

IN THE HIGH COURT OF DELHI AT NEW DELHI

W.P. (C) 13002/2009 & CM APPL No. 13938/2009 (for stay)

Reserved on: January 27, 2010
Decision on : February 18, 2010

CHANDANA KEDIA
SOLE PROPRIETOR, M/S. ADINATH INDUSTRIES
..... Petitioner
Through: Mr. Raman Kapur with
Mr. Dhiraj Sachdeva, Advocate

versus

UNION OF INDIA AND ANR Respondent
Through: Mr. Chandan Kumar, Advocate

CORAM: JUSTICE S. MURALIDHAR

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| 1. Whether reporters of local paper may be allowed to see the judgment? | No |
| 2. To be referred to the report or not? | Yes |
| 3. Whether the judgment should be referred in the digest? | Yes |

J U D G M E N T

1. The Research Designs & Standards Organization ('RDSO') under the Government of India, Ministry of Railways, at Lucknow, by a letter dated 21^s/23rd April 2009 informed the Petitioner, the sole proprietor of M/s. Adinath Industries, that the production and inspection of Elastic Rail Clips (ERCs) Mark-III at its unit was "stopped with immediate effect" since the first sample of the consignment picked up from the consignee when tested was "found not conforming to the norms of IRS specification No.IRS/T-31-1992." This was followed by a notice dated 21st July 2009 whereby the

RDSO informed the petitioner that both the first and the second sets of samples were found not conforming to the IRS specification and asked the petitioner to show cause why necessary action should not be taken against it as per the extant policy. Thereafter, by an order dated 18th/22nd September 2009 the RDSO informed the petitioner that the competent authority was not satisfied with the petitioner's reply to the show cause notice and had "temporarily de-listed" the firm "from the approved list of vendors for ERC MK-III" with effect from 18th September 2009 for a period of six months up to 17th March 2010. The RDSO further directed that till it was satisfied with the corrective action taken by the petitioner and about the quality control system, normal production/inspection shall not be allowed. The aforementioned letter dated 21st/23rd April 2009, the show cause notice dated 21st July 2009 and the "de-listing" order 18th/22nd September 2009 have been challenged in this petition.

2. The Petitioner is a small scale industrial unit located in Delhi exclusively manufacturing ERCs which are used as track components for the Indian Railways. The Petitioner is a captive unit of Indian Railways working under the overall supervision of the Ministry of Railways (Respondent No.1) and the RDSO (Respondent No.2).

3. It is stated that for the year 2007-08 the West-Central Railways invited tenders for the supply of ERC Mark-III ('MK-III'). The Petitioner submitted a tender. Ultimately the work was awarded by a purchase order ('PO') on 28th December 2007 for the supply of 75,000 units of ERCs at all an

inclusive unit rate of Rs.47.62 per unit. The total value of the PO was Rs.35.71 lakhs.

4. As per the terms and conditions of the contract, the raw material for manufacturing of the ERC MK-III was required to be inspected by the competent authority and only after its approval the Petitioner was permitted to take up manufacturing of ERC MK-III. In the instant case, after approval by the competent authority, the Petitioner started manufacturing of ERC MK-III. As per the conditions of the contract, the ERCs were to be manufactured and tested (pre-dispatch inspection and testing) as per the Indian Railway Standard Specification ('IRS Specification') Code No.T-31-1992.

5. It is stated that the Petitioner manufactured 62,000 units of the 75,000 units ordered in May 2008. The pre-dispatch inspection and testing was done by the consignee i.e. Indian Railways on 3rd June 2008 in terms of the ERC Code No. T-31-1992. After such inspection, the manufactured item was to be coated with linseed oil as per clause 9 of the IRS Specification. It is stated that after coating, the consignment was checked and was supplied to the consignee i.e. the Indian Railways and was used and installed at its sites as per requirement. It is stated that since the West-Central Railways was satisfied with the quality of the consignment and the promptness of the Petitioner, it placed an order with the petitioner for a further 30% quantity, i.e. 22,500 units against the same purchase order and by the same delivery period, i.e. 27th December 2008. This was also supplied by the Petitioner

along with the balance quantity of the previous order on 22nd December 2008 after satisfying the condition relating to pre-dispatch inspection and coating by linseed oil.

6. The Petitioner states that its manufacturing unit was audited for quality and its approval was renewed in 1999 and 2004 by the Respondents. The audit was to be done every five years. The Petitioner applied for the next quality audit in November 2008. On 15th/16th March 2009, the officers of the RDSO inspected and audited the quality and approved the petitioner as a 'Part I' vendor. The upgradation of the manufacturing process was also approved. Subsequently, a formal approval certificate was issued on 28th May/1st June 2009. This was valid from 1st January 2009 till 31st December 2014.

7. In the meanwhile, the Petitioner received the aforementioned impugned letter dated 21st/23rd April 2009 from the RDSO in which it was stated that some samples from the last lot supplied by the Petitioner had been picked up from the consignee's end and tested at the RDSO. The first set of the sample was not found conforming to the IRS specifications when tested as per the double sampling plan. The petitioner was therefore asked to stop production with immediate effect. The Petitioner was informed that for testing of the second set of samples, it could send its authorized representative to be present for opening of the samples.

8. When the Petitioner contacted the RDSO, it was informed that eight

pieces of ERC constituting the first sample set had been picked up from the material supplied by the Petitioner to West-Central Railways. A second lot of eight units had also been picked up. According to the Petitioner, the sampling was to be done of 125 units per lot of 10,000 units supplied under the approved plan of sampling as per the relevant IS Code, reiterated in the IRS Code. The petitioner's contention is that a sample size of eight units was highly inadequate. The first sample set to be tested should have contained at least 200 units. Further, the samples had been picked up without informing the Petitioner and they were tested in the absence of the Petitioner. Even the test result was not made available to the Petitioner.

9. In the meanwhile, the quality audit and re-assessment certificate was issued by the RDSO to the petitioner on 28th May/1st June 2009. The Petitioner, therefore, by a letter dated 29th June 2009 requested the Respondents that in view of the said certificate, the Petitioner should be allowed to resume production.

10. As already noticed, the Respondents sent the Petitioner a show cause notice dated 21st July 2009. The Petitioner gave a detailed reply on 13th August 2009 requesting inter alia for a personal hearing. This was responded to by a letter dated 3rd September 2009 of the RDSO followed by a personal hearing on 17th September 2009. Thereafter, the impugned order was issued on 18th/22nd September 2009 temporarily de-listing the Petitioner from the approved list of ERC MK-III/vendors for a period of six months with effect from 18th September 2009 up to 17th March 2010.

11. The petitioner contends that the order of delisting overlooked the fact that the manufacturing unit of the Petitioner was already lying closed for more than six months since 21st April 2009. Effectively therefore, the closure would be for a period of eleven months. Further, it is stated that although after the impugned order was passed, the Respondents had, by a letter dated 15th October 2009, permitted the Petitioner to complete the pending orders, it was asked not to carry out any other production or apply for any fresh tenders. It is submitted that the entire action of the Respondents is arbitrary and illegal and that the Petitioner's workmen, who are solely dependent upon the income of the unit, which is in turn entirely dependent upon the Railways, were in dire straits.

12. Mr. Raman Kapur, learned counsel for the Petitioner refers to the procedures outlined under the applicable IRS conditions of contract. It is stated that under Condition No.9 of IRS Code T-31-1992 once the consignment is coated by linseed oil, no testing or inspection is possible thereafter. The material which was allegedly picked up by the Respondents and tested was duly coated with linseed oil and thus could not and should not have been put to sampling and testing. It is reiterated that in accordance with the IS code, followed in the IRS code, a minimum 200 units should have been picked up and tested/inspected and therefore, the tests conducted by the RDSO were not reliable. Moreover, the quality audit and re-assessment was done on 15th/16th March 2009 as a result of which the Petitioner was approved as a vendor. It is pointed out that the consignee, viz., the Indian Railways, made no complaint about the quality and yet the Petitioner was being penalized by the closure of the production in its unit

since 21st April 2009. The de-listing was made effective from 18th September 2009 up to 21st March 2010, thus extending the period of closure to eleven months, far beyond what was contemplated under the contract. In effect therefore, the punishment was disproportionate and harsh.

13. In the counter affidavit filed by the Respondents, a preliminary objection is raised as to the maintainability of the writ petition. It is pointed out that the contract in question has an arbitration clause. Under Section 8 of the Arbitration & Conciliation Act, 1996 ('Act') read with Clause 200 of the Indian Railway Standard Conditions of Contract, this petition cannot be entertained as the petitioner has an effective alternative remedy by way of arbitration. Having not protested against the taking and testing of the samples as communicated in the RDSO's letters dated 21st/23rd April 2009 and the impugned order 18th September 2009, the Petitioner was estopped from challenging them at a later date. It is urged that the Petitioner is in fact seeking a specific performance of a contract for which the present writ petition was not appropriate.

14. On merits, Mr. Chandan Kumar, learned counsel the Respondents submits that there was no violation of the principles of natural justice. The first of the samples taken on 21st/23rd April 2009 failed the test. On 15th May 2009, despite being informed in advance, the Petitioner did not appear and the second sample was opened one day late in the presence of an independent witness. The second sample also failed the test. Therefore, on 21st July 2009 the petitioner was issued a notice asking her to show cause why necessary action should not be taken against her under the extant

policy. The Petitioner was given a personal hearing and thereafter on 18th September 2009 the impugned order of temporary de-listing of the petitioner was passed.

15. Although the production and inspection of the firm was restored on 15th/16th October 2009 for the limited purpose of completing the pending orders, it made no difference to the temporary de-listing of the petitioner for a period of six months. Referring to the decisions in *Assistant Excise Commissioner v. Issac Peter (1994) 4 SCC 104*, *Indian Oil Corporation Limited v. Amritsar Gas Service (1990) 1 SCC 533* and *S.K. Jain v. State of Haryana (2009) 4 SCC 357*, it is submitted that the petitioner cannot complain of the contract terms being unfair as she has voluntarily accepted them as binding. It is submitted that the petitioner has not challenged the Railway Board Circular dated 30th September 2003 or the tender conditions, or the “General Guidelines for Vendor Development” (GGVD) which have been duly followed in taking samples, conducting the tests and imposing the penalty. It is pointed out that by letter dated 14th May 2008, the petitioner agreed to abide by the said GGVD. It is submitted that the audit conducted and the certificate issued on 28th May 2009 “had nothing to do with the samples manufactured in the past and found to have failed the test.” It is pointed out that the certificate of approval also sets out that the order dated 21st April 2009 stopping production would continue “till further advice.”

16. In the first place, this Court would like to deal with the preliminary objection as to the maintainability of the writ petition. The existence of

alternative remedy by way of arbitration does not prevent this Court from entertaining a writ petition under Article 226 of the Constitution in appropriate cases. The grounds on which the High Court, in its discretionary jurisdiction, might interfere includes violation of the principles of natural justice by the authority whose decision is challenged. It could also be on the ground the authority has in interpreting and applying a clause acted unreasonably and unfairly. Further, if in so acting the authority has subjected the party to a disadvantage, disproportionate to the alleged infraction, then the High Court can interfere within the limited scope of its jurisdiction under Article 226 of the Constitution. The underlying principle is fairness in action of a state enterprise which emanates from Article 14 of the Constitution. As explained in *ABL International Ltd. v. Export Credit Guarantee Corpn. of India Ltd. (2004) 3 SCC 553* (at p. 572):

“(a) In an appropriate case, a writ petition as against a State or an instrumentality of a State arising out of a contractual obligation is maintainable.

(b) Merely because some disputed questions of fact arise for consideration, same cannot be a ground to refuse to entertain a writ petition in all cases as a matter of rule.

(c) A writ petition involving a consequential relief of monetary claim is also maintainable.”

17. As far as the present case is concerned, since the facts are not disputed, all that is required to be examined is whether the Respondents have correctly understood the relevant clauses in terms of which the samples have been taken, tested and the petitioner “de-listed” for a period of six months. The issue that arises is whether the Respondents have acted fairly and reasonably and that can be examined by this Court in the exercise of its powers under

Article 226 of the Constitution. Also, there is no question of the Petitioner being estopped from challenging an order which subjects the petitioner to the adverse consequence of de-listing for more than six months. The Respondents' preliminary objection as to maintainability of this petition is therefore overruled.

18. The principal defence of the Respondents is that they have strictly followed the extant procedures outlined in the Railway Board Circular dated 30th September 2003 for taking "punitive action against suppliers for poor quality track fittings". Clause 1 of the said Circular, under the title 'Quality Checks & Punitive Action' reads as under:

"1.1 Two samples containing 8 pieces each shall be picked up, in case of ERC-MKIII and GPN-66 Liners while in case of GRSP, samples will consist of 16 pieces each.

1.2 The criteria for testing and selection of samples shall be decided at RDSO with the approval of SRED-QA. Defects attributable to raw material shall not be considered if the raw material has been inspected by the Railway.

1.3. If tests on first sample passed a further action will be needed. If it fails the ... production and inspection shall be stopped by a letter to all concerned and action will be advised to depute its representatives or witness the opening of second sample at an appointed date and title. In case the firm's representative does not turn up, the sample shall be opened in the presence of a witness from outside Q.A. Civil Cell and tested.

1.4 If the 2nd sample passes, the firms production and inspection shall be resumed and the firm shall be given a written warning to keep a strict control on the quality of

their samples.”

19. Where the second sample also fails, as in the instant case, then Clause 1.5.1 provides that “the firm shall be temporarily de-listed for a period of six months and a special quality audit of the firm shall be carried out by the Dy. Director/Director RDSO. The list of non-conformities or deficiencies shall be given to the firm on the basis of the special quality audit.” If the corrective action is carried out as suggested then another verification will be carried out by the Dy. Director RDSO and the firm “shall be restored in Pt.II list after completion of 6 months of de-listing.” It is important to note that a period of de-listing for one year is prescribed as a penalty only for a Pt.II firm, whereas in the present case, as will be presently seen the petitioner is a Part I firm.

20. Since Clause 1.5.1 does not say from when the period of six months is to be computed, the question that arises is whether the Respondents were justified in computing the said period from 18th September 2009 when in fact the petitioner’s production had been stopped from 21st April 2009 itself and no fresh orders were placed on it since that date. This assumes significance since even as per the Railway Board Circular dated 30th September 2003, a Part I firm cannot be de-listed for more than six months.

21. Next, it is necessary to refer to the GGDV. Clause 24.1.4 reads as under:

“24.1.4 Opening and testing of samples

- i) Opening: Samples will be opened by a person authorized for this purpose. The opening authority will

collect all the accompanying documents and satisfy himself about their authenticity.

ii) Testing of samples: Testing of the samples shall be organized within RDSO laboratories. However, if the competent authority so desires, the tests can be conducted at any other laboratory of repute. The discretion of the authority (PDSO) on this subject cannot be challenged.

iii) The specific tests to be conducted are included in the Specifications for each individual item. The tests to be generally carried out on the sample sets are listed out. The competent authority has the option of either deleting some tests or including some other tests so as to verify compliance of samples with specifications.

iv) For samples of GRSP whenever possible a time between vulcanization and consignee and testing may be up to 5 months and all tests must meet the acceptance value as specified in Indian Railway Standard Specification for GRSP (6mm thick) for placing beneath Rails Serial No. T-47-2006. However, this shall be applicable only to those cases where this condition has been included in Contract Conditions/P.O. of GRSP.”

22. Under Clause 24.1.6 GGVD where the first set of samples fails the test then a second set of samples will be tested in the same way in the presence of the representative of the vendor. In such event in terms of Clause 24.2.1 the “firm will be advised by the RDSO to stop all further production. No inspection will be carried out till the testing of the second set is done.” Under Clause 24.2.3 in the event of the second set also failing the test a special audit will be conducted by the RDSO and a list of non-conformities will be provided to the firm and it will have to submit compliance. Clause

24.2.4 GGVD sets out the provision for de-listing and it reads thus:

“24.2.4 Delisting of firms: In the event of failure of both the sets of samples, the corrective action will be as detailed below.

- i) **Part I firms:** The firm shall be temporarily delisted for 6 months. Action will be taken to rectify the shortcomings in accordance with the Para 24.2.3 above.
 - A. On successful confirmatory audit, the production and inspection may be started and the firm will be restored to Part II status on expiry of 6 months of temporary delisting.
 - B. In case of non-compliance during confirmatory audit, the firm will not be given a second chance and they will stand delisted for a further period of 1 (one) year. Their status can be restored to Part II only on satisfactory compliance of Spl. Quality audit observations.”

23. From the above clauses it appears that a Part I firm like the petitioner can, at the highest, be de-listed for six months, if both test samples fail and not for a longer period. Even if the Respondent’s contention that it has abided by the procedure outlined in the above two documents is to be accepted, it still does not explain how at the same time the testing of the second sample was taking place, the RDSO also conducted an audit of the petitioner’s unit and gave it approval as a Part I firm till 31st December 2014. The approval certificate dated 28th May 2009 granted by the RDSO is not denied by the Respondents but is brushed aside by saying that it has nothing to do with the failure of the samples manufactured earlier. However, there is more to this than is apparent.

24. The petitioner's earlier registration expired in November 2008 and it applied for renewal. Meanwhile on 22nd December 2008 the petitioner supplied a total of 35,500 pieces of ERC to the West-Central Railways and the supplies were received by the consignee on 26th December 2008. In terms of IRS 1502 the petitioner had to be given a rejection advice within 90 days of the making the supplies. However, the letter dated 21st/23rd April 2009 of the RDSO informing the petitioner about the failure of the first sample set picked up from the consignee was given beyond the period of 90 days from the completion of the supply. Further, under Clause 24.1.6 (i), GGVD the petitioner had to be given 30 days' advance notice of the time of the second sample testing. The letter dated 21st/23rd April 2009 was received by the petitioner on 5th May 2009. The date of the testing of the second sample was indicated as 14th May 2009 thus not adhering to the requirement of 30 days' advance notice. Both these clauses are stated to be mandatory. There is no satisfactory reply by the Respondents as to why these mandatory requirements were not met. Nevertheless, this court is not persuaded to set aside the letter dated 21st/23rd April 2009 or the show cause notice dated 21st July 2009 since the petitioner has filed this petition only on 6th November 2009 essentially aggrieved by the continuation of the de-listing beyond six months after the stoppage of its production.

25. The test results show that the first sample was tested on 20th February and 30th March 2009. In the meanwhile, the inspection team of the RDSO for audit for renewal of the petitioner's registration visited the petitioner's unit on 15th and 16th March 2009. They found the unit to be fit to be granted renewal of registration as a Part I firm for five years from 1st January 2009

till 31st December 2014. Thereafter the second sample was tested on 18th May and 20th July 2009. Throughout this period, there was no complaint from the consignee about the quality of the pieces supplied. The petitioner has also pointed out that the two test results are at variance as regards the 'non-conformities'. All these factors raise serious doubts whether the Respondents were justified in proceeding to de-list the petitioner for six months with effect from 18th September 2009 when by then the petitioner's audit had been successfully done and it had been granted the approval certificate as a Part I firm on 28th May 2009. This apparent contradiction cannot be explained by merely saying that the audit of the unit and the testing of the samples have nothing to do with each other. After all, one of the corrective measures for the failure of the second set is that an audit should be conducted of the unit. If in fact such audit has already been conducted to the satisfaction of the RDSO, then it makes little sense to ignore that fact and proceed to de-list the petitioner for a period of six months and that too with effect from 18th September 2009, nearly five months after it was asked to stop production.

26. In any event, there was no question of the six months period of de-listing being made effective from 18th September 2009 when the petitioner's unit was asked to stop production with immediate effect on 21st April 2009. Effectively therefore, the petitioner became non-functional from that date and was not permitted to make any fresh supplies nor were any orders placed on it. Neither the Railway Board Circular dated 30th September 2009 nor the GGVD envisage de-listing of a Part I firm beyond six months. Therefore, the decision dated 18th/22nd September 2009 of the RDSO de-listing the

petitioner for a period of six months from 18th September 2009, tantamounting to eleven months of effective de-listing, was plainly illegal and arbitrary.

27. The above analysis shows that the Respondents did not act reasonably or fairly in proceeding to de-list the petitioner for a period of six months from 18th September even while the RDSO had itself, by a certificate dated 28th May 2009, renewed the petitioner's registration as a Part I firm for five years from 1st January 2009. The respondents failed to consider relevant materials in arriving at such a decision. An order of even temporary de-listing causes severe prejudice to a vendor and can cause irreparable damage to its reputation. Such a decision will have to pass the test of reasonableness on the touchstone of Article 14 of the Constitution (see *Eurasian Equipments and Chemicals Ltd. v. State of West Bengal* AIR 1975 SC 266; *Saraswati Dynamics (P) Ltd. v. Union of India* 2003 IV AD (DELHI) 225 and *Bharat Filling Station v. Indian Oil Corporation Ltd.* 104 (2003) DLT 601). The impugned order dated 18th/22nd September 2009 cannot be said to be sustainable in law on an application of such a test.

28. Consequently, the impugned order dated 18th/22nd September 2009 issued by the RDSO is hereby set aside. The petitioner's de-listing could in no event have extended beyond the expiry of six months after 21st/23rd April 2009 i.e. beyond 22nd October 2009. Consequently, the production and inspection of ERC MK-III at the petitioner's unit will be permitted to resume forthwith. It is open to the Petitioner to seek other appropriate

remedies available to it in accordance with law for the redressal of its claims for compensation for the losses, if any, on account of the unlawful extension of the de-listing period by the Respondents beyond 22nd October 2009.

29. The writ petition is allowed in the above terms with costs of Rs.10,000/- which will be paid by the Respondents to the Petitioner within a period of four weeks from today. The pending application is disposed of. Order dasti.

S. MURALIDHAR, J.

FEBRUARY 18, 2010

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