Reportable

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

Civil Appeal No 6693 of 2022

M/S Indian Medicines Pharmaceuticals Corporation Ltd .... Appellant

Versus

Kerala Ayurvedic Co Operative Society Ltd. & Ors. ....Respondents

And With

Civil Appeal No. 6694 of 2022

J U D G M E N T

Dr Dhananjaya Y Chandrachud, CJI

This judgment has been divided into the following sections to facilitate analysis:

1 The first respondent, Kerala Ayurvedic Co-operative Society Limited, instituted proceedings before the Lucknow Bench of the High Court of Judicature at Allahabad under Article 226 of the Constitution to challenge an order for the purchase of Ayurvedic medicines issued by the State of Uttar Pradesh in favour of Indian Medicines Pharmaceutical Corporation Limited[1]. By a judgment dated 18 October 2019, a Division Bench of the High Court allowed the petition and directed that the State of Uttar Pradesh must purchase Ayurvedic medicines by adopting a transparent process after inviting tenders. The State of Uttar Pradesh and IMPCL instituted proceedings under Article 136 of the Constitution against the judgment of the High Court. The principle issue is whether, in view of paragraph 4(vi)(b) of the Operating Guidelines of the National AYSUH Mission[2], the appellant could have procured Ayurvedic drugs solely from IMPCL without inviting tenders.

1.0 Facts

2 In September 2014, the Department of AYUSH, Ministry of Health and Family Welfare, Government of India launched NAM, *inter alia,* to promote the AYUSH medical system and provide cost-effective AYUSH Services. Paragraph 3(ii) of the Operational Guidelines of NAM provides that 75 percent of the admissible assistance will be provided as grant-in-aid by the Central Government while the remaining 25 percent must be met by the States, except in the North-Eastern States where the assistance by the Centre and the States shall be in the ratio of 90:10.

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[1] **"IMPCL"**
[2] **"NAM"**

3 Paragraph 4(vi) provides guidelines for the procurement of Ayurvedic medicines. Paragraph 4(vi)(b) states that '*at least'* 50 percent of the grant-in-aid must be used for procuring medicines from IMPCL *or* Public Sector Undertakings[3], pharmacies under State Governments and co-operatives. Paragraph 4(vi) of the Operational Guidelines is extracted below:

> "(vi) (a) Essential drugs and medicines required for implementation of the Mission will have to be procured from Essential Drugs List (EDL) for Ayurveda, Unani, Siddha and Homeopathy published by Department of AYUSH, Government of India.
> (b) At least 50% of the Grant-in-aid provided should be used for procuring medicines from M/s Indian Medicine Pharmaceutical Corporation Limited (a Central Public Sector Undertaking) or from Public Sector undertaking, pharmacies under State Governments and Co-operatives manufacturing units and having Good Manufacturing Practices (GMP) compliance, keeping in view the need for ensuring quality of AYUSH drugs and medicines.
> (c) The remaining Grant-in-aid provided under the Mission for purchase of medicines may be use for procuring medicines as per Essential Drugs List (EDL) of Ayurveda, Unani, Siddha and Homeopathy published by Department of AYUSH, Government of India, from other Good Manufacturing Practices (GMP) compliant units having valid manufacturing licenses.
> (d) Essential non drug items like dressing items for first aid etc. may be provided out of the amount sanctioned for medicine/essential drugs under different components required for achieving the desired objectives subject to a ceiling of five percent of the total amount sanctioned for the purpose."

4 The Uttar Pradesh State AYUSH Society has been purchasing Ayurvedic medicines from a single vendor, namely IMPCL who is the appellant. The purchase order was given to IMPCL on a nomination basis without conducting a tendering process. The first respondent is a registered co-operative society under the Kerala Co-operative Societies Act 1969. On 2 March 1985, the first respondent was

[3] "PSU"

granted a licence to manufacture Ayurvedic and Unani drugs for sale under the provisions of the Drugs and Cosmetics Rules 1945. On 31 August 2016, the first respondent was also certified as a Good Manufacturing Practice[4] unit.

5 On 30 October 2017, the first respondent made a representation to the Principal Secretary to either place direct purchase orders for the supply of Ayurvedic medicines to it according to the existing government policy or to initiate a tender process for the purchase. The first respondent stated that it is eligible to supply Ayurvedic medicines under NAM and that as an MSME registered unit, it is eligible under the policy framework for preferential purchase. A similar representation was made on 21 December 2018 to the Mission Director.

6 The first respondent instituted a petition under Article 226 of the Constitution apprehending that a purchase order for 2019-20 was going to be issued to IMPCL. The first respondent challenged the purchase order in favour of IMPCL and sought a direction for the procurement of Ayurvedic medicines under the National AYUSH Mission Programme by a tender process.

7 The High Court held that the 'practice adopted by the respondents, to purchase Ayurvedic drugs, only from IMPCL' is illegal. The High Court held that under paragraph 4 of the Operational Guidelines, the appellant must invite tenders from prescribed establishments to purchase Ayurvedic medicines. The appellant was allowed to purchase drugs from IMPCL to the extent of the payment already made since for the year 2019-20, the purchase order for medicines to the extent of 50 percent had already been given to IMPCL and a full payment of Rupees 11

[4] **"GMP"**

crores was made. The appellant was directed to invite tenders for competitive rates and quality of drugs for the remaining supplies. The High Court held that:

(i) Paragraph 4 of the Operational Guidelines provides the 'sources' for the procurement of Ayurvedic drugs and medicines;

(ii) Paragraph 4(vi)(b) provides that 50 percent of the grant-in-aid shall be used to purchase Ayurvedic medicines from IMPCL *or* other PSUs and pharmacies under the State Governments and cooperative societies;

(iii) Invitation from pharmacies and PSUs under the State Governments or cooperative societies will foster competition on rates and quality of medicines;

(iv) The Memorandum issued by the Government of India on 8 May 2008 stipulates that in the absence of "fully developed Pharmaceutical standards for Ayurvedic and Unani medicines in the country, the Central Government Health Scheme Research Councils is/are not fully equipped to ensure that the purchased medicines are of right quality." Paragraph 4(vi)(b) emphasises the quality of medicines. There is nothing on the record to show that IMPCL is the only entity producing quality drugs;

(v) No comparison on the quality of medicines can be made unless tenders are invited from IMPCL and other PSU Pharmacies under the State Governments and co-operative societies; and

(vi) At least 50 percent of the grant-in-aid for the procurement of Ayurvedic medicines must be used only after tenders are invited amongst the establishments referred to in paragraph 4(vi)(b) of the Operational

Guidelines. The remaining grant-in-aid, if any, shall be used to procure drugs in the manner specified in paragraph 4(vi)(c).

2.0 Submissions

8 Mr Naresh Kaushik, counsel appearing for IMPCL urged the following submissions:

(i) The Government of India holds 98.11 percent of the shares of IMPCL and 1.89 percent of the shares are held by the Government of Uttarakhand through Kumaon Mandal Vikas Nigam Limited. IMPCL has been established to cater to the needs of the Central Government Health Programs and for ensuring the quality of AYUSH medicines;

(ii) Due to the unique organizational set-up of IMPCL, it is most suited to supply quality medicines at an affordable price. The prices of the medicines manufactured by IMPCL are vetted by the Union Ministry of Finance from time to time. The procurement of medicines from other organizations is also at the rates of IMPCL as these rates are considered the best possible rates. Further, IMPCL is the only government manufacturing company for Ayurvedic medicines with its own certified drug testing laboratory;

(iii) On 16 July 1994, the Government of India issued an order where it had resolved that Ayurvedic medicines cannot be purchased through tenders because (a) there is a wide variation in the prices of raw materials required for making drugs and the cost of the drug will vary based on the quality of the raw material used; and (b) it is not possible to test the exact composition of drugs in terms of the raw materials and their quality;

(iv) The Ministry of AYUSH, Government of India has on various occasions recommended purchasing Ayurvedic medicines directly from IMPCL;

(v) Procurement may be through tender only where the state proposes to dispose of property. Since in this case, there is no disposal of state property, the High Court should have only looked at the relevant material to determine whether an oblique motive is involved in purchasing medicines from IMPCL;

(vi) IMPCL is not a private enterprise. There is no scope for monopoly when the sale is not in an open market, where the prices of the medicines are vetted by the Department of Expenditure, Ministry of Finance, and the establishment is managed by the officials of the Ministry of AYUSH;

(vii) Paragraph 4(vi)(b) of the Operational Guidelines distinguishes IMPCL from other PSUs, pharmacies under the State Government, and cooperative societies by the use of the term "or". Paragraph 4(vi)(b) emphasises ensuring the quality of AYUSH drugs and medicines. The phrase '*atleast'* in paragraph 4(vi)(b) only provides a minimum benchmark for procurement and does not prescribe an upper limit; and

(viii) A combined reading of paragraphs 4(vi)(b) and 4(vi)(c) elucidates that the states have the discretion to procure medicines from IMPCL or any other PSUs, and pharmacies under the State Government and cooperatives. The budget, if any, that is remaining after purchasing medicines from the establishments mentioned in paragraph 4(vi)(b) may be utilized for purchasing medicines from other GMP-compliant establishments.

9 Mr Kaleeswaram Raj, counsel appearing for the first respondent urged the following submissions:

(i) Paragraph 4(vi) only depicts the establishments from which the medicines can be procured- i.e the *whom* question and not the *how* question:

(a) Paragraph 4(vi)(b) of the Operational Guidelines stipulates the establishments from which at least 50 percent of the medicines must be procured. The usage of the term 'or' indicates that all establishments mentioned in the paragraph are equally eligible to supply medicines as much as IMPCL; and

(b) While paragraph 4(vi)(b) does not stipulate that the procurement must be through a tender process, it does not mean that the process of tender cannot be read into the provision. If paragraph 4(vi)(b) is interpreted to allow procurement from any of the establishments mentioned without a tendering process, the same interpretation would also be applicable to paragraph 4(vi)(c). Also, this would mean that even for procurement from private entities, there is no requirement of conducting a tender process.

(ii) The State of UP cannot arbitrarily prefer one of the eligible entities for the procurement of medicines. All the establishments mentioned in paragraph 4(vi)(b) are recognised to be on an equal footing. Therefore, procurement must be by a fair process in which all the eligible establishments are granted an opportunity to secure the procurement order;

(iii) It is an established principle that state largesse must be distributed by public auction save in exceptional situations having regard to the nature of the

trade or where no reasonable substitute exists. There are no exceptional circumstances in the instant case that warrant the procurement of medicines only from IMPCL; and

(iv) The price of medicines procured from IMPCL is vetted by the Department od Expenditure, Ministry of Finance for the limited purpose of undertaking an audit. It is the National Pharmaceutical Pricing Authority that approves the prices of medicines. The Ministry of Finance does not have the power or the expertise to determine the prices of Ayurvedic medicines.

3.0 Analysis

10 Paragraph 4(vi)(b) of the Operational Guidelines prescribes that *at least 50 percent* of the grant-in-aid shall be used to procure medicines from (i) IMPCL, *or* (ii) PSUs and pharmacies under the State Governments and cooperatives. The provision further indicates that to ensure the quality of AYUSH drugs and medicines, the medicines must be manufactured in their manufacturing units which comply with Good Manufacturing Practices (GMP). Paragraph 4(vi)(c) states that the *remaining grant-in-aid* may be used for procuring medicines from other Good Manufacturing Practices (GMP) compliant units having valid manufacturing licenses. The appellant had granted the contract for the purchase of Ayurvedic medicines to IMPCL under paragraph 4(vi)(b) of the Operational Guidelines through nomination, thereby eliminating the other units mentioned in the paragraph. This action of the appellant is challenged as arbitrary and violative of Article 14. Before interpreting paragraph 4(vi)(b) to determine if the action of the appellant is permissible under the law, the law relating to the extent of judicial review of government contracts must be discussed.

3.1 State Largesse: conflation of power and duty

11 The welfare State plays a crucial role in aiding the realisation of the socio-economic rights which are recognised by the Constitution. Social welfare benefits provided by the State under the rubric of its constitutional obligations are commonly understood in the language of 'largesse', a term used to describe a generous donation. Terming all actions of government, ranging from social security benefits, jobs, occupational licenses, contracts and use of public resources – as government largesse results in doctrinal misconceptions. The reason is that this conflates the State's power with duty. The Constitution recognises the pursuit of the well-being of citizens as a desirable goal. In doing this the Constitution entrusts the State with a *duty* to ensure the well-being of citizens. Government actions aimed at ensuring the well-being of citizens cannot be perceived through the lens of a 'largess'. The use of such terminology belittles the sanctity of the social contract that the 'people of India' entered into with the State to protect and safeguard their interests.

3.2Judicial review of government contracts: extent and ambit

12 Paragraph 4(vi)(b) prescribes entities from which Ayurvedic medicines may be procured. The paragraph does not prescribe the method through which they may be procured. The appellant contends that the since the method of procurement is not prescribed, it has the discretion to purchase drugs through 'nomination'. On the other hand, the respondent contends that merely because the Operational Guidelines do not prescribe the method of procurement, unbridled discretion cannot be given to the executive to procure drugs through 'nomination'.

13 In the early 1950s', judicial review of the process of concluding contracts by government was limited. The courts allowed the State due deference on the ground

of governmental policy. In **C.K Achuthan** v. **State of Kerala**[5], a Constitution Bench of this Court held that it is open to the Government 'to choose a person to their liking, to fulfil contracts which they wish to be performed.' The Court observed that when one party is chosen over another, the aggrieved party cannot claim the protection of Article 14 since the government has the discretion to choose with whom it will contract.

14 Over the years, this Court has applied the non-arbitrariness standard under Article 14 to test the validity of government action. In **Ramana Dayaram Shetty** v. **International Airport Authority of India**[6], a three-Judge Bench of this Court observed that the government does not have unlimited discretion in granting State largesse and it must act in fairness. In **New Horizons Limited** v. **Union of India**[7], the Department of Telecommunications, invited sealed tenders for printing, binding, and supply of telephone directories. While determining the validity of the eligibility criteria prescribed for tenderers, the Court observed that the State when entering into a contract does not stand on the same footing as a private person. The Court held that the government cannot act arbitrarily while dealing with the public, whether it is while giving jobs or entering into contracts. The relevant observations are extracted below:

> 17. At the outset, we may indicate that in the matter of entering into a contract, the State does not stand on the same footing as a private person who is free to enter into a contract with any person he likes**. The State, in exercise of its various functions, is governed by the mandate of Article 14 of the Constitution which excludes arbitrariness in State action and requires the State to act fairly and reasonably. The action of the State in the**

[5] AIR 1959 SC 490
[6] 1979(3)SCC 489; Also see Sterling Computers Ltd. v M/s M& Publications Limited, (1993) 1 SCC 445; Jesper I. Slong v. State of Meghalaya, (2004) 11 SCC 485; Also see Association of Registration Plates v. Union of India, (2005) 1 SCC 679
[7] (1995) 1 SCC 478

> **matter of award of a contract has to satisfy this criterion. Moreover a contract would either involve expenditure from the State exchequer or augmentation of public revenue and consequently the discretion in the matter of selection of the person for award of the contract has to be exercised keeping in view the public interest involved in such selection.** The decisions of this Court, therefore, insist that while dealing with the public, whether by way of giving jobs or entering into contracts or issuing quotas or licences or granting other forms of largesse, the Government cannot act arbitrarily at its sweet will and like a private individual, deal with any person it pleases, but its action must be in conformity with the standards or norms which are not arbitrary, irrational or irrelevant. It is, however, recognised that certain measure of "free play in the joints" is necessary for an administrative body functioning in an administrative sphere."
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> **(emphasis supplied)**

15 In **Food Corporation of India** v. **M/s Kamdhenu Cattle Feed Industries**[8], this Court held that 'in the contractual sphere […] the State and all its instrumentalities have to conform to Article 14 of the Constitution.' The respondent filed a writ petition before the High Court challenging the appellant's refusal to accept the highest tender submitted by it for a stock of damaged rice. This Court held:

> "7. In contractual sphere as in all other State actions, the State and all its instrumentalities have to conform to Article 14 of the Constitution of which non-arbitrariness is a significant facet. There is no unfettered discretion in public law: A public authority possesses powers only to use them for public good. This imposes the duty to act fairly and to adopt a procedure which is 'fairplay in action'. Due observance of this obligation as a part of good administration raises a reasonable or legitimate expectation in every citizen to be treated fairly in his interaction with the State and its instrumentalities, with this element forming a necessary component of the decision-making process in all State actions. To satisfy this requirement of non-arbitrariness in a State action, it is, therefore, necessary to consider and give due weight to

[8] (1993) 1 SCC 71

> the reasonable or legitimate expectations of the persons likely to be affected by the decision or else that unfairness in the exercise of the power may amount to an abuse or excess of power apart from affecting the bona fides of the decision in a given case. The decision so made would be exposed to challenge on the ground of arbitrariness. Rule of law does not completely eliminate discretion in the exercise of power, as it is unrealistic, but provides for control of its exercise by judicial review."

3.2.1 Tender: a constitutional requirement?

16 This Court has consistently held that government contracts must be awarded by a transparent process. The process of inviting tenders ensures a level playing field for competing entities. While there may be situations which warrant a departure from the precept of inviting tenders or conducting public auctions, the departure must not be unreasonable or discriminatory.[9] In **Centre for Public Interest Litigation** v. **Union of India**[10] the 'first-cum-first serve' policy was held to be arbitrary while alienating natural resources. However, the Court observed that though auction is a 'preferred' method of allocation, it cannot be construed to be a constitutional requirement.

17 In **Natural Resources Allocation, in re Special Reference No. 1 of 2012**[11], a Presidential Reference was made in the backdrop of the decision in **Centre for Public Interest Litigation** (supra) where this Court had held that the method of first-cum-first serve used to allocate 2G radio spectrum was arbitrary and illegal. The reference was on whether the 'only permissible method for disposal of all natural resources across all sectors and in all circumstances is by the conduct of auctions'. Justice Khehar in his concurring opinion in **Natural Resources**

[9] M/s Kasturi Lal Lakshmi Reddy v. State of Jammu and Kashmir, (1980) 4 SCC 1; Sachidanand Pandey v. State of West Bengal, (1980) 4 SCC 1; Haji T.M Hassam Rawther v. Kerala Financial Corporation (1988) 1 SCC 166
[10] (2012) 3 SCC 1
[11] (2012) 10 SCC 1

Allocation (supra) held that while there is no constitutional mandate in favour of auction under Article 14, deviation from the rule of allocation through auction must be tested on grounds of arbitrariness and fairness. In this context, it was observed as follows:

> "148. In our opinion, auction despite being a more preferable method of alienation/allotment of natural resources, cannot be held to be a constitutional requirement or limitation for alienation of all natural resources and therefore, every method other than auction cannot be struck down as ultra vires the constitutional mandate.
> 149. Regard being had to the aforesaid precepts, we have opined that auction as a mode cannot be conferred the status of a constitutional principle. Alienation of natural resources is a policy decision, and the means adopted for the same are thus, executive prerogatives. However, when such a policy decision is not backed by a social or welfare purpose, and precious and scarce natural resources are alienated for commercial pursuits of profit maximising private entrepreneurs, adoption of means other than those that are competitive and maximise revenue may be arbitrary and face the wrath of Article 14 of the Constitution. Hence, rather than prescribing or proscribing a method, we believe, a judicial scrutiny of methods of disposal of natural resources should depend on the facts and circumstances of each case, in consonance with the principles which we have culled out above. Failing which, the Court, in exercise of power of judicial review, shall term the executive action as arbitrary, unfair, unreasonable and capricious due to its antimony with Article 14 of the Constitution."

18 In **Vallianur Iyarkkai Padukappu Maiyam** v. **Union of India**[12], a three-judge Bench of this Court held that the State is not bound to allot resources such as water, power, and raw materials through tender and is free to negotiate with a private entrepreneur. In that case, the Government of Pondicherry entered into an agreement for the development of Pondicherry Port without issuing an

[12] (2009) 7 SCC 561

advertisement or inviting tenders. This Court held that the action of the Government of Pondicherry was justified because on account of historical, political and other reasons, the Union Territory is not yet industrially developed and thus, entrepreneurs have to be offered attractive terms to persuade them to set up industries. The relevant observations are extracted below:

> "171. In a case like this where the State is allocating resources such as water, power, raw materials, etc. for the purpose of encouraging development of the port, this Court does not think that the State is bound to advertise and tell the people that it wants development of the port in a particular manner and invite those interested to come up with proposals for the purpose. The State may choose to do so if it thinks fit and in a given situation it may turn out to be advantageous for the State to do so, but if any private party comes before the State and offers to develop the port, the State would not be committing breach of any constitutional obligation if it negotiates with such a party and agrees to provide resources and other facilities for the purpose of development of the port.
> 172. The State is not obliged to tell Respondent 11 "please wait I will first advertise, see whether any other offers are forthcoming and then after considering all offers, decide whether I should get the Port developed through you". It would be most unrealistic to insist on such a procedure, particularly, in an area like Pondicherry, which on account of historical, political and other reasons, is not yet industrially developed and where entrepreneurs have to be offered attractive terms in order to persuade them to set up industries. The State must be free in such a case to negotiate with a private entrepreneur with a view to inducing him to develop the Port and if the State enters into a contract with such an entrepreneur for providing resources and other facilities for developing the Port, the contract cannot be assailed as invalid because the State has acted bona fide, reasonably and in public interest."

19 In **Nagar Nigam** v. **Al Farheem Meat Exporters (P) Ltd.**[13], the respondent was granted a license for a year to run a slaughterhouse owned by the appellant-corporation. On the completion of the term of the license, the appellant issued an

[13] (2006) 13 SCC 382

advertisement inviting applications for granting a fresh contract. The respondent challenged the advertisement. The Court observed that it is the requirement of the principle of non-arbitrariness postulated in Article 14 that contracts by the State, its corporations, instrumentalities, and agencies should as a general rule be granted through public tender. Noting that it is necessary to maintain transparency in the grant of public contracts, the Court ruled that the State must give contracts only by tender and not through private negotiations. This Court held that a contract can be granted by private negotiation only in exceptional circumstances having regard to the 'nature of the trade or largesse or for some other good reason'. Some of the exceptional circumstances that were listed were: (a) award of contracts in the event of natural calamities and emergencies; (b) situations where the supplier has exclusive rights over goods and there is no reasonable alternative; and (c) there are no bidders or where the bid offered is too low. The Court has upheld the award of contracts without holding a public auction in situations where conducting a public auction is impossible given the surrounding circumstances. When the government deviates from the general rule of allotting a contract without following a transparent process such as inviting tenders, it has to justify its actions on the touchstone of the principles postulated in Article 14 :

> 13. This Court time and again has emphasised the need to maintain transparency in grant of public contracts. Ordinarily, maintenance of transparency as also compliance with Article 14 of the Constitution would inter alia be ensured by holding public auction upon issuance of advertisement in the well-known newspapers. That has not been done in this case. Although the Nagar Nigam had advertised the contract, the High Court has directed that it should be given for 10 years to a particular party (Respondent 1). This was clearly illegal.
> 14. It is well settled that ordinarily the State or its instrumentalities should not give contracts by private negotiation but by open public auction/tender after wide

> publicity. In this case the contract has not only been given by way of private negotiation, but the negotiation has been carried out by the High Court itself, which is impermissible.
> 15. We have no doubt that in rare and exceptional cases, having regard to the nature of the trade or largesse or for some other good reason, a contract may have to be granted by private negotiation, but normally that should not be done as it shakes the public confidence.
> 16. The law is well settled that contracts by the State, its corporations, instrumentalities and agencies must be normally granted through public auction/public tender by inviting tenders from eligible persons and the notification of the public auction or inviting tenders should be advertised in well-known dailies having wide circulation in the locality with all relevant details such as date, time and place of auction, subject-matter of auction, technical specifications, estimated cost, earnest money deposit, etc. The award of government contracts through public auction/public tender is to ensure transparency in the public procurement, to maximise economy and efficiency in government procurement, to promote healthy competition among the tenderers, to provide for fair and equitable treatment of all tenderers, and to eliminate irregularities, interference and corrupt practices by the authorities concerned. This is required by Article 14 of the Constitution. However, in rare and exceptional cases, for instance during natural calamities and emergencies declared by the Government; where the procurement is possible from a single source only; where the supplier or contractor has exclusive rights in respect of the goods or services and no reasonable alternative or substitute exists; where the auction was held on several dates but there were no bidders or the bids offered were too low, etc., this normal rule may be departed from and such contracts may be awarded through "private negotiations". (See *Ram and Shyam Co.* v. *State of Haryana* [(1985) 3 SCC 267 : AIR 1985 SC 1147] ."

20 Inviting tenders and conducting public auctions are considered to be preferred methods of allocation for two reasons: *firstly* procurement can be made at the best price; *and secondly,* allocation is through a transparent process. However, if the purpose of allocation by the State is not revenue maximization, the State could award contracts through other methods, provided it is non-arbitrary and meets the requirements of Article 14.

21 The appellant-State contends that since in the present case, there is no involvement of 'State largesse' and no disposal of State property, it was not bound to grant the contract to IMPCL through tender. It is argued that in such a situation, the High Court on a perusal of the relevant material, ought to have only scrutinised if there was an oblique motive involved in purchasing medicines from IMPCL. Government contracts involve expenditure out of the public exchequer. Since they involve payment out of the public exchequer, the moneys expended must not be spent arbitrarily. The State does not have absolute discretion while spending public money. All government actions including government contracts awarded by the State must be tested on the touchstone of Article 14.

22 The following principles emerge from the discussion above:

(i) Government action must be just, fair and reasonable and in accordance with the principles of Article 14; and

(ii) While government can deviate from the route of tenders or public auctions for the grant of contracts, the deviation must not be discriminatory or arbitrary. The deviation from the tender route has to be justified and such a justification must comply with the requirements of Article 14.

3.3 Interpretation of paragraph 4(vi)(b) of the Operational Guidelines

23 Before interpreting paragraph 4(vi)(b) of the Operational Guidelines, it is necessary that we refer to the circulars on the procurement of Ayurvedic drugs. In 1994, the Ministry of Health and Family Welfare issued a communication stating that Ayurvedic medicines are to be procured only from IMPCL because it is the only entity which manufactures quality medicines. On 8 May 2008, the Government

of India issued another memorandum on similar lines. On 9 August 2016, the Ministry of AYUSH issued a circular responding to the clarification sought by the States on the procurement of AYUSH medicines from IMPCL. The circular stipulates that the States 'may' procure Ayurvedic and Unani Medicines from IMPCL. On 7 December 2016, the Ministry of AYUSH issued a circular stating that the procurement guidelines under NAM also allow for the purchase of medicines from PSUs and pharmacies of the State Governments and co-operatives that have their own manufacturing units and are GMP compliant. It was thus stated that the States may also procure Essential Ayurvedic Medicines directly from Oushadhi (A Kerala Government owned Ayurvedic medicine manufacturing unit) subject to the condition that medicines have to be provided within the rates of IMPCL.

24 On 2 January 2019, the Ministry of AYUSH issued a notification[14] in supersession of the notification dated 7 December 2016. While stipulating that the procurement of medicines is the 'prerogative' of the State Government, the notification stated that the following guidelines have to be observed:

(i) Essential drugs have to be procured from the Essential Drugs List (EDL) published by the Ministry of AYUSH;

(ii) At least 50 percent of the grant-in-aid has to be used to procure medicines from IMPCL or other Central/State PSUs' or pharmacies under the State-Governments and Co-operatives;

(iii) The remaining grant-in-aid may be used for procuring the medicines from other units that have valid manufacturing licenses; and

[14] "2019 Notification"

(iv) The medicines have to be manufactured in their own manufacturing units and must be GMP compliant.

25 Thus, the letter which was issued by the Union Ministry of Health and Family Welfare in 1994 stating that Ayurvedic medicines must be procured only from IMPCL is superseded by the latest notification issued by the Ministry of AYUSH in 2019 which stipulates that paragraph 4(vi)(b) of the Operational Guidelines does not differentiate between the units mentioned in the provision. Paragraph 4(vi)(b) does not stipulate that IMPCL will have a higher standing as compared to other manufacturing units of the State Governments and cooperatives mentioned in the paragraph. The position of the Ministry of AYUSH as evidenced by the 2019 notification is that 50 percent of the grant-in-aid shall be used to procure medicines from *any* of the establishments specified in the paragraph. This conclusion is substantiated by the use of the phrase 'or' in paragraph 4(vi)(b) - IMPCL 'or' from PSUs', pharmacies under State Governments and co-operatives. Thus, on a plain reading of paragraph 4(vi)(b), it is evident that all the units mentioned in the paragraph are placed at an equal footing. The provision does not create a gradation amongst the manufacturing units mentioned in the paragraph. Nor does it evince an intent to create a monopoly.

3.4 Validity of award of government contract to IMPCL

26 The appellant flags the insurmountable difficulties in awarding contracts for the purchase of Ayurvedic drugs because of peculiar problems in the process of manufacture. Reference was made to the letter dated 16 July 1994 issued by the Ministry of Health and Family Welfare stating that purchase through tender would be 'inadequate' for the procurement of Ayurveda, Siddha, and Unani medicines

because (i) there is a wide variation in the prices of the raw materials as a result of which the cost of the same drug using the 'best raw materials' maybe ten times the cost if the 'poorest' quality of raw materials is used; and (ii) it is impossible to test the composition and the quality of raw materials used in the drugs. The letter of the Ministry of Health and Family Welfare dated 16 July 1994 is extracted below:

> "You may perhaps be aware that Government of India has set up in collaboration with Government of Uttar Pradesh, Indian Medicines Pharmaceutical Corporation ltd. for manufacture of high quality drugs of the Indian Systems of Medicine. The drugs are prepared strictly in accordance with the classical texts and genuine raw materials are used to prepare these drugs.
>
> 2. It is our experience that the ordinary financial procedures such as tendering are inadequate in relation to the purchase of Ayurveda, Siddha and Unani medicines. This is because:-
>
> 1. Of the very wide variation in prices of raw materials required for making the drugs. The cost of the same drug using the best raw materials may be 10 times the cost if the poorest quality raw materials are used.
> 2. The impossibility of testing the exact composition of drugs of its raw materials and their quality.
> 3. Pharmacopeial work in these systems of medicines is at a very initial stages. Tests presently available can reveal the presence of harmful ingredients/adulterants and could indicate **the presence of certain compounds at best. However, since the basic components of ISM medicines are herbs which are themselves composed of many organic compounds, its well nigh impossible with the present state of technology to test and check whether the ingredients claimed are actually present in the proportion claimed and whether they are of the right quality and whether the proper process prescribed in the classical texts have been used to prepare the medicines.** Thus purchases purely on the basis of tendering are likely to lead to purchase medicines which are inefficacious.
> 4. The only alternative available at present to ensure quality drugs is to have inspectors at the manufacturing site when the manufacturing process is going on. This also is not a practical alternative since drug control organisations do not have the man power for close supervision. This situation is responsible for the reported malpractices with regard to such medicines. It is under these circumstances that a decision has been taken in the Ministry of Health and

> Family Welfare to purchase the requirements of the CGHS only from IMPCL at process which are been [] as fair and have been scrutinised by a representative of the Cost Accounts Branch of the Finance Ministry.
>
> 5. Despite ensuring preparation of drugs strictly according to the classical texts, the prices charged by IMPCL compare favourably with competing brands in most cases, for a few cases the process may be a little higher but as already pointed out there is more reliability in terms of quality assurance because IMPCL does not allow commercial interests over the mandate for preparing medicines strictly according to the classical texts using genuine raw materials. For instance IMPCL does not use extra sugar or other taste enhancers mainly to make its medicines more popular.
> 6. In view of the above, you may like to consider meeting the requirements of State Government Dispensaries and Hospitals for medicines manufactured by IMPCL at the rates fixed for CGHS supplies but subject to the local variation in transport costs. In that case you may like to contact Chairman cum Managing Director, Indian Medicines Pharmaceutical Corporation ltd., (IMPCL), Mohan Distt, Almora, U.P"
>
> **(emphasis supplied)**

27 On 8 May 2008, the Government of India issued another memorandum stipulating that the medicines produced by IMPCL are according to classical texts and of assured quality. The memorandum mentioned that there is an absence of fully developed pharmaceutical standards to test the quality of Ayurvedic and Unani medicines. The relevant paragraph of the memorandum indicates that:

> "(i) The medicines produced by IMPCL are strictly as per classical texts and hence prove quality.
> (ii) The rates of the medicines produced by the company are reasonable as the same are fixed by the Cost Accounts Branch of the Ministry of Finance;
> (iii) In the absence of fully developed pharmaceutical standards for Ayurvedic and Unani Medicines in the country, the CGHS Research Councils is/are not fully equipped to ensure that the purchased medicines are of right quality."

28 The letter indicates that there is no method to determine the ingredients and quality of Ayurvedic drugs. This would mean that there was no method to determine the quality of the medicines produced by IMPCL as well. The Ministry of Health and Family Welfare noted that it has decided to purchase Ayurvedic drugs only from IMPCL because the process is fair and is scrutinised by a representative of the Ministry of Finance. However, the first respondent contends that the medicines procured from IMPCL are vetted by the Ministry of Finance for the limited purpose of undertaking an audit. At this juncture, it is necessary to note that IMPCL has been set up by the Government of India in collaboration with the Government of Uttarakhand. The Government of India holds 98.11 percent of the shares of IMPCL and 1.89 percent of the shares are held by the State Government. The letter issued by the Ministry of Health and Family Welfare indicates that merely because IMPCL is an establishment in which the Central Government has a major stake, it is assumed that there is no 'commercial interference' and the medicines are prepared according to classical texts using 'genuine raw materials'.

29 There is no material on record to support the submission that IMPCL is the only establishment among the establishments mentioned in paragraph 4(vi)(a) that manufacture good quality Ayurvedic drugs. In fact, paragraph 4(vi)(b) states that 50 percent of the grant-in-aid shall be used to purchase medicines from the units mentioned in the paragraph "keeping in view the need for ensuring quality of AYUSH drugs and medicines." This would indicate that the need for ensuring quality is subserved by all the sources mentioned there. Besides IMPCL, which is an establishment of the Government of India, paragraph 4(vi)(b) includes other establishments of the State Governments or co-operative societies. The contention

that IMPCL does not have any commercial interest because it is an establishment developed by the Government of India is then equally applicable to other establishments prescribed in paragraph 4(vi)(b).

30 The argument that the procurement of Ayurvedic drugs from IMPCL would fall within the exceptional circumstances (assurance of quality medicines) is erroneous. The submission of the appellant that IMPCL is the sole producer of quality Ayurvedic medicines is based on surmises and conjectures without any cogent material to support the claim.[15] In fact, the notification of 2 January 2019 issued by the Ministry of AYUSH stipulates that 50 percent of the grant-in-aid has to be used to procure medicines from IMPCL or other Central/State PSUs' or pharmacies under the State-Governments and co-operatives. It is open to the appellant to procure medicines using any method other than tender, so long as it is not arbitrary. The claim of the appellant is that it deviated from the rule of tender because IMPCL is the only establishment that produces quality medicines. However, there is no material to substantiate the claim that IMPCL is the only establishment which manufactures 'quality' medicines to the exclusion of other establishments mentioned in paragraph 4(vi)(b). The appellant has been unable to discharge the burden placed on it by producing cogent material demonstrating that the procurement of medicines through nomination is warranted because of the existence of exceptional circumstances bearing on need for quality. The action of the appellants of procuring medicines only from IMPCL to the exclusion of the other establishments mentioned in paragraph 4(vi)(c) is arbitrary and violative of Article 14 of the Constitution.

[15] See State of Tamil Nadu v. National South Indian River Interlinking Agriculturist Association, Civil Appeal 6764 of 2021.

31 In the given circumstances, inviting tenders from the entities mentioned in paragraph 4(vi)(b) is the most transparent and non-arbitrary method of allocation that can be undertaken. Hence, the appellant must henceforth purchase Ayurvedic medicines only through a free and transparent procedure such as tenders. The appellant may deviate from this rule and procure medicines by nomination only if exceptional circumstances exist. In such a situation, the appellant must demonstrate the existence of exceptional circumstances on the basis of cogent material.

32 For the reasons indicated above, the appeals against the judgment of the Lucknow Bench of the High Court of Judicature at Allahabad dated 18 October 2019 are dismissed.

33 Applications for intervention[16] were filed by the Federation of AYUSH drugs Manufacturers[17], the President and Secretary of the Federation, the investor of "S-compound"[18], and a small-scale manufacturing unit engaged in the production of Ayurvedic Medicines. The Federation consists of nine members who are registered under the Micro, Small and Medium Enterprises Development Act 2006 and are engaged in the manufacture and sale of Ayurvedic drugs. The following arguments were made in the application:

(i) This Court in **Caterpillar India Pvt. Ltd.** v. **Western Coal Fields**[19] observed that purchase preference creates a monopoly. In view of the judgment in **Caterpillar India** (supra), the Union Cabinet by an order dated 21 November

[16] IA 9631 of 2020; IA No. 46786 of 2022
[17] **"Federation"**
[18] S-Compound is a recognised herbal ayurvedic drug used in the treatment of 'rheumatoid arthritis' and 'osteo arthritis'.
[19] (2007) 11 SCC 32

2007 adopted a policy whereby purchase preference to Central Public Sector Enterprises was terminated from 31 March 2008; and

(ii) The Director, Central Vigilance Commission issued a circular on 9 November 2009[20] to review the Purchase Preference Policy for the products and services of Central Public Sector Enterprises in view of the judgment in **Caterpillar India Pvt. Ltd.** (supra). On 23 March 2012, the Ministry of MSME framed a policy titled "Public Procurement Policy for Micro and Small Enterprises (MSEs) Order 2012" which stipulates that every Central Ministry or Department of PSU shall procure a minimum of 20 percent of the total annual purchases from micro and small enterprises.

34 The intervention applicant submitted as follows:

(i) Policies of the Central and State government stipulate that 25 percent of the medicines shall be procured from MSMEs. Thus, the term 'at least 50%' in paragraph 4(vi)(b) of the Operational Guidelines must be read as limiting the procurement from establishments in paragraph 4(vi)(b) to 50 percent and giving other manufacturers a level playing field under paragraph 4(vi)(c);

(ii) The Central and the State Governments have notified procurement policies directing that a certain percent of the procurement must be from the MSMEs'. The procurement of medicines from IMPCL on nomination is contrary to the procurement policies notified by the Government;

(iii) IMPCL also sells products in the open market. Thus, the argument that IMPCL is established solely to supply medicines to the Government is misleading; and

[20] Circular No. 31/10/09

(iv) IMPCL has not submitted records to show that the other manufacturers cannot supply equivalent or better-quality drugs.

35 The intervention applications seek to enlarge the scope of the Special Leave Petition. The issue before this Court falls squarely on the interpretation of paragraph 4(vi)(b). However, the intervention applicant has prayed that in accordance with the policies of the State and the Central Government, a minimum percent of Ayurvedic drugs must be procured from MSMEs under paragraph 4(vi)(c). This is beyond the scope of the instant Special Leave Petition.

36 For the reasons indicated above, IA 9631 of 2020 and IA No. 46786 of 2022 are dismissed. The interveners would have to follow their own independent remedies in accordance with law.

37 Pending application(s), if any, stand disposed of.

.....CJI
[Dr Dhananjaya Y Chandrachud]

.....J
[Hima Kohli]

New Delhi;
January 03, 2023