IMFCML) in February 2002. IMFCML failed to repay the interest as well as the loan instalments as it was unable to generate funds on its own. IMFCML went into liquidation in March 2003 and the official liquidator took possession of its assets for their disposal. The process of liquidation was not yet complete (July 2006). As guarantor of the loan, BL paid Rs.19.55 crore[♣] in partial repayment of principal and interest to OIDB, resulting in additional payment of Rs.2.61 crore[♦] till date (September 2006). BL would also have to pay Rs.19.32 crore[♥] towards the balance of principal and interest thereon till the loan is repaid.

[♣] ***Principal Rs.7.73 crore plus interest Rs.11.32 crore plus 0.50 crore = Rs.19.55 crore***
[♦] ***Rs.19.55 crore minus Rs.16.94 crore repayment of loan to BL***
[♥] ***Rs.27.05 crore minus Rs.7.73 crore = Rs.19.32 crore***

The Ministry stated (January 2007) that they thought that the container manufacturing industry would face a shake out followed by consolidation and hence survival for a few more years was required at that point of time. Accordingly, satisfied with the merit of the proposal for revival of IMFCML, they had approached OIDB for financial assistance. It was also stated that the Company being the promoter had tried its best for revival of IMFCML by providing corporate guarantee to ensure release of funds by OIDB to IMFCML.

Ministry's contention was not tenable as BL was well aware that the hypothecation of the assets of IMFCML could not be made as it had already been hypothecated against secured loan taken from banks. Standing guarantee for a loan to IMFCML in such a situation particularly when BL had no legal obligation for the revival of IMFCML was not a financially prudent decision.

This resulted in a loss of Rs.2.61 crore in discharge of its liability, in addition to an undischarged liability of Rs.19.32 crore on the balance.

Chennai Petroleum Corporation Limited

13.2.1 Extra expenditure on procurement of Hydrochloric Acid

Improper estimation and inability to enforce contracted terms resulted in extra expenditure of Rs.82.70 lakh.

Chennai Petroleum Corporation Limited (Company) utilises Hydrochloric Acid (HCl) for their process units, power plants and tertiary treatment plant. The Company assessed the requirement of HCl at 5,000 MT for 2004-05 including the requirement of 1,868 MT for the three MMTPA♠ refinery (Refinery-III), which was in the commissioning stage and floated (February 2004) a limited tender enquiry. The purchase order (PO) was placed in June 2004 on M/s. Tamil Nadu Petroproducts Limited (TPL) at a landed cost of Rs.2,164 *per* MT with the option to order additional quantities at the same rate and terms within the contract period of one year. Immediately thereafter (July 2004), requirement for additional 4,000 MT HCl arose for the Company's Captive Power Plant and Demineralization (DM) Plant of Refinery-III. Although the Company approached (July 2004) TPL for the additional requirement, the latter did not accede to the request. Instead, TPL offered to supply the additional quantity at the higher rate of Rs.5169 *per* MT. Therefore, the Company had to make emergency purchases (3,999 MT) during July 2004 to July 2005 from TPL and other suppliers at rates much higher than the prevailing contract rate.

Audit scrutiny (July 2005) revealed that while Refinery-III of the Company was commissioned during March 2004 to August 2004 but the Company did not estimate the HCl requirement with reasonable accuracy considering the ongoing commissioning of the Refinery-III and the quality of the water usually available during the season. Consequently the Company had to resort to emergency purchases of 3,999 MT of HCl at higher rates from different sources and incurred an extra expenditure of Rs.82.70 lakh. Of

♠ ***Million metric tonne per annum***

the purchased quantity of 3,999 MT, 1,690 MT was procured from TPL after payment of Rs.50.79 lakh over and above the contracted price.

The Management attributed (December 2005 and July 2006) the additional requirement of HCl to teething problems in the DM Plant and to the quality of raw water, which was not as per design values. They further added that as per tender it had the option to order additional quantity at the same rate and conditions within the contract period. The Ministry stated (January 2007) that increase in requirement of HCI could not be assessed beforehand. The additional quantity was purchased at the then prevailing maket prices and the expenditure of Rs.82.70 lakh was unavoidable.

The reply was not tenable as they were aware of the probable dates of commissioning of Refinery-III and the quality of local water available and should, therefore, have estimated their requirements with reasonable accuracy. Further, despite a clause for the supply of additional quantity in the PO, the Company could not enforce the option available only because it had not specified the additional quantity to a proximate degree. Moreover, no plausible explanation was given for abruptly increasing the annual estimate of requirement by 4,000 MT (80 *per cent*) within a month of placing the order for 5,000 MT. Thus, improper estimation and inability to enforce the contractual terms resulted in extra expenditure of Rs.82.70 lakh.

GAIL (India) Limited

13.3.1 Blocking of funds due to indecisiveness of the Company

GAIL (India) Limited purchased land at Vadodra in June 2000 but could not decide upon its utilisation resulting in loss of interest of Rs.3.56 crore on the blocked funds of Rs.9.36 crore apart from wasteful expenditure of Rs.89 lakh on construction, lease rent and miscellaneous activities.

GAIL (India) Limited (Company) decided (November 1998) to construct 148 houses alongwith other facilities at Vadodara mainly to meet the anticipated requirement of additional housing after commissioning of its compressor station at Vaghodia. The Company purchased (June 2000) 14,700 square metres of land from Vadodara Municipal Corporation (VMC) at Rs.8.82 crore on 99 years' lease. The Company also paid (May 2001) Rs.53.94 lakh as development charges for the land to VMC.

It was observed in Audit (March 2005) that soon after the purchase of land, the Management Committee of the Company decided (April 2001) to construct an administrative building and 39 houses in place of 148 houses approved earlier. The need for additional accommodation did not arise due to reduction in manpower at Vadodra and Vaghodia and many employees had constructed their own houses or arranged for cheaper accommodation. Subsequently (February 2002), the proposal for construction of administrative building was dropped as an office of the Company already existed in the Company's own premises at Vadodra and the Company was thinking of strengthening its Ahmedabad office in the State Capital.

The Company, therefore, requested (June 2002) VMC for permission to sell the land or take it back on 'as is where is' basis against refund of the amount paid. When the matter was discussed with VMC, the Municipal Commissioner VMC advised (August 2002) the Company to reconsider the proposal because the plot was meant for a specific purpose and any disposal, if agreed to by VMC, would only be for the same purpose. The Municipal Commissioner further informed that no profit on the sale of the land could be passed on to the Company but the loss, if any, on sale of land was to be borne by the Company.

The Vadodara Unit, accordingly requested (August 2002) the Corporate Office of the Company to reconsider the proposal for construction of Vadodara Office Building and the same was approved (September 2002).

The work of construction of the office building was awarded (November 2002) to M/s. Klassic Constructions Private Limited, Mumbai and the construction started in December 2002 with the scheduled completion period of 14 months. A mobilisation advance of Rs.60.44 lakh was also released (December 2002) for the same. While the construction work of administrative building was in progress, the Management stopped the work (January 2003) in view of the formation of zonal office at Ahmedabad (June 2002) and decentralisation of operations at sites around Vadodara.

The Corporate Office finally decided (May 2004) not to construct the building at Vadodara and advised the Vadodara Unit to dispose of the land and close the contract awarded for construction of administrative building. Meanwhile the Company had incurred a further expenditure of Rs.28.65 lakh towards consultancy charges, security cabin, lease rent to VMC and expenditure on shifting of High Tension power lines from the plot. The Management was yet to initiate action for the disposal of the land (June 2006).

The Management stated (August 2006) that they could not decide and dispose of the land as the VMC had not clarified their terms. The reply of the Management was not tenable as they took up the issue of disposal of land with VMC in June-August 2002 but did not pursue it thereafter. The use or disposal of land was, thus, delayed due to lack of decision and improper planning on the part of the Company.

Lack of timely decision by the Company resulted in avoidable loss of interest of Rs.3.56 crore[♣] on the blocked funds over the last six years apart from wasteful expenditure of Rs.89 lakh on construction and miscellaneous activities.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

♣ ***At the average annual yield (ranging from 4.75 per cent per annum to 9.77 per cent per annum) on short term investment of the Company during 2001-02 to 2005-06***

Hindustan Petroleum Corporation Limited

13.4.1 Loss of revenue of Rs.3.77 crore due to failure to recover compensation

The failure of the company to recover compensation towards shortfall in lifting of the Minimum Guaranteed Offtake as per the terms and conditions of the Fuel Supply Agreement resulted in loss of Rs.3.77 crore.

Hindustan Petroleum Corporation Limited (Company) entered into (June 1996) a Fuel Supply Agreement (FSA) with M/s. Nagarjuna Fertilisers and Chemicals Limited (customer) for supply of Naphtha and other liquid fuels/lubricants for a period of 10 years from June 1997 to May 2007. The agreement prescribed an annual Minimum Guaranteed Offtake (MGO) of Naphtha by the customer and in case the quantity lifted happened to be less than the agreed MGO, the customer would compensate the Company at the rate of Rs.300 *per* MT.

The details of actual quantity lifted *vis-à-vis* MGO, the short fall involved and the amount of compensation payable by the customer during the period 1997-98 to 2003-04 are given below:

Period	MGO quantity as per FSA (MT)	Quantity actually lifted (MT)	Shortfall (MT)	Compensation for shortfall (Rs. in crore)
1.6.97 to 31.5.98	42000♣	37,993	4,007	0.12
1.6.98 to 31.5.99	1,50,000	2,51,340	-	-
1.6.99 to 31.5.00	1,50,000	2,06,903	-	-
1.6.00 to 31.5.01	1,25,000	1,39,935	-	-
1.6.01 to 31.5.02	1,25,000	68,823	56,177	1.69
1.6.02 to 31.5.03	1,25,000	60,732	64,268	1.93
1.6.03 to 31.5.04	1,00,000	98,958	1,042	0.03
Total	**8,17,000**	**8,64,684**	**1,25,494**	**3.77**

The data shows that the customer did not lift the MGO of Naphtha during the year 1997-98, 2001-02, 2002-03 and 2003-04. There was a short fall of 1,25,294 MT on account of which the Company was entitled to a compensation of Rs.3.77 crore.

Although the compensation towards shortfall in MGO was to be claimed on year-to-year basis as per the terms and conditions of the FSA, the Visakh Regional Office of the Company preferred (February 2005) the claim with a delay ranging from 8 months to 80 months. However, the Company had not pursued the claim on the plea that the cumulative quantity lifted was more than the MGO.

The Management in its reply stated (February 2006) that if the quantity lifted was taken cumulatively during the entire period from June 1997 to December 2005 the commitment of the customer had been fulfilled. The customer was not willing to pay compensation

♣ ***As the first supply was commenced from 19 February 1998 the MGO for the first year was proportionally worked out to 42,000 MT*** towards shortfall in the lifting of MGO on year-to-year basis. However, the Company had taken up the claims for recovery of dues from the customer.

The reply of the Management was not tenable as the customer was liable to pay compensation towards shortfall in the lifting of MGO on year-to-year basis as per clause 12 of the terms and conditions of the FSA.

Thus, the failure of the Company to recover compensation towards shortfall in the lifting of the MGO as per the terms and conditions of the FSA resulted in loss of Rs.3.77 crore.

The matter was reported to the Ministry in October 2006; reply was awaited (January 2007).

Indian Oil Corporation Limited

13.5.1 Avoidable loss due to misinterpretation of tax law

Misinterpretation by Indian Oil Corporation Limited about the leviability of additional sales tax resulted in avoidable loss of Rs.13.44 crore to Oil Marketing Companies.

Transactions relating to sale and/or purchase of petroleum products♣ between the Oil Marketing Companies (OMCs) were exempt from sales tax and additional sales tax in Bihar. The Government of Bihar withdrew the exemption from additional sales tax (AST) by a notification on 27 July 2000 and levied AST at the rate of one *per cent* on inter-OMC transactions.

Indian Oil Corporation Limited (IOCL) is the only company having a refinery in Bihar. IOCL sold petroleum products, *viz.* Motor Spirit (MS) and High Speed Diesel (HSD) to the other OMCs within the State and raised invoices without charging one *per cent* AST on the presumption that in view of the sales tax exemption, AST on OMC transactions was also not leviable and, thus, did no act on the notification of 27 July 2000.

The Commercial Taxes Department, Bihar, raised demand (May 2002) for AST of Rs.13.44 crore on IOCL, on the subject OMC transactions. IOCL sought legal opinion on this issue, which clarified (May 2002) that AST on OMC transaction was not exempt. IOCL subsequently paid (June 2002) the AST of Rs.13.44 crore for the period from August 2000 to March 2002.

These transactions pertained to the period when the under-recoveries by the Oil companies were reimbursed through the Oil Pool Account maintained by the Petroleum Planning and Analysis Cell (PPAC). PPAC reckoned the under recoveries for arriving at the state surcharge rates for inclusion in the price of the products in the State concerned for subsequent recovery and reimbursement to the OMCs. To claim reimbursement, the OMCs were required to submit to the PPAC detailed statements for the under recoveries, audited and certified by a Chartered Accountant.

♣ ***Motor Spirit, High Speed Diesel, Light Diesel Oil and Aviation Turbine Fuel***

IOCL and other OMCs took up the matter in 2002 with PPAC for reimbursement of AST. However, PPAC rejected (April 2003) the claim of OMCs in the instant case on the ground that the under-recoveries were not factored in while working out the state surcharge rates of Bihar and Jharkhand as these were not reported by the OMCs earlier.

IOCL also demanded reimbursement from the OMCs for the supplies made to them. IBP Limited paid Rs.2.26 crore. Hindustan Petroleum Corporation Limited (HPCL) and Bharat Petroleum Corporation Limited (BPCL) were yet to respond to the debits of Rs.4.65 crore and Rs.6.53 crore respectively raised on them by IOCL. Thus, an unwarranted interpretation of the notification by IOCL led to avoidable expenditure of Rs.13.44 crore to OMCs.

The case was noticed during the course of Audit of IBP Limited in November 2003 and was pursued with IBP Limited subsequently. The Management stated (April 2006) that the Oil Industry was under the bonafide belief that AST was not payable on inter OMC transactions.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.5.2 Wasteful capital investment on retrofitting job

Despite information from Oil Co-ordination Committee in July 1998 about the non-availability of Assam crude consequent on commissioning of Numaligarh Refinery Limited, the Company retrofitted 10 chillers in the Solvent Dewaxing Unit (SDU) plant for production of wax at a cost of Rs.12.76 crore. The operation of the SDU was stopped in November 2001 due to non-availability of Assam crude, making the investment infructuous.

The Solvent Dewaxing Unit (SDU) at Barauni Refinery of Indian Oil Corporation Limited (Company) produced slack wax from Assam crude. The equipment included 15 Russian make chillers. The Company replaced/retrofitted five of these chillers in 1997-98. In July 1998 the Oil Co-ordination Committee (OCC) informed the Company that consequent on the commissioning of Numaligarh Refinery, Assam crude would not be available for processing at Barauni and instead, low sulphur imported crude would be supplied. Due to the low wax content of the imported crude it was economically unviable for production of slack wax. Despite this, the Company placed an order with a foreign supplier in December 1999 for retrofitting the remaining 10 chillers. The work was completed in May 2001 at a cost of Rs.12.76 crore.

Barauni Refinery started receiving low sulphur imported crude from February 1999 and supply of Assam crude was totally stopped in November 2000. The Company had to stop the operation of the SDU in November 2001 as the production of wax from imported crude was uneconomical. The Company’s efforts (since April/ May 2003) for utilising the idle chillers at other refineries/units had not yielded any results so far (June 2006). Thus, the decision of the Company to retrofit 10 chillers, after the supply of Assam crude was stopped, was injudicious and resulted in wasteful capital investment of Rs.12.76 crore.

The Ministry stated (January 2007) that the proposal to retrofit the chillers was made in February1998 to maintain continuous supply of slack wax. The idling of the unit was not anticipated at that time. SDU operation also continued upto 2001-02. Therefore, expenditure towards retrofitting of chillers was felt necessary for safety and reliability.

The contention of the Ministry was not tenable. The Company had been categorically informed by the OCC in July 1998 about non-availability of Assam Crude after commissioning of Numaligarh Refinery and that only low sulphur imported crude would be supplied from February 1999. Despite this, the Company issued orders in December 1999 for retrofitting of chillers without any proper cost benefit analysis. The Company had to stop the operation of SDU, as it was economically unviable, within a period of six months after retrofitting the chillers.

13.5.3 Avoidable expenditure on uneconomic movement of product

The Company supplied product from Haldia Refinery to Raxaul Depot via Rajbandh Terminal instead of from Barauni Refinery and thereby incurred additional transportation cost of Rs.7.52 crore.

Rajbandh Terminal of Indian Oil Corporation Limited (Company) receives petroleum products from Haldia Refinery through Haldia-Mourigram-Rajbandh Pipeline (HMRPL) and dispatches the same to other locations including Raxaul Depot which is 593 km away from the said Terminal. During April 2002 to August 2004, out of the product received from Haldia Refinery at Rajbandh Terminal, 3,98,268.70 KL of Superior Kerosene Oil (SKO) was dispatched by Railway rakes to Raxaul Depot. To dispatch the above SKO from Haldia Refinery to Raxaul depot via Rajbandh terminal the Company incurred an expenditure of Rs.16.06 crore♣.

During the Audit conducted in September 2003, it was observed that Raxaul Depot was 246 km from Barauni. The Barauni Installation was well connected with Haldia Refinery through Haldia Barauni Pipeline (HBPL), owned and controlled by the Company. Further, the Barauni installation had SKO storage capacity of 41,473 KL and the Barauni Refinery had SKO storage capacity of 24,420 KL alongwith adequate tank wagon loading facilities. For dispatching SKO from Haldia refinery to Raxaul depot, the Company could utilise this existing infrastructure by dispatching SKO through HBPL from Haldia Refinery to Barauni for feeding Barauni Refinery-fed areas and the products of Barauni Refinery could have been dispatched directly to Raxaul Depot by tank wagons. For the movement of SKO between Haldia refinery to Raxaul depot the Company would have spent Rs.95 lakh on pipeline transportation from Haldia Refinery to Barauni and Rs.7.59 crore as rail freight from Barauni Refinery to Raxaul Depot between April 2002 and August 2004. Thus, use of this economic linkage would have saved transportation cost by Rs.7.52 crore♠ during April 2002 to August 2004 and ensured better utilisation of the Company's pipelines.

♣ ***The Company incurred Rs.0.48 crore on pipeline transportation from Haldia to Rajbandh and for further transportation from Rajbandh to Raxaul Depot by Railway tank Wagon it incurred rail freight of Rs.15.58 crore.***

♠***Rs.15.58.crore plus Rs.0.48 crore minus (Rs.7.59 crore plus Rs. 0.95 crore)***

The Ministry stated (February 2006) that due to infrastructure limitation the option of pipeline delivery at Barauni through HBPL and then further transport to Raxaul by rail could not be exercised. The Barauni installation does not have any tank wagon loading facility and tanks at Barauni refinery where tank wagon loading facilities exist, were not adequate to handle that additional volume of operation. Further the Company saved entry tax of Rs.26.03 crore by not importing the products in Bihar, although additional logistic cost of Rs.7.20 crore was incurred.

The Ministry's point regarding limitation of infrastructural facilities was not acceptable since no dispatches were made to Raxaul depot from Rajbandh terminal after August 2004 after Audit had raised the issue in September 2003. Further the contention regarding saving of entry tax of Rs.26.30 crore was also not tenable as the entry tax paid on entry of products is adjustable against payment of sales tax. Thus, the effects of entry tax would be nullified.

Thus, due to uneconomic linkage of product movement, the Company incurred avoidable transportation cost of Rs.7.52 crore.

13.5.4 Underutilisation of the pipeline due to creation of a parallel pipeline

Due to lack of proper planning, the Company was using two parallel pipelines connecting the same stations, leading to underutilisation of both and entailing wasteful expenditure of Rs.5.13 crore.

Indian Oil Corporation Limited (Company) leased (December 1999) 14" crude oil pipeline of Oil and Natural Gas Corporation (ONGC) of length 78 km between Koyali and Navagam (KNPL) at annual lease rental of Rs.50 lakh for transporting products from Koyali Refinery to Navagam. The Company incurred an expenditure of Rs. two crore for cleaning and conversion of KNPL from crude service to product service and for providing connecting lines. The pipeline was commissioned in March 2003 after the terminal facilities at Navagam were developed.

It was observed in Audit (January 2005) that before KNPL could be commissioned, the Company decided (March 2001) to convert its existing 18" Koyali-Viramgam-Sidhpur pipeline (KVSPL), which also provided an alternate route for connecting Koyali to Navagam, from crude service to product service thereby creating a product pipeline parallel to KNPL. KVSPL was converted to product service on the consideration that the Company would de-lease KNPL after its commissioning. Though KVSPL was commissioned in October 2003, KNPL could not be de-leased as the agreement with ONGC did not provide for its de-leasing before 10 years from the date of takeover. Due to creation of KVSPL product pipeline parallel to KNPL the actual average capacity utilisation of KNPL reduced from 24 *per cent* in March 2003 to 13.7 *per cent* during 2003-04, 14.9 *per cent* during 2004-05 and 12.6 *per cent* during 2005-06.

While accepting that the delivery to Navagam through KNPL had come down after commissioning of KVSPL and due to its low utilisation the desired internal rate of return could not be achieved, the Management stated (June 2005) that the products were still being pumped intermittently through KNPL. The Management further added that conversion of KVSPL was not only cheaper but also had other advantages. The Ministry endorsed (January 2007) a similar reply.

The reply was not tenable because the pipelines being parallel, KVSPL had also not been optimally utilised and the freight realised for the products transported through KNPL could also be earned by transporting the same through KVSPL. Moreover, if conversion of Koyali-Viramgam pipeline from crude to product pipeline was a better option, the Company should have planned for it *ab initio* instead of leasing KNPL.

Thus due to lack of proper planning, the Company had two parallel pipelines resulting in underutilisation of both KNPL and KVSPL. The expenditure of Rs.two crore on KNPL's conversion apart from the lease rental of Rs.3.13 crore upto March 2006 could have been avoided if KVSPL were planned *ab initio* instead of leasing KNPL.

13.5.5 Excess build - up of tankage

Despite sufficient tankage to meet the projected demand upto 2006-07, the Company invested Rs.3.34 crore in construction of two tanks.

Mourigram terminal of Indian Oil Corporation Limited (Company) receives petroleum products from Haldia Refinery through Haldia-Mourigram-Rajbandh pipeline. The terminal handles, *inter alia*, Motor Sprits (MS), Superior Kerosene Oil (SKO) and High Speed Diesel Oil (HSD). In January 1997, the terminal had tankage of 25,300 KL for SKO and 28,800 KL for HSD. The Company decided (January 1997) to construct 30,434 KL of additional tankage for SKO and HSD with the objective of increasing the coverage[♣] in 2001-02. In February 1999 the Company decided to construct another 24,000 KL of additional tankage at Mourigram and the work order was issued in May 1999. Two tanks of 15,217 KL each for SKO and HSD were commissioned in November 2001. Two more tanks with total capacity of 23,322 KL[♦] were constructed at a cost of Rs.3.34 crore and were commissioned in January 2002 and February 2002 respectively.

Audit observed that the average daily throughput for SKO and HSD during 1998-99 was 1,659 KL and 1,514 KL respectively and the coverage, considering 90 per cent capacity utilisation of tankage including additional 30,434 KL tankage under construction, was 22 days for SKO and 26 days for HSD. The then existing tankage was sufficient to cater to the projected demand of SKO and HSD even for the year 2006-07. As the targeted coverage had already been achieved with construction of tankage of 30,434 KL in November 2001, further augmentation of the tankage by 23,322 KL was not necessary. This was also corroborated by the fact that the actual coverage of the terminal in respect of SKO ranged between 31 days and 35 days and that of HSD between 38 days and 46 days respectively during the period 2003-04 to 2005-06.

The Management stated (June 2006) that the additional facilities were planned based on the then prevailing situation and the changes envisaged in growth rate at that time. Additional tankage were planned to increase the coverage in terms of days and also to

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♣ ***Capacity in terms of days to cater to the throughput of the terminal***
♦ ***11,661 KL each for SKO and HSD***

take care of the proposed capacity augmentations. The Ministry endorsed (January 2007) the views of the Management.

The reply was not tenable as at the time of mooting the proposal, the overall growth rate in throughput of the terminal during 1995-96 to 1997-98 was only 2.9 *per cent* and tankage (including tankage under construction of 30,434 KL) was sufficient to meet the projected demand upto 2006-07.

Thus, investment of Rs.3.34 crore in construction of additional tankage of 23,322 KL despite having sufficient tankage capacity did not have adequate justification and led to excess capacity build-up.

13.5.6 Loss of excise duty benefit

Failure to implement the orders issued by the excise authority in time led to loss of Rs.2.07 crore and unnecessary litigation.

Budge Budge terminal of Indian Oil Corporation Limited (Company) used to receive excise-bonded Light Diesel Oil (LDO) of its various Northeastern (NE) Refineries[♣] via Siliguri and Tinsukia terminals. A part of this bonded LDO was being sent to Paradeep terminal of the Company from Budge Budge. The bonded products were cleared on subsequent payment of excise duty. The GOI issued notifications in March and May 2002 to permit removal of petroleum products drawn from NE refineries by paying excise duty at 50 *per cent* of normal rates. In June 2002 this exemption was also extended in respect of goods removed under bond without payment of duty from any of the NE refineries to a warehouse and subsequent removal from the said warehouse. The price of the products to end consumers was to remain unchanged irrespective of the source refinery and the excise benefit so arising was to be passed on to NE refineries.

Despite the notification in June 2002, the Company continued to supply bonded LDO of NE refineries to Budge Budge and Paradeep terminals and sold the LDO from both these terminals without retaining 50 *per cent* of excise duty. The Company implemented the notification at Budge Budge terminal and Paradeep terminal only in October 2002 and March 2003 respectively. During the period from July 2002 to the date of implementation of the notification, non-adjustment of excise benefit by the Company resulted in a loss of excise concessions of Rs.2.07 crore, to its NE Refineries.

The Management stated (June 2006) that due to lack of clarity in the notifications regarding applicability of exemption, clarifications had to be sought which led to delay in implementation of the notification. The Ministry endorsed (January 2007) the views of the Management.

The reply was not tenable as the notification issued in June 2002 clearly stated that the benefit of exemption in excise duty was extended in case of goods removed under bond without payment of duty from NE refineries to a warehouse and subsequently removed from the said warehouse on payment of 50 *per cent* of duty.

[♣] ***Guwahati Refinery, Digboi Refinery and Bongaiaon Refineries and Petrochemical Limited***

Thus, due to delay in implementation of excise notification that gave benefit to NE refineries, the Company lost excise benefit of Rs.2.07 crore.

13.5.7 Unjustified expenditure due to delay in closure of Jodhpur depot

Due to delay in closure of Jodhpur depot, Indian Oil Corporation Limited incurred avoidable expenditure of Rs. two crore from April 2001 to March 2006.

Jodhpur depot (Depot) of Indian Oil Corporation Limited (Company) has been operating since 1977 on land taken on lease from Railways for supplying petroleum products to retail outlets and other consumers. After laying of Kandla Bhatinda Product Pipeline of the Company in February 1996 and commissioning of Salawas (Jodhpur) terminal in April 1996, supplies from the Depot were shifted to Salawas Terminal for all retail outlets and other consumers except the Army and the Air Force. This resulted in a decline in the scale of operations of the Depot and underutilisation of the facilities.

It was observed in Audit (November 2004) that the proposal for closure of the Depot was approved by the Oil Coordination Committee (OCC) in February 2000 subject to shifting of defence requirements of Aviation Turbine Fuel to Salawas Terminal. However, the Company formally took up the issue of shifting of supplies from the Depot to Salawas Terminal with the Army and the Air Force only in April 2003. They agreed to the shift of supplies to Salawas Terminal in December 2003 and May 2005 respectively. However, the Depot had not been closed till August 2006, ten years after the commissioning of Salawas Terminal and six years after approval of OCC and shifting of major operations to Salawas Terminal. After the decision of OCC, the Company incurred an expenditure of Rs. two crore towards lease rent, operational expenses and property tax for land and building during the period 2000-01 to 2005-06 due to delay in closure of the Depot.

The Management stated (August 2006) that the delay was on account of non-receipt of approvals of the Army and the Air Force. The construction of additional tanks at Salawas started in August 2004 and new tanks were completed in March 2006 and June 2006. Action to dispose of assets had been initiated and was expected to be completed by December 2006.

The argument regarding non-receipt of response from the Army and the Air Force was not tenable because after approval of OCC to close the Depot, the Company did not formally take up the matter with the Army and the Air force till April 2003.

Thus, due to delayed action for closure of Depot, the Company incurred avoidable expenditure of Rs. two crore which will further increase till the closure of the depot and surrender of the land to Railways.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.5.8 Loss due to misinterpretation of Customs Act

Misinterpretation of free period for storage of imported crude at bonded warehouses and consequent delay in payment of customs duty by Indian Oil Corporation Limited led to loss of Rs.1.02 crore.

Indian Oil Corporation Limited (Company) has been storing imported crude oil initially in public bonded warehouse at Vadinar and then in its own bonded warehouse at Gujarat Refinery. From 1 June 2001, the free warehousing period as allowed under section 61(2)(ii) of the Customs Act, 1962 for storage of imported crude oil was reduced from 180 days to 30 days by the Customs Notification of 22 May 2001.

The Company presumed that the amended provision was applicable independently allowing free period of thirty days for each warehouse in which the crude oil is stored before customs clearance and continued to store the crude oil accordingly. As a result, the imported crude remained in the bonded warehouses beyond 30 days for periods ranging between three days and 42 days during July to October 2001. For this period, the Company had to pay interest of Rs.1.96 crore at the rate of 24 *per cent per annum* in September 2003 and November 2003 on customs clearance.

Audit observed (August 2004) that the Company received a legal opinion on 27 June 2001 which clearly stated that the Company would not get 30 days separately for storage of imported crude in public bonded warehouse at Vadinar and then at its own bonded warehouse in Gujarat Refinery. Despite this, the Company delayed the clearance of crude oil and had to pay the penal interest for delayed payment of customs duty.

In reply, the Management contended that the stand taken by the Customs Department that 30 days was available for the combined warehouse storage (both Vadinar and Gujarat Refinery) was not acceptable and an appeal for refund of claim filed in March 2005 against the Commissioner's Order was pending (October 2006) before the Customs Excise and Service Tax Appellate Tribunal (CESTAT), New Delhi.

The reply of the Management was not tenable as the public notice for amendment in the Act *ibid* clearly stated that customs duty, interest at the rate of 24 *per cent* and other charges shall be levied on goods lying in the bonded warehouse beyond 30 days. There was no ambiguity in the notification for reckoning each warehouse separately. Despite having received the legal opinion against its interpretation, the Company delayed payment of customs duty. The appeal before the customs authorities was filed by the Company in March 2005 after Audit pointed out the matter to the Management (August 2004).

Thus, erroneous interpretation of the amendment to the Customs Act by the Management and delay in payment of customs duty on crude oil stored at bonded warehouses resulted in avoidable expenditure of Rs.1.96 crore. Taking into account the interest saved by the Company on borrowings at the rate of 11.5 *per cent per annum* for the same period, the Company sustained a net loss of Rs.1.02 crore, being the interest paid over and above the borrowing rate.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.5.9 Loss due to extension of cheque facility without financial safeguards

By extending cheque facility to bulk consumers without any security and in contravention of its own policy, the Company suffered a loss of Rs.76.82 lakh.

According to the policy (October 2001) of Indian Oil Corporation Limited (Company) for sale of petroleum products, facility for payment through cheques could be granted to the customers either against security or based on the credit worthiness of the customer assessed through CRISIL module. The required security in such cases was irrevocable bank guarantee or collateral security in the form of mortgage of immovable properties, hypothecation of stock, plant and machinery. The cheque facility was to be granted to provide operational convenience to the customer and not as a financial assistance.

It was observed in Audit (November 2004) that the Company supplied petroleum products to four[♣] bulk customers against payment through cheques without obtaining any security. Cheques aggregating Rs.95.31 lakh tendered by these customers during October 2001 to March 2003, were dishonoured. The credit rating on CRISIL module was also not available with the Company in respect of two[♦] out of the four customers. Out of the amount of Rs.95.31 lakh, the Company could recover Rs.18.49 lakh; the balance of Rs.76.82 lakh was outstanding as on March 2006. The outstanding amount could not be recovered despite filing criminal suits against the defaulters under section 138 of the Negotiable Instruments Act, 1881. Three[♥] out of four customers had closed their units (December 2004) due to financial crunch. Considering the doubtful recoverability of these dues, the Company provided for these amounts as doubtful in its books of accounts.

The Management stated (July 2005) that the cheque facility was granted to facilitate regular lifting of High Speed Diesel by the parties.

The reply was not tenable because the Company departed from its own policy and compromised its basic security requirements. Even after the matter was pointed out by Audit, the Company continued to supply petroleum products against cheque without obtaining any security and further cheques aggregating to Rs.37.73 lakh were dishonoured during the year 2005-06.

Thus due to extending cheque facility without taking adequate financial safeguards as per policy, the Company suffered an avoidable loss of Rs.76.82 lakh.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.5.10 Non-recovery of the dues due to non-observance of the provisions of the agreement

IOCL could not recover dues of Rs.50.87 lakh due to its failure to adhere to contractual terms of periodical reconciliation and due to allowing credit sales in excess of the *ad hoc* amount received from the Party.

Indian Oil Corporation Limited (Company) entered (October 1994) into an agreement with M/s. Damania Shipping (India) Limited (Party) for supply of Low Sulphur High

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[♣] ***Shiva Paper Mills Limited, Egro Fibres Limited, Egro Paper Moulds Limited and Shree Acids and Chemicals Limited***

[♦] ***Shiva Paper Mills Limited and Shree Acids and Chemicals Limited***

[♥] ***Shiva Paper Mills Limited, Egro Fibres Limited and Shree Acids and Chemicals Limited***

Flash High Speed Diesel which was being used by the Party for their catamaran plying between Mumbai and Goa.

According to clause eight of the agreement, the Party was to make *ad hoc* payments on the 5th, 15th and 25th of every month to cover the value of the supply of fuel from the 1st to 10th, 11th to 20th and 21st to the end of the month respectively. Any excess of the total bill value over the three *ad hoc* payments made during the month would be made good by the Party by the 10th of the month following. If the said payment was not made as agreed, the outstanding amount was to attract interest at the ruling State Bank of India interest rate plus one *per cent.*

The Party started lifting the product from October 1997 *ex* Mumbai (Wadala) and Vasco terminals. The ferry service was suspended from mid 1998 and the Party placed no indent on the Company thereafter for supply of fuel. However, reconciliation done to finalise the accounts after stoppage of the operations revealed that a sum of Rs.50.87 lakh was due to the Company for supplies effected during October 1997 to mid 1998. Due to lack of response, a legal notice was issued to the Party on 18 September 2000. On an application made by the Company, the High Court of Bombay appointed a sole Arbitrator in June 2001 and the Company filed its statement of claim in September 2001. The award was given (October 2003) in Company's favour directing the Party to pay the dues alongwith prescribed interest and the cost of the arbitration of Rs.8.21 lakh. The Party neither honoured nor challenged the award. To recover the dues, the Company entrusted the work of ascertaining the properties of the Party to M/s. Flash Services who stated (July 2005) that the Party did not have any property. The Advocates of the Company advised (October 2005) that since the Party had changed its name as Western State Engineers Limited, the properties held by this firm may be ascertained. This fact was also brought to notice of the Arbitrator who permitted amendment to the statement of claim in the name of M/s. Western State Engineers Limited. The Company was yet (July 2006) to execute the award even after two years of the decision.

Audit observed (May 2001) that the agreement clearly provided for frequent reconciliation of the account of the Party. However, no check was exercised to ensure that the Party settled its account on a monthly basis. It was only when the Party suspended its ferry service that the reconciliation of accounts was done and the large outstanding against it was noted. Though the Party ceased its operations in May 1998, the Company issued legal notice only in September 2000 after more than two years. The award was declared in the Company's favour in October 2003; however, the same had not been executed till July 2006.

Thus, due to non-observance of the provisions of the agreement, the Company could not recover dues amounting to Rs.50.87 lakh and a sum of Rs.8.21 lakh being the cost of arbitration.

The Management stated (March 2006) in reply that since *ad hoc* payments were regular and mostly in line with supplies released, no monthly reconciliation seemed necessary. It further stated that action was being initiated for filing Execution application for execution of award. However, non-reconciliation of dues as per contractual provisions on the ground of regular advance payments was not justified. Failure of the Company in timely reconciliation resulted in accumulation of arrears and eventual non-recovery reflecting the absence of a sound internal control system. The reply also did not explain the delay in issuing notice to the Party. Despite repeated correspondence by the Company, the Party did not respond till August 1999. The Company could have initiated action for legal notice in 1998-99 itself, whereas it issued notice to the Party only in September 2000.

Thus, absence of internal control in effecting supplies on credit in excess of the *ad hoc* payments and reconciling the dues resulted in non recovery of dues and interest thereon. Further, the Company was yet (July 1996) to execute the award even after two years.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

Indian Oil Corporation Limited and Bharat Petroleum Corporation Limited

13.6.1 Avoidable payment of interest due to under payment of advance tax

Indian Oil Corporation Limited, Bharat Petroleum Corporation Limited and BPCL Kochi Refinery calculated incorrectly the advance income tax payable, resulting in payment of interest of Rs.165.75 crore.

Under Section 234C read with Section 208 of the Income Tax Act 1961 (Act), if in any financial year, the advance tax paid by a Company on its current income on or before 15 June is less than 15 *per cent* of the tax due on the returned annual income; that paid on or before 15 September is less than 45 *per cent*; that paid on or before 15 December is less than 75 *per cent* and the last instalment paid on or before 15 March is less than 100 *per cent* of the tax due on the returned income, the Company shall be liable to pay interest at the prescribed rates on the shortfall. However, if the advance tax paid by the Company on its current income on or before 15 June and 15 September is not less than 12 *per cent* and 36 *per cent* respectively of the tax due on the returned annual income, then it shall not be liable to pay interest on the amount of shortfall on those dates. Further, the assessee is liable to pay interest under Section 234B of the Act if the total advance tax paid is less than 90 *per cent* of the assessed tax.

It was observed (February 2006) in Audit that Indian Oil Corporation Limited (IOCL), Bharat Petroleum Corporation Limited (BPCL) and BPCL Kochi Refinery (BPCL-KR)[♠] computed the advance tax payable incorrectly at the time of remitting quarterly instalments of advance tax and a number of quarterly instalments of advance tax fell short of the minimum prescribed percentage. The quarterly instalments of advance tax remitted by IOCL fell short of the prescribed limit in 17 out of 20 quarters during the five previous years *viz.* 1999-2000 and 2001-02 to 2004-05. The shortfall ranged between one *per cent* and 61 *per cent* (Appendix-I). Consequently, IOCL had to pay interest of Rs.127.27 crore under Section 234C of the Act. For the previous year 2001-02, IOCL had to pay interest of Rs.3.64 crore under Section 234B of the Act since the advance tax paid worked out to only 64 *per cent* of assessed tax for the year. Thus, IOCL paid an aggregate amount of Rs.130.91 crore towards interest on under payment of advance tax during these years. Similarly, the quarterly advance tax remitted by BPCL for 11 out of the 16 quarters of the

[♠] ***Kochi Refinery Limited, a subsidiary of Bharat Petroleum Corporation Limited has since been merged with Bharat Petroleum Corporation Limited with effect from April 2004.***

four previous years 2000-01 and 2002-03 to 2004-05 fell short of the permissible limits by 3 *per cent* to 35 *per cent (*Appendix-I) for which it had to pay interest of Rs.30.11 crore under Section 234C of the Act. Six out of eight quarterly instalments of advance tax remitted by BPCL-KR also fell short of the prescribed limit by one *per cent* to twelve *per cent* (Appendix-II) during the previous years 2003-04 and 2004-05 and it paid interest of Rs.4.73 crore under Section 234C of the Act. Thus, inaccurate estimates by IOCL, BPCL and BPCL-KR resulted in under payment of advance tax and consequent payment of interest amounting to Rs.165.75 crore.

The Managements stated (March 2006 and June 2006) that under the Administered Pricing Mechanism (APM), the receipt of arrears of marketing margins from the Government was not certain and these receipts could not be considered while computing payment of advance tax for the previous year 1999-2000. Further, the notification on subsidy on kerosene and Liquefied Petroleum Gas (LPG) under post APM period and intimation from Petroleum Planning and Analysis Cell (PPAC) regarding sharing of under recoveries were received after the due date for payment of advance tax and so, these could not be factored in while calculating the advance tax payable. They also contended that due to wide fluctuations in prices of petroleum products in international markets, the refinery profits estimated♣ for advance tax payment were considerably affected. IOCL further stated that there would have been no significant financial implication if the savings in the cash flows to pay such advance tax were also reckoned simultaneously. In the case of BPCL-KR, the Ministry stated (December 2006) that wide and sudden fluctuations in global prices influenced the margin of domestic refining companies. Though quarterly revisions in profit estimates were made considering the fluctuations in prices, the actual variations in the refining margins were beyond the normal expectations, which affected the profit estimation resulting in short payment of advance tax. They further added that the cost of funding short paid advance tax would amount to Rs.3.87 crore.

The replies were not tenable as during the APM period, oil companies were required to submit audited accounts and the claim for reimbursement of cost and margins *etc*. on quarterly basis. As such the accrued income could have been considered for payment of advance tax for the previous year 1999-2000. The subsidy/discount is based on under-recovery worked out by the Companies. Hindustan Petroleum Corporation Limited, another oil marketing company, placed in similar condition of volatility in the prices of petroleum products in the international market, actually assessed the advance tax properly and could avoid payment of penal interest. Further, even after taking into account the saving in cash flow *vis-à-vis* the cost of borrowing, the avoidable payment of interest would have been Rs.31.38 crore in the case of IOCL, Rs.7.42 crore in the case of BPCL and Rs.0.86 crore in the case of BPCL-KR.

The matter was reported to the Ministry in November 2006; replies in respect of IOCL and BPCL were awaited (January 2007).

♣ IOCL for the previous year 2003-04, BPCL and BPCL-KR for the previous years 2003-04 and 2004-05

Numaligarh Refinery Limited

13.7.1 Under recovery of excise duty of Rs.9.98 crore due to erroneous billing

The Company raised invoices at Refinery Gate Price and paid excise duty on that basis. The Oil Marketing Companies reimbursed the excise duty on the basis of reduced RGP after deducting notional rail freight from refinery point to New Jalpaiguri as per agreement. This resulted in under recovery of excise duty of Rs.9.98 crore.

Oil Marketing Companies (OMCs)[♣] entered into (March 2002) a multilateral product sharing agreement for purchase and sale of petroleum products from each other for a period of two years commencing from 1 April 2002. Numaligarh Refinery Limited (Company) being a subsidiary of BPCL was governed by this agreement. According to clause 5.4 of the agreement, the basic price of products for sales ex-northeast (NE) refineries should be reduced by the notional railway freight (NRF) from the supplying refinery to New Jalpaiguri (NJP) and the rail freight for the movement beyond NJP would be borne by OMCs buying the product from the NE refineries. Thus, the Transaction Value as per section 4 (3) (d) of the Central Excise Act, 1944 for calculation of excise duty was the basic price *i.e.* Refinery Gate Price (RGP) less NRF from supplying refinery to NJP as it was the price actually paid or payable for the goods by the buyer to the assesses.

For supplies made to OMCs namely IOCL, HPCL and IBP during the period from April 2002 to January 2004, the Company raised invoices at RGP without deducting NRF from refinery point to NJP and paid excise duty on the basis of RGP. In respect of rail freight, the Company paid the entire freight from refinery point to destination and billed the OMCs for freight from NJP to destination point. However, during settlement of dues, OMCs reimbursed the excise duty on the reduced RGP *i.e.* after deducting NRF from refinery point to NJP from RGP as per agreement. This resulted in under recovery of excise duty of Rs.9.98 crore from the OMCs. The Company, however, corrected the billing procedure and paid the excise duty on the reduced basic price from February 2004.

The Company could not recover the differential excise duty from the OMCs (July 2006). Besides, out of the under-recovered amount of Rs.9.98 crore, Rs.5.28 crore pertained to 2002-03 and Rs.4.70 crore pertained to 2003-04. The Company lodged (May 2004) a refund claim for Rs.4.70 crore with the Excise Authorities, as the balance was time-barred. The refund claim is now under appeal in CESTAT[♦] (April 2006). The effort of the Company to collect the amount pertaining to the year 2002-03 amounting to Rs.5.28 crore from OMCs has not yielded any result (July 2006).

The Management while accepting the facts stated (April 2006) that the intention of the agreement was to keep the price of NE refinery at par with Haldia and the NE refineries

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[♣] *Indian Oil Corporation Limited (IOCL), Bharat Petroleum Corporation Limited (BPCL), Hindustan Petroleum Corporation Limited (HPCL) and IBP Company Limited (IBP)*

[♦] *Central Excise and Service Tax Appellant Tribunal* to absorb the railway freight from refinery location to NJP. The Company had adopted the correct billing procedure since February 2004.

The Ministry replied (December 2006) that the OMCs had agreed in principle to pay up the amount.

Oil and Natural Gas Corporation Limited

13.8.1 Extra expenditure due to delayed decision and consequent re-tendering

Delay in award of contract resulted in re-tendering and award of the contract at a cost higher by Rs.235.51 crore.

As a part of Mumbai High South Redevelopment Plan, the Oil and Natural Gas Corporation Limited (Company) invited international competitive bids (ICB) in September 2002 for installation of four unmanned platforms, laying of 22 pipeline segments and modifications on 25 existing platforms. The likely date of issue of Notification of Award (NOA) was 31 January 2003 with the completion of the project scheduled by 30 April 2004. Technical bids were opened on 3 January 2003 after one month of the scheduled date. Tender Committee (TC) revised the date of NOA to 14 March 2003 and recommended (January 2003) opening of price bids of M/s. Larsen and Toubro (L&T) and M/s. Engineers India Limited (EIL). The bidders were asked to confirm unconditional compliance with the original project completion schedule *i.e.* 30 April 2004, despite revision in the date of NOA. As EIL did not agree, its offer was rejected. L&T confirmed (4 March 2003) compliance with the project completion schedule with revised NOA with a request for a grace period of 15 days before levy of liquidated damages (LD).

On evaluation, TC recommended (13 March 2003) the award of work to L&T with grace period of 15 days. In view of likely delay in the award of contract, the Executive Purchase Committee (EPC) asked (31 March 2003) L&T to re-confirm project completion schedule of 30 April 2004 with NOA by 15 April 2003 alongwith the negotiations for price reduction. During negotiations L&T did not offer any price reduction but confirmed (3 and 4 April 2003) compliance with the completion schedule subject to issue of NOA by 7 April 2003 with grace period of 15 days. TC recommended (4 April 2003) placing of order on L&T stating that re-tendering would delay the project by one year and would involve loss of 0.13 MMT[♠] of oil. The EPC, however, approved the award of contract to L&T on 9 April 2003 without grace period. Accordingly, L&T was asked (9 April 2003) to confirm unconditional compliance with the original completion schedule without grace period. As this was not in conformity with their offer, L&T refused the offer. Subsequent offer (12 April 2003) with a grace period of 15 days was also rejected.

The Company invited (September 2003) fresh tenders for nine well platforms including four platforms for which the tender was cancelled. The work relating to laying of 22

[♠] ***Million Metric Tonne***

pipelines and modifications in 25 existing platforms was included in a separate fresh tender under RSPPM♠ project.

The 'Nine Well Platforms' Project was awarded (February 2004) to L&T at a total lump sum price of Rs.1,006.52 crore and the RSPPM Project was awarded (February 2004) to Iranian Offshore Engineering Construction Company at a lump sum price of Rs.738.55 crore involving extra expenditure of Rs.235.51 crore in respect of four well platforms, related pipelines and modifications of existing platforms in comparison to the rates offered earlier by L&T.

Audit observed (December 2005) that the scheduled date of NOA was extended by three months due to delay in opening of tenders, delay in furnishing soil data to bidders and extended deliberations for granting grace period *etc*. Further, the EPC on its part did not take timely decision to place order on L&T despite knowing the adverse impact of re-tendering. Thus, the Company incurred an avoidable expenditure of Rs.235.51 crore due to its failure in awarding the earlier contract in time and resultant placement of orders at a higher cost through re-tendering.

The Management stated (June 2006) that despite all its efforts, NOA could not be placed in time due to time taken in obtaining clarifications from the bidders on reduction in price *etc*. and its inability in holding the EPC meeting before 9 April 2003 to finalise the offer.

The reply of the Management was not tenable since despite all delays, L&T was willing to accept the award with the scheduled date of completion remaining undisturbed. In view of the specific recommendations of the TC against re-tendering, an urgent decision by the EPC was required to place the NOA by 7 April 2003.

Thus, due to undue delay in finalising the tender and failure in taking timely decision to place NOA for four Well Platform Project on L&T, the Company incurred avoidable extra expenditure of Rs.235.51 crore on re-tendering the work.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.8.2 Avoidable loss due to delay in awarding tender and consequent idling of rigs

Barytes♣ being an insurance item, ONGC is required to maintain a buffer stock of 5,000 MT and a minimum stock holding of 100 MT to 150 MT in a rig to meet any exigencies. However, delay in awarding a tender for procurement of barytes resulted in suspension of rig operations and consequent loss to the extent of Rs.37.18 crore.

In April 2003, Oil and Natural Gas Corporation Limited (Company) initiated action for inviting tenders for procurement of 3.50 lakh MT of barytes to meet its requirement for two years (2004-05 and 2005-06). The Bid Evaluation Criteria (BEC) was finalised in

♠ ***Redevelopment South Pipelines and Platforms Modifications***

♣ ***Barytes is a mineral consisting of barium sulphate and is used to raise the density of drilling fluid in order to control formation of pressure and sloughing of shale. It is a critical constituent in drilling operation and treated as an insurance item.***

December 2003; the Notice Inviting Tenders (NIT) was published in January 2004, three months before expiry of existing contract period of March 2004. On opening the price bids the Company observed (July 2004) that four of the five bidders who participated in the tender, had quoted the same L_1 (lowest) rate (Rs.1,244.88 *per* MT). Even after negotiations (August 2004) all four bidders offered the same reduced price of Rs.1,170 *per* MT.

The Tender Committee (TC) observed (August 2004) that though the rates were higher in comparison to the last purchase price, these were comparable with the prevalent market trend and, therefore, recommended placing order on all the four L_1 bidders to the Executive Purchase Committee (EPC)[♥]. As the L_1 parties had quoted the same price, TC on the direction of EPC carried out (September 2004) negotiation with L_2 party, a State Government undertaking having major rights for mining of barytes. The State Government undertaking also refused to reduce the rates on the ground of steep increase in input costs. EPC, therefore, decided (September 2004) to close the tender and to invite fresh tenders. Accordingly, the Company invited limited tenders in January 2005 from known established suppliers to meet the requirement for one year and placed orders in February 2005.

Meanwhile in February 2004 and May 2004, the Company had placed orders for 51,460 MT of barytes on nomination basis from existing contractors to meet the emergent requirement. Even with this order, there was a shortfall in the availability of barytes requirement. During September 2004 to January 2005 the stock position of barytes on 29 rigs was either nil or less than the minimum requirement and as a result the rig operations had to be suspended. Total idling cost of owned and hired rigs during this period was Rs.37.18 crore.

Audit observed (June 2005) that initially the Management did not invite the tender for procurement of barytes well before the expiry of the then existing contract. Further, the Management was aware that requirement of barytes was urgent and its non-availability would result in idle rig cost of Rs.7.50 crore per day. Since the rates quoted by the five parties in response to the tender floated in January 2004 were compatible with the prevailing market trend, the decision of not placing any order in response to the tender was apparently not in order.

While justifying the placement of orders on nomination basis to meet the urgent requirement, the Management in its reply (March 2006) stated that the shut down would have been manifold had some bold decisions not been taken like continuing drilling operations without keeping the minimum safety stock on rigs, maintaining only 1,000 MT barytes on vessels to meet exigencies, arranging dispatch of smaller lots by road, accepting deviation in material specifications at reduced rate as per the contractual provisions *etc.* The Management, however, did not offer any comments on the delay in finalising the tender.

Reply of the Management was not tenable since for insurance items like barytes, an alarming situation of stockout should not have been allowed to arise in the first place. The action of the Regional Management to continue drilling operation even at the cost of

[♥] ***EPC is Headed by the Chairman and Managing Director of the Company.***

not complying with the minimum safety stock could not completely remedy the situation as the Corporate Management failed to finalise the tender in time.

Thus, delay in finalisation of the tenders and consequent suspension of rig operations for want of barytes resulted in an avoidable loss of Rs.37.18 crore.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.8.3 Unproductive expenditure on production testing of an exploratory well

Non-availability of left hand drill pipes♣ of required specifications for resolving complications faced in production testing of an exploratory well led to unproductive expenditure of Rs.27.14 crore.

With a view to exploring hydrocarbon potential of Rudrasagar formation♦, drilling of an exploratory well 'CDAB' with target depth of 4,900 metres in Assam was approved by Oil and Natural Gas Corporation Limited (Company) in June 1999. Spudding♥ of the well commenced on 29 July 2001. After drilling upto 4,534 metres, complications in drilling were anticipated and the target depth was revised to 4,700 metres. The drilling was terminated on 18 October 2002 on attaining the revised target depth. Six objects were planned and identified for testing in 60 days. The well was handed over on 4 December 2002 for production testing after testing it hermetically. Production testing of Object-I was started on 1 January 2003. However, on 24 February 2003, production tubing got stuck during re-perforation♠ of the first object. In a bid to release it, other complications such as snapping of wireline; leaving of full length wire alongwith dummy jar inside the 2⅞″ tubing and non-functioning of tool also occurred. Ultimately, fishing• operations were started. However, due to non-availability of 2⅞″ left hand (LH) drill pipes, it was decided on 27 April 2003 to abandon the fishing operations till the drill pipes became available. Other five objects could also not be tested. The rig was released on 1 May 2003 for next location without attaining the objective of drilling the well 'CDAB'.

Audit observed (March 2004) that the production testing of the well could not be completed due to non-availability of 2⅞″ LH drill pipes and the expenditure of Rs.27.14 crore incurred on drilling the well proved unproductive. Though the Company procured 17.56 km of 2⅞″ LH drill pipes during October 2003 to June 2004, the production testing had not been conducted yet (May 2006) due to complexities in fishing operations and priorities of drilling the wells in other areas.

♣ ***Steel pipe used for carrying and rotating the drilling tools and for permitting the circulation of the drilling mud***

♦ ***A succession of sedimentary beds that had deposited continuously under the same conditions. It may consist of one type of rock or alterations of types.***

♥ ***Act of hoisting the drill pipe and permitting it to fall freely so that the drill bit strikes the bottom of the well bore with considerable force***

♠ ***Method of making holes through the casing opposite the producing formation to allow the oil or gas to flow into the well and eventually to the surface***

• ***Operation on the rig for the purpose of retrieving casing or other items from the well bore***

The Management stated (January 2006) that 2⅞″ LH drill pipes is an insurance item and these are not allotted to a particular rig or location. These are maintained as common inventory and issued on first come first served basis. The drill pipes were available at the time of complication but could not be made available as they were already in use. It was decided to discontinue the fishing operations till the arrival of fresh lot of pipes expected in three-four months. The well was abandoned temporarily and the Company would resume the operations with the availability of improved technology and tools. The Management argued that the days consumed on production testing should not be considered wasteful as the well was taken up for production testing after completion of all steps prior to it; it was drilled upto revised target depth and handed over for production testing after successful hermetical testing.

The reply of the Management was not tenable as the basic objective of exploring the hydrocarbon potential of Rudrasagar formation could not be achieved in view of the fact that the Company did not maintain the minimum stock requirement of the 2⅞″ LH drill pipes at drill site as a result of which its production testing operation was affected. Production testing had still (May 2006) not been completed even after three years though the pipes were procured subsequently during October 2003 to June 2004.

Thus, due to the non availability of a critical insurance spare in time, the objective of production testing of an exploratory well could not be completed and the expenditure of Rs.27.14 crore already incurred remained unproductive.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.8.4 Wasteful expenditure due to incorrect decision

ONGC incurred a wasteful expenditure of Rs.26.02 crore by ignoring past experience and the recommendations of its drilling section and the Institute of Drilling Technology for vertical drilling of an exploratory well.

Oil and Natural Gas Corporation Limited (Company) planned to commence exploration of 'Barails'/'Kopili' strata at location GK-11 in Upper Assam Region in May 1997 with a target of drilling a 4,710 metres deep well. The Company drilled the well directionally (June 2002). The drilling operation faced many complications and by September 2004 it was not feasible to drill beyond the depth of 4,230 metres due to high 'torque' and 'drag'[♦]. The rig was released on 7 December 2004. As against the estimate of 290 days, the Company took 869 days in drilling the well from 6 June 2002 to 22 October 2004 without achieving the exploratory objective and charged off Rs.26.02 crore as an expenditure on a dry well in 2004-05 accounts.

Audit observed (November 2005) that before commencement of the drilling operations, the need to plan the drilling vertically had been brought (December 1998) to the notice of the competent authority since such deep wells were not drilled directionally in the Upper Assam Region. Moreover, two similar formations drilled in June 2000 and September

[♦] ***Torque: A turning or twisting force; Drag: Current overpull. Torque and drag are the most important factors which can disturb the drilling of directional wells***

2000 had encountered complications due to high 'torque' and 'drag' and consequent 'stuck up'♠. A study conducted in July 2001 by the Institute of Drilling Technology (IDT) had also recommended that Kopili wells must be drilled vertically with high performance mud system. In March 2002, the drilling section of the Company had envisaged drilling of the well GK-11 vertically to avoid complications. The Company, however, chose to drill the exploratory well directionally and ultimately failed to achieve its objective after incurring a wasteful expenditure of Rs.26.02 crore.

The Management stated (May 2006) that vertical drilling as suggested by the drilling section and IDT could not be undertaken due to non-availability of land and that drilling the well GK-11 vertically from a common point would not have served the exploratory objective. However, the Management assured that in view of the experience in drilling the GK-11 well, care was being taken for completing the drilling of such wells by changing the drilling profile after hiring the requisite services and tools and by applying new generation mud system which helps in reducing the torque and drag and improve bore stability. The Ministry endorsed (January 2007) the reply of the Management.

The reply was not tenable because there was sufficient evidence that directional drilling was not successful in the terrain. Hence, the decision to opt for directional drilling resulted in wasteful expenditure of Rs.26.02 crore.

13.8.5 Extra expenditure due to award of civil works without having title to the site

Lapse on the part of ONGC in awarding civil works to a contractor on land not belonging to it led to extra expenditure of Rs.16.04 crore due to termination of the contract followed by retendering.

Oil and Natural Gas Corporation Limited (Company) placed (May 2003) a Letter of Award (LOA) on Engineering Projects (India) Limited, Kolkata (EPIL) for upgrading its existing Gas Collection Station (GCS) at Baramura, Tripura at a cost of Rs.15.79 crore. The work was to be completed within 18 months from the date of LOA. In October 2003, the Tripura State Electricity Department (TSED) asked the Company to stop the new civil works as the same was being undertaken outside the boundary of the existing GCS of the Company on land belonging to TSED. After resolving the issue with TSED, the Company handed over the site to EPIL free of encumbrance in June 2004. Due to the delay, EPIL was not willing to resume the work at the old rates and demanded revision in contract price and requested the Company to reckon the start of the project from the date of handing over the site to them. The Company agreed to seven months' extension of time, but did not agree to the escalation on the grounds that the contract was a lump sum turnkey contract and directed EPIL to commence work within 10 days. EPIL invoked the arbitration clause and stopped the work (August 2004). The Company terminated (October 2004) the contract with EPIL as they were not ready to commence the work. In June 2005, a fresh contract for this work was awarded to M/s. Larsen & Toubro for Rs.31.83 crore.

♠ *Any drilling string or bit getting trapped/jammed up*

Audit observed (November 2005) that the Company had proposed to utilise the adjoining area of an abandoned well for upgradation of the GCS. The Company, however, did not check the title to the land or obtain necessary clearances from TSED before handing over the site to EPIL (May 2003). The omission to obtain clearance from TSED before awarding the work resulted in the avoidable expenditure of Rs.16.04 crore.

The Management stated (April 2006) that the custody of the land in question on which TSED raised an objection was initially transferred by the Forest Department to the Company in 1976 for drilling operations. TSED never raised any objection against the custody of this land between January and April 2003. The Management also contended that EPIL had no intention of completing the work and the matter of land dispute had simply provided an escape route to them and, thus, the Company had no option but to terminate the contract.

Reply of the Management was not tenable as the forest department had allotted 7.48 acres of land to the Company on lease for the Baramura well number four for the period from December 1974 to March 1976 and the Company's request for extension of the lease period had been rejected by that department in October 1985. The upgradation work of GCS was, therefore, assigned to EPIL on the land which did not belong to the Company whereas in terms of the contract, the Company was to hand over the site free of all encumbrances to EPIL.

The matter was reported to the Ministry in November 2006; reply was awaited (January 2007).

13.8.6 Unfruitful expenditure on application of a new technology

ONGC ignored the results of pilot study and unduly favoured contractors whose technology had either failed in the pilot study or had not been tested at all. ONGC also delayed identification of wells for the use of the technology which resulted in the use of shelf-expired chemicals.

Oil and Natural Gas Corporation Limited (Company) inducted (1999-2000) gel technology on pilot basis to ascertain its suitability in Mumbai High Field. The pilot job comprised application of gel technology for Gas Shut Off (GSO) in five wells, Water Shut Off (WSO) in three wells and profile modification in one well. Pilot study revealed that H2Zero gel used for Gas Shut Off (GSO) by M/s. Halliburton Offshore Service Inc. (HOSI) was unsuccessful in one of the three wells, no positive results could be obtained in the second one due to diagnostic failure to locate the source of gas. In the case of the third well, it was a partial success as there was rising trend of gas production which could be controlled with the same level of liquid production. Unogel used by M/s. Tiorco and M/s. Gel Tech was successful in two wells each for GSO and WSO jobs. H2Zero used by HOSI was also successful for WSO job in one well.

In August 2001, the Company decided to award the work for GSO jobs by application of gel technology to HOSI and M/s. Schlumberger Asia Services (SASL) for three wells each on nomination basis. As the chemicals to be used by the parties were different from those used in the pilot study, it was decided to award the work subject to the results of lab performance test to be conducted under simulated reservoir conditions.

The work was awarded in October 2001. The GSO jobs carried out by SASL and HOSI in December 2002/January 2003 in one well each proved unsuccessful. The Company, however, amended the contract in October 2003 and allowed the same parties to conduct WSO jobs using gel technology for the remaining wells also.

Audit observed (May 2005) that the Company awarded contracts to HOSI despite the fact that results of conducting similar jobs in the pilot study had not been successful. In the case of SASL, no pilot study had been conducted on the efficacy of the technology and the gel used by the party. The letters of award issued (October 2001) to both the parties did not include the condition that the execution of work was subject to successful pre-testing of the gel, though it was a normal pre-condition for the award of the work. Consequently, no lab tests were conducted prior to the award of such work. While the gel/chemical used by SASL tested after the award of the work in May 2002 was found suitable, HOSI's request to waive off such a test was accommodated and no lab test on the gel/chemical of the party was conducted even after the award of work. Despite the GSO jobs carried out by both SASL and HOSI in December 2002/January 2003 having been unsuccessful, the Company did not de-hire their services for the remaining two wells each though clauses 19.3 and 19.4 of the contract empowered the Company to do so. Instead, the Company amended the contracts in October 2003 and assigned WSO jobs using gel technology for two wells each to both the parties. The wells for these jobs were identified after a lapse of one year in October 2004 by which time the shelf life of the gels had expired and the WSO jobs carried out (November 2004) were also unsuccessful. Thus, expenditure of Rs.10.06 crore incurred by the Company on application of gel system for GSO/WSO jobs proved unfruitful.

The Management stated (May, 2006) that WSO/GSO jobs by applying gel technology needed extensive trials before concluding that it was a case of success or failure. However, decision to further test the technology with different gels was a conscious decision. As regards award of work to HOSI and SASL, the Management contended that since gel technology used by M/s. Gel Tech and M/s. Tiorco was similar to the gel technology developed by ONGC's Institute, it was decided to try the gel technology of HOSI and SASL. Even though the GSO jobs by HOSI and SASL were unsuccessful, it was decided to continue the efforts as both parties had already mobilized the chemicals and as per contract the remaining two wells were required to be completed. The Management further contended that wells repaired/treated by H2Zero gel were performing well with respect to undesirable gas production and, hence, it was decided to dispense with lab test which resulted in saving of time and associated cost. As regards the use of expired chemicals, the Management stated that the efficacy of the chemicals was confirmed by SASL even though the shelf life had expired. The Ministry endorsed (January 2007) the reply of the Management.

Reply was not tenable because despite being aware of the uncertainty involved in successful application of a new technology, the Company awarded the contracts without insisting on the standard condition of testing in simulated reservoir conditions, thereby rendering the expenditure of Rs.10.06 crore unfruitful.

13.8.7 Avoidable expenditure due to not availing of Deemed Export Benefit

By not inviting tenders for procurement of Oil Well Cement on International Competitive Bidding (ICB) basis in time and because of subsequent delay in processing the ICB tenders, ONGC could not avail of Deemed Export Benefit that led to avoidable expenditure of Rs.1.35 crore.

Under a GOI Notification of August 2000, goods meant for use in areas where the Petroleum Exploration Licence (PEL)/Mining Lease (ML) was issued or renewed after 1 April 1999 were eligible for Deemed Export Benefit, by way of exemption of excise duty on the goods manufactured in India and purchased under International Competitive Bidding (ICB) tenders. This notification was circulated to all its Regions by Oil and Natural Gas Corporation Limited (Company) in September 2000.

A contract for purchase of Oil Well Cement (OWC) executed in December 2000 was due to expire in December 2001. The Company invited fresh tenders for two years on limited tender basis from all indigenous empanelled bidders only in December 2001. The Executive Purchase Committee (EPC), headed by the Chairman and Managing Director of the Company, in its meeting in March 2002 noted the delay in inviting tender and issued instructions to fix responsibility. The Committee further directed that the tender be re-invited on ICB basis for three years on firm rate basis so as to enhance competition and to avail of possible Deemed Export Benefit. Accordingly, a new tender on ICB basis was invited in September 2002. Only two bids were found to be technically acceptable. The EPC besides observing the delay in processing of tender decided (November 2003) to close the existing tender and invite fresh tenders due to lack of competition and inconsistencies observed in the processing of initial bid. The Committee again ordered that responsibility for delay should be fixed and a report submitted within 15 days. A new tender was floated in January 2004 and purchase orders were placed in January 2005.

Meanwhile, in order to meet the operational requirement, the Company gave approval on piecemeal basis to its Regional Officers to procure OWC from local suppliers. Mumbai Region of the Company accordingly procured 44,400 MT of OWC during April 2002 to December 2004 out of which 22,703 MT was utilised in PEL/ML areas for which Deemed Export Benefit of Rs.1.35 crore could not be availed of.

Audit observed that the Company had not only delayed invitation of tenders but also failed to take cognizance of the Notification of August 2000 circulated to all its Regions by the Company in September 2000, wherein all concerned were advised to incorporate specific tender provisions for procurement of supplies in respect of areas covered under PEL/ML. Hence, the Company should have invited the tender on ICB basis in the first instance itself. Further, the existing contract was to expire in December 2001. Fresh tenders were, however, invited only in December 2001. As a result, the Company incurred an extra expenditure of Rs.1.35 crore on procurement of OWC at the level of regional offices.

The Management in its reply (September 2005) stated that as tender was floated on ICB basis for the first time in several years, bid evaluation criteria (BEC) had to be formulated afresh. Since tender was floated for three years, revised requirement was to be compiled by various Regions. Re-floating of tender resulted in re-compilation of requirement and formulation of BEC.

Reply of the Management was not tenable due to the following:

(i) The Company failed to invite tenders on ICB basis in the first instance, since the notification to this effect was circulated to all Regions in September 2000 and the existing contract was expiring in December 2001.

(ii) Noting the delay in invitation of tenders, EPC had given directions twice (March 2002 and November 2003) to fix responsibility. Audit, however, did not come across any papers to indicate action taken by the Company.

(iii) Finalising of ICB tenders is not new to the Company and OWC is a regular item of consumption. Therefore, procedural delays could have been curtailed/avoided.

Thus, due to lack of internal control and procedural delays in inviting/processing of tender, the Company could not avail of Deemed Export Benefit leading to extra expenditure of Rs.1.35 crore.

The matter was reported to the Ministry in October 2006; reply was awaited (January 2007).