

# Dispute Resolution Hotline

November 26, 2013

## SUPREME COURT BALANCES POWER TO BLACKLIST WITH PRINCIPLES OF REASONABLENESS

- Supreme Court holds that power to blacklist a contractor is inherent in the party allotting the contract and there is no need for conferment of such power by a statute.
- A decision to blacklist a contractor has serious consequences and can be scrutinized by a High Court. Further, such decisions will be examined on principles of natural justice and doctrine of proportionality.
- Supreme Court relies on guidelines prescribed by the US Federal Government for blacklisting (debarment under US law). Supreme Court also relies on the guidelines for factors that may influence debarring official's decision.

### INTRODUCTION

In *Kulja Industries Limited v. Chief Gen. Manager W.T. Proj. BSNL and Ors*<sup>1</sup> the Supreme Court of India (“**Supreme Court**”) ruled on the power of an authority to blacklist a company on the basis of the terms of the underlying contract (“**Ruling**”). The Appellant, Kulja Industries (“**Contractor**”) was blacklisted by Bharat Sanchar Nigam Limited (“**Authority**”) due to fraudulent payments which were obtained by Contractor from Authority. The Supreme Court set aside the order of blacklisting issued by the Authority as it had the effect of permanently affecting the business of the Contractor. The Ruling clearly identifies the limits of powers of statutory authorities to take coercive actions against companies. The Supreme Court has ensured that principles of reasonableness are incorporated in every action and decision of statutory authorities.

### BACKGROUND

Two tender notices for supply of permanent lubricated HDPE Pipe and Installation of O.F. Cable through Blowing Technique were issued by Authority in year 2004 and 2005. The Contractor was successful in both the tender notices and several orders for supply of the material were placed with the Contractor from 2004 to 2006 and goods were supplied to various consignee units of the Authority. Upon issuance of the ‘receipt certificate’, the bills for payment were raised in triplicate to the Chief Controller of Accounts of the Authority. Subsequently, a single account to receive 95% of the payment under the contract due from the Authority was identified by the Contractor. However, details of the contracts were not mentioned on the cheques issued for payment to Contractor. The Contractor’s case was that on gaining knowledge about excess payments received from the Authority, Contractor made an offer of reconciliation of accounts with the Authority by their letter dated May 10, 2006. The Authority however contended that four of the Authority’s officers abused their official position and fraudulently generated ‘voucher numbers’ on the duplicate and triplicate copies of the bills submitted by the Contractor to facilitate additional and excess payments to the tune of Rs. 7.98 Crores. On these facts, the Authority lodged a First Information Report with the Central Bureau of Investigation Anti-Corruption Bureau (“**CBI ACB**”) against employees of the Contractor (for offences under the Indian Penal Code, 1100% “**IPC**”) and employees of the Authority (for offences under the Prevention of Corruption Act, 1988). The Authority consequently blacklisted the Contractor for gross misconduct and irregularities by receiving excessive payments amounting to Rs. 7.98 Crores. The Contractor challenged the blacklisting in the Bombay High Court as the Authority had not granted the Contractor an opportunity to present its case and rebut the contentions of the Authority. The Bombay High Court directed the Authority to comply with the principles of natural justice and grant the Contractor an effective hearing before passing such any order. A show cause notice was issued and Contractor was called for a personal hearing. After considering the submissions of the Contractor, the Authority passed Order dated January 15, 2011 blacklisting the Contractor (“**Blacklisting Order**”). The Contractor challenged the Blacklisting Order in the Bombay High Court and the Bombay High Court upheld the Blacklisting Order. The Authority had permanently banned the Contractor and also observed that the Authority was never to transact with the Contractor in the future.

### ISSUE

The only issue which arose for consideration before the Supreme Court was whether Blacklisting Order was valid.

### CONTENTIONS

#### *Submissions by the Contractor*

The Contractor contended that the Blacklisting Order was wholly arbitrary and unjustified as the Authority had blacklisted the Contractor permanently without considering relevant facts. The Contractor contended that a blacklisting order had serious civil consequences for the person blacklisted thus making it obligatory for an authority passing such an order to act fairly and reasonably. It was also submitted that since the products manufactured by the Contractor were almost exclusively supplied to the Authority, any order permanently blacklisting the Contractor from entering into contracts with the Authority would effectively close the business of the Contractor. Contractor also submitted that Paras 31 and 32 of the tender document<sup>2</sup> (power of Authority to disqualify and blacklist) provided for blacklisting only for a ‘suitable period’, and therefore, for a definite period and not permanently. Therefore, the Blacklisting Order was totally disproportionate to the gravity of the offence allegedly committed by the Contractor. Contractor therefore contended that the power to blacklist was therefore not available with the Authority in the

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manner the Authority sought to blacklist the Contractor.

### *Submissions by the Authority*

Authority contended that it had power under Para 2.3 of the tender document<sup>3</sup> (disqualification clause) to permanently debar the Contractor. It was further contended that even if the power of blacklisting was to be related to Paras 31 and 32 of the tender document, permanently blacklisting the Contractor was justified having regard to the nature of the fraud committed.

### **SUPREME COURT RULING**

The Supreme Court partly allowed the appeal and held that permanently blacklisting the Contractor was not reasonable and proportional to the offence in the facts and circumstances. The Supreme Court examined the provisions relating to disqualification and blacklisting and concluded that the power to disqualify a contractor was provided for in the tender document and in terms of the same the Authority would have to show that the supplier:

- Habitually failed to supply equipment in time;
- Equipment supplied by the supplier did not perform satisfactorily, or,
- Failed to honour the bid without sufficient grounds.

The Supreme Court noted that if the power of blacklisting was to be limited to these 3 narrow grounds, the Authority would not have power to take action in the context of far more serious offences. The Supreme Court therefore concluded that the power to blacklist is an inherent power and did not have to be conferred by a statute or even the underlying contract. In this context, the Supreme Court held that the principle of fair hearings was imperative while considering a blacklisting order. Relying on several precedents<sup>4</sup>, the Supreme Court reiterated that any decision to blacklist a contractor / supplier could be challenged on the ground that the blacklisting was arbitrary or discriminatory. Further, such decisions could also be challenged on the ground that they were violative of the principles of natural justice and doctrine of proportionality.<sup>5</sup>

In the present case, the Authority did not have any guidelines on exercising the power of blacklisting and consequently, the Supreme Court examined similar guidelines framed by the US Federal Government and UK. The Supreme Court noted that the US Federal Government considered 'suspension and debarment' as powerful tools for protecting public interest and ensuring integrity of transactions entered into by the Federal Government. The Supreme Court noted that the power to debar was considerable but the power was only to debar and this was not intended to be permanent. The Supreme Court noted similar measures in England, Northern Ireland and Wales and that such guidelines were important to ensure that parties who indulged in fraudulent practices were effectively made ineligible.

The Supreme Court noted that the Authority had alleged that the Contractor had fraudulently withdrawn a substantial amount of money through collusion and conspiracy with the officials of the Authority. However, even in such a situation permanent debarment from future contracts for all times to come would be too harsh and heavy since the Contractor was supplying bulk of its manufactured products to the Authority and the excess amount was received back by the Authority.

Consequently, the Supreme Court remanded the matter to the Authority for consideration of the period for which the blacklisting was to operate. The Supreme Court held that a remand order was appropriate since the quantum of penalty vests with the Authority and was to be exercised by the Authority. Further, the Supreme Court observed that it would be appropriate for the Authority to frame guidelines on the basis of which such power could be exercised. The Supreme Court highlighted that factors such as gravity of offence, violations and breaches could be prescribed as guidelines. The Supreme Court clarified that while an exhaustive list of factors cannot be set out, an indicative list should be made to eliminate the possibility of arbitrariness in blacklisting orders.

### **ANALYSIS**

Several important aspects emerge from the present case. It is important to note that even before the court investigating the case registered by the Authority had convicted the employees of the Contractor, the Blacklisting Order has been upheld by the Supreme Court. If the court were to acquit the accused of the charges under the IPC, it is possible that the finding of blacklisting itself can be set aside. Further, although there is no discussion on facts of the case, it is important to note that the Contractor, a company, is adversely and prejudicially affected by the actions of individual employees. There is no discussion by the Supreme Court with respect to actions if any taken by the Contractor against its errant employees (assuming that the employees were in fact guilty). The Supreme Court has also not discussed any mitigating factors such as acts of employee and acts of employer. It is a well-recognized principle of law that in appropriate cases, a fraudulent act by an employee is not a duly authorized act by the employer and hence, the employer cannot be prosecuted by unauthorized and illegal acts of the employee.<sup>6</sup> Unfortunately, the Supreme Court has not discussed these very important aspects which would have helped companies take measures to protect against negligent and fraudulent acts of employees.

Another important aspect that emerges from the Ruling is that the Supreme Court has held that the power of blacklisting is an inherent power and does not require express conferment by a provision of a law or otherwise. Therefore, based on the Ruling, it would not be possible to challenge an action of blacklisting on the ground that there is no power to blacklist. This is contrary to the general principle of exercise of powers (under administrative law) that for exercise of any power, it has to be expressly conferred<sup>7</sup>, particularly where exercise of such powers have an adverse effect on a party.

Finally, the Ruling has made it abundantly clear that although these powers are inherent with a statutory authority, the statutory authority is bound to exercise them in a reasonable manner. The Supreme Court has also highlighted the importance of guidelines in sentencing and has also noted that the terms of blacklisting will also have to be reasonable and proportional to the facts of the offence. It is hoped that statutory authorities and government departments take these observations in the appropriate spirit and frame guidelines to deal with blacklisting companies. These measures would go a long way in ensuring integrity in public contracts and fairness and reasonableness in actions of statutory authorities.

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<sup>1</sup> 2013 (12) SCALE 423.

<sup>2</sup> Paras – 31. Purchaser reserves the right to disqualify the supplier for a suitable period who habitually failed to supply the equipment in time. Further, the suppliers whose equipment do not perform satisfactory in the field in accordance with the specifications may also be disqualified for a suitable period as decided by the purchaser.

32. Purchaser reserves the right to blacklist a bidder for a suitable period in case he fails to honour his bid without sufficient grounds"

<sup>3</sup> Para - 2.3 Disqualification Clause: The supplier/Manufacturers in the following category are not eligible to bid in the said tender.

i ....

ii. Firms against whom investigation cases are registered with the CBI or other statutory investigations agencies of State/Central Govt.

iii ....

<sup>4</sup> The Supreme Court of India in Erusian Equipment & Chemicals Ltd. v. State of West Bengal and Anr. (1975) 1 SCC 70 held that blacklisting has the effect of preventing a person from entering into lawful relationship with the Government for purposes of gains and that the Authority passing any such order was required to give a fair hearing before passing an order blacklisting a certain entity. Subsequent decisions of the Supreme Court in M/s Southern Painters v. Fertilizers & Chemicals Travancore Ltd. and Anr. AIR 1994 SC 1277; Patel Engineering Ltd. Union of India (2012) 11 SCC 257; B.S.N. Joshi & Sons Ltd. v. Nair Coal Services Ltd. & Ors. (2006) 11 SCC 548; Joseph Vilangandan v. The Executive Engineer, (PWD) Emakulam & Ors. (1978) 3 SCC 36 have followed the ratio laid down in Erusian Equipment.

<sup>5</sup> "By proportionality, it is meant that the question whether while regulating exercise of fundamental rights, the appropriate or least restrictive choice of measures has been made by the legislature or the administrator so as to achieve the object of the legislation or the purpose of the administrative order, as the case may be. Under the principle, the court will see that the legislature and the administrative authority "maintain a proper balance between the adverse effects which the legislation or the administrative order may have on the rights, liberties or interests of persons keeping in mind the purpose which they were intended to serve." Teri Oat Estates (P) Ltd. v. U.T. Chandigarh and Ors. (2004) 2 SCC 130.

<sup>6</sup> An employer is held vicariously liable for actions of the employee subject to the manner in which the employee acted, whether the actions were authorized and the extent of the transgression by the employee. Ordinarily, an employer is liable for acts done by the employee in the course of employment for which the employee was duly authorized.

<sup>7</sup> Halsbury's Laws of England, 4<sup>th</sup> Edition, Vol. 1 and Vol. 44.

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