

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 26.02.2013

Decided on: 07.11.2013

+ **LPA 976/2002**

UNION OF INDIA Appellant
Through : Sh. B.V. Niren, CGSC with Sh.
Prasouk Jain, Advocate.

Versus

M/S. SYNBIOTICS LIMITED AND ANR. Respondents
Through : Sh. Vibhu Bakhru, Sr. Advocate
with Sh. Pravin Bahadur, Ms. Mallika Joshi,
Sh. Mohit Mudgal, Sh. Amit Agarwal and
Sh. Rajan Narain, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE SUDERSHAN KUMAR MISRA

MR. JUSTICE S. RAVINDRA BHAT

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1. The present appeal by the Central Government (described as such, or as the “Union Government”) impugns a judgment and order of a learned Single Judge by which the respondents’ writ petition challenging a demand made in terms of the Drugs (Prices Control) Order (DPCO) of 1979 was allowed.

2. The Respondent No.1 is a manufacturer of various drugs and pharmaceutical products, including streptomycin and Respondent No.2 is its Director. The respondents herein, contended before the

learned Single Judge that a manufacturer of a bulk drug like it cannot be compelled to sell its product only at the pooled price and not for lower price. It also argued that as manufacturer of bulk drugs it could not be compelled to deposit into the Drug Prices Equalisation Account excess amounts constituting the difference between the pooled price and the retention price particularly when such excess amount is not realized if the manufacturer sells the bulk drug at retention price.

3. Clause 3 of the DPCO empowered the Central Government to, with a view to regulating the equitable distribution of an indigenously manufactured bulk drug specified in the First Schedule or the Second Schedule and making it available at a fair price subject to Rule 3(2) and after making such inquiry as is deemed fit, “.....*fix, from time to time, by notification in the Official Gazette, the maximum price at which such bulk drug shall be sold.....*” Rule 3 (2) states that while fixing bulk drug prices, the Government “may” take into account the “.....*average cost of production of such bulk drug manufactured by an efficient manufacturer and allow a reasonable return on networth.*” Clause 4 empowered the Central Government to, notwithstanding Clause 3, if it felt it necessary to increase production of indigenously manufactured bulk drugs under the First or Second Schedule, fix (a) a retention price for the bulk drug and (b) a common sale price for such bulk drug, taking into account the weighted average of the retention price fixed under Clause (a). Clause 7 states that where a bulk drug is indigenously manufactured as well as imported, the Central Government can, after making

necessary adjustments, fix “(a) retention prices for individual manufacturers, importers or distributors of such bulk drugs” or (b) “a pooled price for the sale of such bulk drugs.” Clause 7 (2) read as follows:

“(2) Where a manufacturer of formulations utilises in his formulations any bulk drug, either from his own production or procured by him from any other source, the price of such bulk drug being lower than the price allowed to him in the price of his formulations, the Government may require such manufacturer --

(a) to deposit into the Drug Prices Equalisation Account referred to in paragraph 17 the excess amount to be determined by the Government; or

(b) to sell the formulations at such prices as may be fixed by the Government..”

4. On 02.04.1979 the Central Government issued an order fixing the pooled price for streptomycin and also the retention price for the writ petitioners (respondents herein) and other manufacturers. The pooled price for streptomycin was fixed at ₹475 per k.g. and retention price was fixed at ₹449.71 per k.g. for first respondent and ₹498 for other manufacturers. The Central Government by circular dated 19.11.1979 required further information in view of the representation from the manufacturers of drugs and pharmaceuticals for granting an immediate price increase for bulk drug and formulation in order to compensate for the rapid increase in the price of input materials, particularly petroleum based products. It was claimed – by the respondents herein that w.e.f. 01.07.1979 they had started selling all the streptomycin manufactured by them to M/s. Sarabhai Chemicals, a

division of Ambalal Sarabhai at the rate of ₹449.71 per k.g. which was retention price allowed to the respondents herein, by order dated 02.04.1979. Sarabhai Chemicals manufactured formulations out of the said streptomycin supplied by M/s. Synbiotics Ltd. On 10.06.1980 the Central Government called upon the respondents - M/s. Synbiotics Ltd. to pay into the Drugs Prices Equalisation Account an amount calculated at ₹25.29 per k.g. on the entire produce of streptomycin sold by it after commencement of the said order. Arguing on behalf of the M/s. Synbiotics Ltd., learned counsel has contended that as no excess amount was collected by it, nothing was to be paid to the Drug Prices Equalisation Account. On 06.10.1980 in exercise of the power conferred by paragraph 7 (1) of the said order, the Central Government revised the respondents' [M/s. Synbiotics Ltd.'s] retention price from ₹449.71 per k.g. downward to ₹429.00 per k.g. The pooled price of streptomycin was, on the other hand, raised from ₹475 per k.g. to ₹660 per k.g. At the same time, retention price of streptomycin for other manufacturers were raised from ₹498 to ₹660.75, so that it was equal to the pooled price.

5. On 29th November, 1980, the Ministry of Petroleum, Chemicals & Fertilizers addressed two letters/orders to Petitioner No. 1 (Respondent No.1 in the present matter) stating that in October, 1980, petitioner No. 1 had been required to sell streptomycin at the pooled price of ₹475/- per k.g, for the period 01.07.1979 to 06.10.1980, when the pooled price was revised to ₹660.75/-. The Union's position was that the respondents' action in selling

streptomycin at the retention price of ₹449.71 per k.g. was without justification. Consequently, a demand was made upon it, to pay the difference between the pooled price and the retention price, into the Drug Prices Equalisation Account. It was in these circumstances, that the writ petition was preferred. The learned Single Judge held that the demand by the Central Government was unsustainable. The Central Government has appealed against that decision.

6. It is argued by the appellant – the Central Government, that the learned Single Judge fell into error in interpreting the Drugs (Prices Control) Order, 1979 [hereafter referred to as “DPCO”]. It is urged in this context that the Scheme required that the “Pooled Price” was the basis at which the bulk drug had to be sold in the market or what the manufacturer could realise. The “Retention Price”, on the other hand, was the price at which he could retail the bulk drug for manufacturing the formulation in the event he was also a formulator. The latter, i.e. Retention Price was fixed on the basis of returnable cost of production. The object of creating the Drug Prices Equalisation Account under Clause 17 of the DPCO was that in the event the Pooled Price was higher than the Retention Price, the difference between the two was to be credited to the account by the manufacturer and if the converse happened, the manufacturer was to be reimbursed from the fund. Learned counsel urged that this mechanism was necessary to ensure a suitable cost of goods and ensure that monopoly in essential products was avoided.

7. Elaborating on the submission, it was urged by Mr. B.V. Niren, learned counsel, that if an importer or a manufacturer, with access to

resources, was in a position for some time, to ensure that the cost of production was lower than that of the competitors who might be small or new manufacturers, the Retention Price would naturally be lower in the former's case. The Pooled Price, on the other hand, was a concept arrived at to ensure that bulk drugs were sold at a uniform and suitable price. In the event the newer or smaller units' Retention Price was higher than the Pooled Price they would be driven out of the market, thus eliminating competition, and consequently, undermining competition and the larger public interest. Consequently, the Drug Price Equalisation Account ensured that such eventualities were dealt with, and the smaller or newer units are reimbursed the difference from the account which had to be credited by all concerned parties. In other words, the system was one of benefits and compensation and also of disincentive. The disincentive was to stop large manufacturers from selling below the indicated Pool price in a bid to secure monopoly; the benefit was to small or fresh manufacturers and new entrants in the market who would not be otherwise able to compete with economies of scale, thus giving rise to an undesirable monopolistic situations.

8. It was submitted that the Single Judge erred in holding that the DPCO did not mandate the deposit of the difference in the case of manufacturer selling the bulk drug at the Retention Price and not at the Pooled Price. In this context, it was submitted that Clause 17(a) (ii) is independent of the sale being made at the Pooled Price. The difference between the Pooled Price and the Retention Price necessarily had to be deposited into the account irrespective of the

price at which the bulk drug was sold. In other words, the ability of the large manufacturer to sell the bulk drug at cost or Retention Price and at rates below the Pooled Price was an irrelevant factor; in the event the Retention Price was lower than the Pooled Price, the manufacturer had to deposit the difference in the account.

9. It was argued next that the Single Judge fell into error in holding that the Central Government was obliged to invoke para 7(2) of the DPCO to realize the difference from the formulator, M/s. Ambalal Sarabhai Enterprises. Reliance was placed upon paras 17(1)(a)(ii) to say that such difference between Pooled Price and Retention Price is to be borne by the seller of the drug, into the account.

10. Learned senior counsel for the respondents submitted that the findings and conclusions of the learned Single Judge are sound and do not require interference. It is argued that a plain reading of para 7(2)(a) of DPCO clarifies that it applies to the formulator of drugs. When the provision itself is clear, the constrained interpretation sought to be placed by the Central Government was that irrespective of the actual sale, the bulk drug manufacturer, such as the respondent, is to be made liable, and not the formulator, is without merit. It was argued that the reference to Clause 17(1)(a)(ii) by the Central Government in this case to say that the bulk drug manufacturer like the respondent are to be made liable over and above the liability of the drug manufacturer under Clause 7(2), would amount to unjustly levying an impost not authorised by law.

11. Learned counsel contended that if indeed the Central

Government's contentions with respect to large bulk drug manufacturers' ability to control prices and drive-out competitors is correct, the fact remains that the advantage derived from lower cost of procuring from such large manufacturers by the formulators is sought to be offset by Clause 7(2). It is for the Central Government to enforce that condition and recover the advantage derived by the formulator, if any, and credit the fund. If such eventuality is correct and valid, the question of the bulk drug manufacturer being made to bear the burden once over, not only defies logic but also amounts to levying a penalty and an impost which the Essential Commodities Act, 1955 did not clearly authorise.

12. Before dealing with the merits of the rival contentions, it would be necessary to analyse the salient features of the DPCO, 1970. Its relevant provisions are extracted below:

“DRUGS (PRICES CONTROL) ORDER, 1979

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2. Definitions.-In this Order, unless the context otherwise requires-

(a) "bulk drug" means any substance including pharmaceutical, chemical, biological or plant product or medicinal gas conforming to pharmacopoeial or other standards accepted under the Drugs and Cosmetics Act, 1940 (23 of 1940), which is used as such or as an ingredient in any formulations;

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(c) **"distributor"** means a distributor of drugs or his agent or a stockist appointed by a manufacturer or an importer for stocking his drugs for resale to a dealer;

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(t) **"retention price"** in relation to a bulk drug means the price fixed under paras. 4 and 7^{1a}[which shall be the maximum retention price] for individual manufacturers, or importers, or distributors, of such bulk drugs;

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3. Power to fix the maximum sale price of indigenously manufactured bulk drugs specified in First Schedule or Second Schedule:-

(1) The Government may, with a view to regulating the equitable distribution of an indigenously manufactured bulk drug specified in the First Schedule or the Second Schedule and making it available at a fair price and subject to the provisions contained in sub-paragraph (2) and after making such inquiry as it deems fit, fix from time to time, by notification in the Official Gazette, the maximum price at which such bulk drug shall be sold.

(2) While fixing the price of a bulk drug under sub-paragraph (1), the Government may take into account the average cost of production of such bulk drug manufactured by an efficient manufacturer and allow a reasonable return on net-worth.

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4. Power to fix retention price and common sale price.-Notwithstanding anything contained in paragraph 3 the Government may, if it considers necessary or expedient so to do for increasing the production of an indigenously manufactured bulk drug specified in the First Schedule or the Second Schedule, [by order published in the Official Gazette], fix:-

(a) a retention price of such bulk drug;

(b) a common sale price for such bulk drug taking into account the weighted average of the retention price fixed under clause(a) :

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7. Power to fix retention price and pooled price for the sale of bulk drugs specified in First Schedule or Second Schedule indigenously manufactured as well as imported.-(1) Where a bulk drug specified in the First Schedule or the Second Schedule is manufactured indigenously and is also imported, the Government may, having regard to the sale price prevailing from time to time in respect of indigenously manufactured bulk drugs and those of imported bulk drugs, by order, fix, with such adjustments as the Government may consider necessary,-

(a) retention prices for individual manufacturers, importers, or distributors of such bulk drugs;

(b) a pooled price for the sale of such bulk drugs.

(2) Where a manufacturer of formulation utilizes in his formulations and bulk drug, either from his own production or procured by him from any other source, the price of such bulk drug being lower than the price allowed to him in the price of his formulations, the Government may require such manufacturer-

(a) to deposit into the Drug Prices Equalization Account referred to in paragraph 17 the excess amount to be determined by the Government ; or

(b) to sell the formulations at such prices as may be fixed by the Government.

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17. Drug Prices Equalization Account.-(1) *The Government shall maintain an Account to be known as the Drugs Prices Equalization Account to which shall be credited-*

(a) by the manufacturer, importer or distributor, as the case may be-

(i) the amount determined under sub-paragraph (2) of para. 7 ;

(ii) the excess of the common selling price or, as the case may be, pooled price over his retention price; and

(b) such other sums of money as the Central Government may, after due appropriation made by Parliament by law in this behalf, grant from time to time.

(2) The amount credited under sub-paragraph (1) shall be spent only:-

(a) for paying to the manufacturer, importer or distributor, as the case may be, the short-fall between his retention price and the common selling price or, as the case may be, the pooled price for the purpose of increasing the production, or securing the equitable distribution and availability at fair prices, of drugs;

(b) for expenses incurred by the Government in discharging the functions under this paragraph.

(3) Every manufacturer, importer or distributor may, if he has any claim under clause (a) of sub-paragraph (2), make an application to the Government and the Government may, in settling the claim, require the manufacturer, importer or distributor, as the case may be, to furnish such details as may be specified by it in this behalf.

(4) The Government shall maintain account of all moneys credited to, and expended from out of, the Drugs Prices Equalization Account and such other

reports and returns as it may consider necessary relating to the said account.

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13. The Central Government on 02.04.1979 fixed the Pooled Price for *Streptomycin* at ₹475 per k.g. Simultaneously, the Retention Price in the case of respondents was fixed at ₹449.71/- per kg. For other manufacturers, it was fixed at ₹498/-. The respondents' claim that it had started selling all the *Streptomycin* with effect from 01.07.1979 to M/s. Sarabhai Chemicals, a division of Ambalal Sarabhai at the Retention Price levels fixed by the Government. The sole purchaser manufactured the formulation and sold them. On 10.06.1980 the Central Government called upon the respondent to pay into the Equalisation Fund the amount calculated at the rate of ₹25.29/- per kg. on the entire produce of *Streptomycin* sold by the respondent after the Retention Price fixation. The respondents contended that in effect they had not recovered any amount in excess of price and seeking to extract the difference is arbitrary and unjustified. With effect from 06.10.1980, the Central Government revised the respondents' Retention Price downward to ₹429/- per kg. for *Streptomycin* and at the same time increased the Pooled Price to ₹660 per kg. Likewise the Retention Price for the product for the other manufacturers was increased to ₹660.75/- per kg. The Central Government urged that the respondents had to sell *Streptomycin* at the Pooled Price for the period upto 06.10.1980 at ₹475/- per kg. and thereafter at ₹660.75/- and that having not done so and having sold it at lower price, was obliged to

pay the difference.

14. The finding of the learned Single Judge on one aspect, which has a bearing on the discussion on merits of this case, is that the respondents disclosed that 52% of its share capital was held by Karamchand Premchand Pvt. Ltd. (KPPL) and balance by E.R. Squibb and Sons Inc., an American company. The respondent, therefore, was a joint-venture of those two groups. In 1978, the KPPL sold its shareholdings to M/s. Ambalal Sarabhai Enterprises. Learned Judge, on the basis of these materials – in the form of affidavits and documentary evidence alluded by the respondents held that it was a distinct and separate corporate entity, and therefore, could not be said to have connection with M/s. Ambalal Sarabhai Group of Companies.

15. The Learned Single Judge, after noticing the scheme of the DPCO held that there was merit in the respondents' contentions that no obligation was cast upon it to make good the difference between the Retention Price and the Pooled Price. Once it was established that it had not sold the drug above the Retention Price, the Single Judge also held that the Central Government could have invoked the aid of DPCO and charged M/s. Ambalal Sarabhai, the formulator, the difference in terms of Clause 7(2). Not having done so, the deficiency could not have been recovered by default as it were, from the respondents.

16. The plain language of Clause 7 (2) casts the obligation on the formulator to make good the difference between the pooled price and the price of the bulk drug, wherever it procures it at a rate lower than the pooled price (which is what is meant by the expression "the price

allowed to him in the price of his formulations”), an obvious allusion to the price of the principal input, i.e. the bulk drug, which the formulator might have procured at less than pooled price – either at or below retention price (fixed for the bulk drug manufacturer). This is evident from the terms “*Where a manufacturer of formulation utilizes in his formulations and bulk drug*”, either from his own production or procured by him from any other source, when the price of the bulk drug is lower than “the price allowed to him in the price of his formulations” that formulation manufacturer, or formulator has to “*to deposit into the Drug Prices Equalization Account referred to in paragraph 17 the excess amount to be determined by the Government*” (Clause 7 (2) (a)). The other contingency (Clause 7 (2) (b)) is where the formulator has, “*to sell the formulations at such prices as may be fixed by the Government.*” This was precisely what the Single judge stated, in the impugned order, when he found that the obligation or duty, if any, was cast upon the formulator to deposit or pay into the Drug Prices Equalisation Account the difference between the two prices, so as to offset any advantage it might have enjoyed. This Court holds that the conclusions of the learned Single Judge on this score are justified.

17. As regards Clause 17, this Court is of opinion that it does not independently locate or create any liability. It can be said to be descriptive of what the fund is made up, when it refers to the two sources - Sub clause (1). The reference to Clause 7 (2) clarifies that it is the formulator’s liability – because that class of manufacturer, who uses bulk drugs alone has been saddled with the liability to pay into

the fund amounts, to offset any advantage secured by him, on account of procurement of bulk drugs, on account of their prices being lower than the determined pooled price. As far as Clause 17 (1) (b) goes, this Court is not persuaded by the Central Government's submission that this reinforces any obligation cast upon the bulk drug manufacturer. The reason for this is obvious. There is no primary duty on the bulk drug manufacturer to pay into the Fund, any amounts. Under Clause 7 (2), *it is the advantage presumably secured by the formulator which is sought to be offset by obliging it to deposit the difference determined, into the Fund.* If that obligation is fulfilled, the question of asking even the bulk drug manufacturer, who has not realized any excess amounts, to pay into the Fund, any amounts, cannot arise at all. It was not, and cannot be, in the circumstances of the present case at least, that the DPCO contains any taxing provision which casts general liability. If such is the case, there is no obligation in law cast upon bulk drug manufacturers to pay any amounts over incomes or advantages which they have not secured. On account of efficiencies in their production processes, they were able to sell bulk drugs at the prices fixed in respect of their units (retention price). What the Central Government is asking the Court to uphold is its action in demanding a penalty, as it were, for selling at prices fixed or determined by it. It would be useful to recollect in this context that what Clause 3 of the DCPO empowers the Central Government to do is to fix “.....*the maximum price at which such bulk drug shall be sold*”. The Court also holds that there is no infirmity with the finding of the learned Single Judge

that the formulator in this case was a different entity from the respondents.

18. For the foregoing reasons, this Court is of opinion that the appeal is without merit. LPA No.976/2002 is consequently dismissed, without any order on costs.

**S. RAVINDRA BHAT
(JUDGE)**

**SUDERSHAN KUMAR MISRA
(JUDGE)**

NOVEMBER 7, 2013