Arbitration Case *Insights*

Shardul Amarchand Mangaldas

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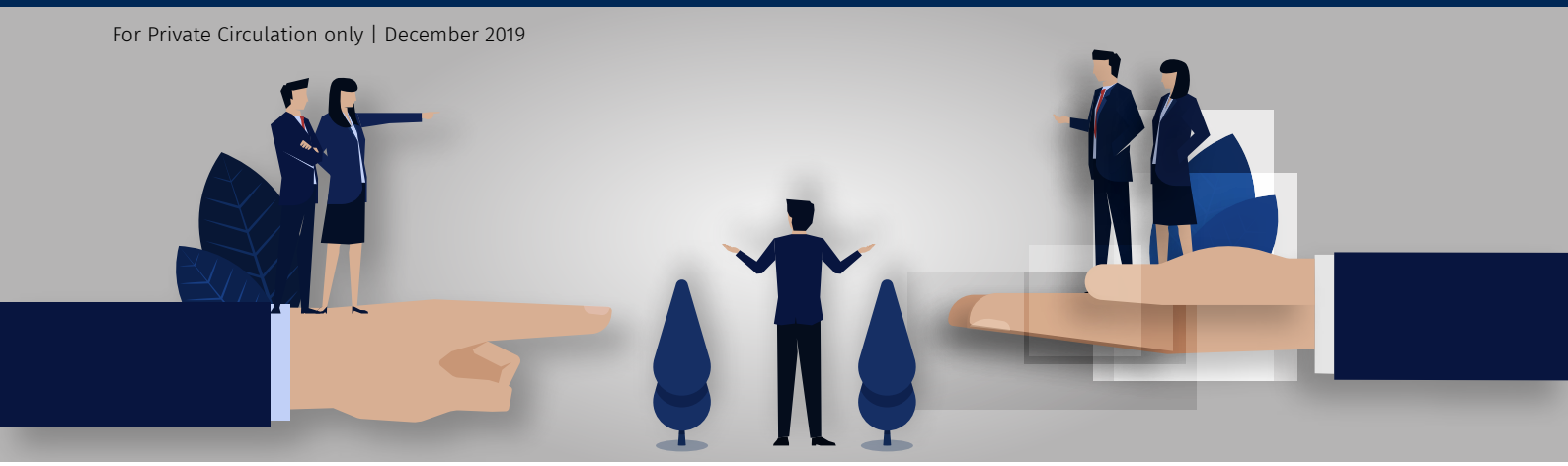

Supreme Court strikes down Section 87 of the Arbitration & Conciliation Act, 1996 inserted by the 2019 Amendment Act, and omission of Section 26 of the 2015 Amendment Act[1]

Brief Facts

Hindustan Construction Company Ltd. ("**Petitioner**") through the public tendering system, undertook building projects as a contractor for government bodies such as NHAI, NHPC, NTPC and IRCON International Ltd. In the petition, the Petitioner has claimed to have arbitral awards ("**Awards**") amounting to INR 6,070 crores in its favour. However, the said Awards have been challenged by the respondents under Sections 34 and 37 of the Arbitration and Conciliation Act, 1996 ("**Act**"), which affects their enforcement and the Petitioner is unable to recover the awarded amounts. The Petitioner therefore sought formulation of a process that would amount to immediate payment the moment an arbitral award is passed in its favour. The Petitioner also sought to challenge various provisions of the Insolvency & Bankruptcy Code, 2016 ("**IBC**") and sought quashing of proceedings under the IBC initiated by its creditors before various National Company Law Tribunals.

The Petitioner premised its case on the basis that government bodies other than government companies are exempt from the IBC as they are statutory authorities or government departments, and submitted that 'corporate person' as defined by Section 3(7) of the IBC should include government bodies other than government companies (which are already included). This is because on the one hand, on an automatic stay of arbitral awards in Petitioner's favour granted under the Act, those monies cannot be used to pay-off the debts of its client's creditors. On the other hand, any debt of over INR 1 lakh owed to a financial or operational creditor which remains unpaid, would attract the provisions of the IBC against Petitioner No. 1, making these provisions arbitrary, discriminatory and violative of Articles 14 and 19(1)(g) of the Constitution of India.

The Petitioner also challenged the constitutional validity of Section 87 of the Act inserted vide the Arbitration and Conciliation (Amendment) Act, 2019 ("**2019 Amendment Act**"). The effect of Section 87 is such that filing of a petition challenging an award under Section 34 of the Act, in relation to an arbitral proceeding which commenced before 23 October 2015, leads to an automatic stay on the enforcement of the award because of operation of Section 36 as it stood before its amendment in 2015. Petitioner argued that Section 87 takes away the vested right of enforcement and binding nature of award and reverses the beneficial effect of the Arbitration and Conciliation (Amendment) Act, 2015 ("**2015 Amendment Act**"), which remedied the original mischief in the Act. The Petitioner further sought to challenge the omission of

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Section 26 of the 2015 Amendment Act, vide the 2019 Amendment Act.

The Petitioner also challenged NITI Aayog's Office Memorandum No.14070/14/2016-PPPAU dated 5 September 2016 ("**Scheme**") because to retrieve amounts payable under Awards which would get automatically stayed, it was able to get 75% of a "pay-out amount" under the Scheme, which is the awarded amount plus interest. This could only be done against a bank guarantee of the equivalent amount. However, apart from such bank guarantee, an additional bank guarantee of 10% per year on the pay-out amount would also have to be given, which is then compounded annually. Given that 75% of such pay-out amount can only be released on the bank guarantee of the equivalent amount, asking for anything over and above this would amount to an arbitrary exercise of power, which is liable to be struck down.

Issues

(i) Whether Section 87 of the Act inserted vide the 2019 Amendment Act is unconstitutional?
(ii) Whether provisions under the IBC are unconstitutional?
(iii) Whether the requirement of a top up bank guarantee of 10% per annum as stipulated by the Scheme is unconstitutional?

Judgment

Issue (i)

Section 36 of the Act after the 2015 Amendment Act, did away with the position of automatic stay on enforcement of an award on filing of a petition challenging the award. Section 26 of the 2015 Amendment Act was to apply *in relation to* arbitral proceedings commenced after 23 October 2015, meaning that for a petition under Section 34 of the Act filed after 23 October 2015, amended Section 36 of the Act was applicable. The Srikrishna Committee Report recommended that the Section 26 of the 2015 Amendment Act shall be prospective in nature. Later, the Supreme Court in *BCCI v. Kochi Cricket Pvt. Ltd.*[2] ("**BCCI**") held that Section 36, which provides for enforcement of award, being procedural and not substantive in nature, shall apply retrospectively to ensure Section 34 is not misused and does not act as a clog to the very process of execution of awards.

Section 87 of the Act, in contradiction to *BCCI's* (*supra*) position, stated that 2015 Amendment Act shall only apply prospectively (after commencement of the 2015 Amendment Act) and not retrospectively. In essence, this again created divergence in the way the cases will be dealt with pre-2015 Amendment Act and post-2015 Amendment Act, particularly in regard to stay under Section 36 of the Act.

The Court held that "*Whatever uncertainty there may have been because of the interpretation by different High Courts has disappeared as a result of the BCCI judgment, the law on Section 26 of the 2015 Amendment Act being laid down with great clarity. To thereafter delete this salutary provision and introduce Section 87 in its place, would be wholly without justification and contrary to the object sought to be achieved by the 2015 Amendment Act*". The Court held that Section 87 retrospectively resurrects automatic stay, turns the clock backwards, fails to adequately determine the application of Section 36, is contrary to the public interest and therefore being manifestly arbitrary, is struck down. The Court also struck down omission of Section 26 of the 2015 Amendment Act, vide the 2019 Amendment Act.

The Court also held that *National Aluminium Company Ltd. (NALCO) v. Pressteel & Fabrications (P) Ltd. and Anr.*[3] and *Fiza Developers and Inter-trade Pvt. Ltd. v. AMCI (India) Pvt. Ltd. and Anr.*[4] are *per incuriam* and have laid down the law incorrectly. The said judgments enforced automatic stay on the mere filing of the Section 34 applications rendering the purpose of Section 36 vitiated. The Court held that Section 36 was enacted for a different purpose and "*to state that an award when challenged under Section 34 becomes unexecutable merely by virtue of such challenge being made because of the language of Section 36 is plainly incorrect*".

Issue (ii)

The Court held that NHPC, NTPC and IRCON who owe money to Petitioner No. 1, would be subsumed within the definition of 'Government Company' in Section 2(45) of the Companies Act, 2013. Further, NHAI is a statutory body functioning as an extended limb of the Government and such authority cannot be wound-up. Therefore, the Court held that it is "*not possible to either read in, or read down, the definition of 'corporate*

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person' in Section 3(7) of the IBC". The Court reiterated that the moment challenges are made to the arbitral awards, the amount said to be due by an operational debtor would become disputed, and therefore be outside the clutches of the IBC. Further, the Court held that IBC is not a debt recovery legislation and therefore debts owed by a third party to persons like the Petitioner cannot be fastened on to PSUs. Therefore, the Court rejected Petitioner's plea for rendering the provisions of IBC unconstitutional.

Issue (iii)

The Court noted that the Scheme was formulated due to the hardship faced by the construction sector, so that it can get the fruits of arbitral awards. The Court held that the Petitioner was free to avail or not avail the benefits of the Scheme. However, having availed the benefits, it is not possible for the Petitioner to now turn around and state that one part of the Scheme is onerous and should be struck down. Therefore, the Court upheld the Scheme.

Analysis

This is a landmark judgment since it will promote a pro-arbitration regime in India. It clarifies that the Act never contemplated automatic stay on the enforcement of an award upon filing an application for challenge of the award under Section 34. It further holds that the 2015 Amendment Act providing for need for seeking specific stay of enforcement was only clarificatory in nature. Striking down of Section 87 inserted by the 2019 Amendment Act, which provided that the provisions of the 2015 Amendment Act shall only apply to arbitral proceedings commenced on or after 23 October 2015 and to court proceedings arising out of or in relation to *such* arbitral proceedings, is a welcome step and reinstates the law laid down by the Supreme Court in the ***BCCI*** (*supra*). The Court also rejected challenge to the provisions of IBC ensuring both IBC and the Act co-exist in their respective realms.

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1 Authored by Tejas Karia, Partner & Head-Arbitration, Gauhar Mirza, Principal Associate, Avlokita Rajvi, Senior Associate, and Manavendra Gupta, Associate; *Hindustan Construction Company Limited & Anr. v. Union of India & Ors.*, Writ Petition (Civil) No. 1074 of 2019, Supreme Court, 2019 SCC OnLine SC 1520, judgment dated 27 November 2019.

Team of Shardul Amarchand Mangaldas & Co led by Tejas Karia, Partner & Head-Arbitration and comprising of Gauhar Mirza, Principal Associate, Amee Rana, Senior Associate, and Nishant Doshi and Manavendra Gupta, Associates, represented IRCON Limited (Respondent No. 7) and assisted the Solicitor General, Mr. Tushar Mehta.

Quorum: RF Nariman, Surya Kant and V. Ramasubramanian, JJ.

2 (2018) 6 SCC 287.

3 (2004) 1 SCC 540.

4 (2009) 17 SCC 796.

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