



ELP Arbitration Alert



[Hindustan Construction Company Limited and Anr. v. Union of India and Ors.¹](#)

Introduction

On 27 November 2019, the Supreme Court of India (**SC**), delivered a seminal verdict in the case of *Hindustan Construction Company Limited & Anr. v. Union of India & Ors.* wherein, inter alia², the constitutional validity of Section 87 of the Arbitration and Conciliation Act, 1996 (Act) was challenged.

Award holders in India have historically had an arduous time realizing the proceeds of an award when awards are challenged by award debtors and the enforcement proceedings are automatically stayed. **By the present decision, the SC, under the Act, has given means to an award holder to secure a part or whole of the award amount pending the outcome of the petition to set aside the award under the Act.** The award debtor, pending the outcome of the challenge to the award, is compelled to file an application for stay against the enforcement of the award wherein it may be required to deposit the award amount in court. This position which was made available through the Arbitration and Conciliation (Amendment) Act, 2015 (**2015 Amendment Act**) has now been extended to even those matters which commenced prior to 23 October 2015.

Setting the Context

1996

A key issue under the Act was that a petition for setting aside the award, filed under section 34 by an award debtor, meant an automatic stay against the enforcement of the award³. This seemed antithetical to the nature of arbitration, i.e., a

¹ WP (Civil) No. 1074 of 2019

² At the outset, this decision involved other facets including a challenge to the provisions of the Insolvency and Bankruptcy Code, 2016. However, we will not venture into that realm in the present discussion.

³ *National Aluminum Company Ltd. (NALCO) v. Pressteel & Fabrications (P) Ltd. and Anr.*, 2004 1 SCC 540 – While the judgment held that the mere filing of an application under Section 34 of the Act operates as an automatic stay on the operation of the award, the judgment also observed that a recommendation had been made by the relevant Ministry to the Parliament to amend the language of Section 34 because an automatic stay would be against the principles of an efficient alternate dispute resolution system.

speedy and efficacious alternate dispute resolution mechanism. Therefore, an award holder could not realize the amounts under an award, until the setting aside petition was finally disposed.

2015

The above dichotomy, amongst others, was sought to be rectified by 2015 Amendment Act whereby under section 36(3) the award debtor was now required to make a specific application seeking a stay against the enforcement of the award. The said stay could be granted by the court subject to conditions including deposit of the award amount. Soon after the 2015 Amendment Act came into force, questions arose as to the applicability of the 2015 Amendment Act i.e. whether it was applicable retrospectively or prospectively. In the ensuing months companies that had received arbitral awards in their favor were unsure if the awards were enforceable or would suffer the fate of an automatic stay. Thus, section 26 of the 2015 Amendment Act, which dealt with the applicability thereof came under judicial scrutiny in various courts across the country.

2017

In the meanwhile, the ambiguity was noted by the Srikrishna Committee Report ⁴in 2017. The said report recommended that certainty ought to be brought about by clarifying that the 2015 Amendment Act was prospective in nature.

The Supreme Court's decision in BCCI⁵

Before a legislative clarification on the applicability of the 2015 Amendment Act could be made, the SC in BCCI v. Kochi Cricket Private Limited (BCCI) clarified that while the 2015 Amendment Act was prospective in nature, the change brought about in the position vis-à-vis the erstwhile automatic stay against enforcement, was retrospectively applicable. Thus, even for arbitrations pre-dating 23 October 2015, the award holder could not be simply shut out by a pending setting aside petition against the award. At the time when BCCI was under consideration before the SC, the legislature proposed the change recommended by the Srikrishna Committee Report, i.e. to make the 2015 Amendment Act prospective. The SC being aware of such intended change, recommended that the legislature should not undo the object of the 2015 Amendment Act along the proposed lines.

2019

Unfortunately, despite the observation of the SC in BCCI, the legislature, enacted the Arbitration and Conciliation (Amendment) Act, 2019 (**2019 Amendment Act**), repealing section 26 of the 2015 Amendment Act and clarifying through section 87 that the 2015 Amendment Act was prospectively applicable only. This meant that those companies which (in pending matters) had relied upon the BCCI decision to claim benefit of the section 36(3) of the Act and the provisions for enforcement, were forced to reevaluate their positions.

The Issue before the SC

These companies (**Petitioners**) hence moved the SC, by way of a writ, challenging the constitutionality of section 87 introduced by the 2019 Amendment Act, the repeal of section 26 of the 2015 Amendment, as also certain provisions of IBC.

Contentions on behalf of the Petitioner

It was contended that the unamended Act deviated from the UNCITRAL Model Law by not allowing two bites at the cherry to an award debtor, i.e., one during setting aside proceedings under section 34 and one during enforcement proceedings under section 36. Hence, the erstwhile interpretation that the setting aside proceedings would create an automatic stay was itself fallacious when section 35 provided for finality of the award.

It was argued that it was inconceivable that while in civil appeals there is no automatic stay of a money decree, there should be an automatic stay against the arbitral award when a setting aside application is filed.

It was further contended that section 87, by applying the 2015 Amendment Act prospectively, was violative of Article 14, 19(1)(g), 21 and 300-A of the Constitution of India, namely because:

- It was contrary to the object of the Act
- It took away the vested right of enforcement and diluted the binding nature of an arbitral award

⁴ Report of the High Level Committee to Review the Institutionalisation of Arbitration Mechanism in India – available at <http://legalaffairs.gov.in/sites/default/files/Report-HLC.pdf>

⁵ BCCI v. Kochi Cricket Private Limited, (2018) 6 SCC 287

- It encroached upon the BCCI decision without formally neutralizing it, and was introduced without justification by simply relying upon the Srikrishna Committee Report which predated the BCCI decision
- It recreated the mischief that was sought to be done away with by the 2015 Amendment Act
- It was unreasonable, excessive, disproportionate and arbitrary

Contentions on behalf of the Respondents

The Respondents argued that there was no merit in the Petitioners' contention that the introduction of section 87 in the Act and the repeal of section 26 of the 2015 Amendment Act was unconstitutional.

It was also contended that there was no substance to the challenge that the cut-off date of 23 October 2015 for prospective applicability was arbitrary. It was also submitted that courts should not intervene unless the cut-off date is blatantly discriminatory.

It was submitted that the BCCI decision was declaratory and did not set aside any executive action. Therefore, section 87 was clarificatory of the original legislative intent and did not encroach upon the BCCI decision.

The Verdict and Reasoning

The SC agreed with the Respondents that there was no requirement to expressly refer to the BCCI decision in order to nullify it by way of legislation. The SC also agreed that the very foundation of the BCCI decision having been uprooted, there was no direct assault on the decision.

However, the SC agreed with the Petitioners that the reading of the unamended Act leads to the conclusion that there was a conscious deviation from the UNCITRAL Model Law by not allowing two bites at the cherry to an award debtor, i.e., one during setting aside proceedings under section 34 and one during enforcement proceedings under section 36. The SC read section 35 (which deals with finality of an award) along with section 34 and 36 to state that it was never intended that a setting aside petition would automatically stay enforcement.

This obviously was a complete departure from the earlier position that had been stated by the SC itself. In NALCO⁶, Fiza⁷ and National Buildings⁸ the SC had held that a setting aside petition would inherently stay the enforcement of an award. Thus, in the decision under discussion, while coming to its conclusion as above, the SC expressly overruled these decisions.⁹

The SC also relied upon section 9, which enables a party to apply for interim reliefs after making of the award but before it is enforced, in support of the conclusion that the award is enforceable and there is no automatic stay against enforcement upon the filing of a setting aside petition. The SC thus clarified that even under the Act, there was never any automatic stay intended and that the 2015 Amendment Act was merely clarificatory in this regard. By extension, the SC implied that the 2015 Amendment Act was therefore retrospectively applicable.

The SC observed that section 87 was introduced merely on the basis of the recommendation in the Srikrishna Committee Report to remove uncertainty around the prospective applicability of the 2015 Amendment Act, when in fact such uncertainty was removed by the BCCI decision. The SC clarified that having held that there was no automatic stay under the unamended Act, the 2015 Amendment Act was only introduced to clarify such position. Therefore, section 87 was contrary to the object sought to be achieved by the 2015 Amendment Act as it sought to make the 2015 Amendment Act only applicable from 23 October 2015. Further, the legislature without referring to the BCCI decision which had pointed out the pitfalls of introducing such a provision, had brought into play a provision that was manifestly arbitrary, without adequately determining principle, and contrary to public interest.

The SC agreed with the Petitioner that the introduction of section 87 resurrects the mischief sought to be corrected by the 2015 Amendment Act and was therefore unconstitutional. At first blush this seems contrary to the reasoning adopted by the SC that there was no mischief under the Act itself – namely there was no automatic stay under the unamended Act. However, it would appear that the SC was referring to its earlier decisions in NALCO and Fiza, which had led to an erroneous interpretation of the Act, that the 2015 Amendment Act aimed to rectify.

The SC also concurred with the Petitioners that when read with the IBC, the consequence of section 87 leads to an absurd result, i.e., the award holder becoming insolvent as it was unable to recover sums under arbitral awards. The SC hence

6 National Aluminum Company Ltd. (NALCO) v. Pressteel & Fabrications (P) Ltd. and Anr., (2004) 1 SCC 250

7 Fiza Developers and Inter-trade Pvt. Ltd. v. AMCI (India) Pvt. Ltd., (2009) 17 SCC 796

8 National Buildings Construction Corporation Ltd. v. Lloyds Insulation India Ltd., (2005) 2 SCC 367

9 The SC clarified that the said decisions were only overruled on this limited aspect.

found the introduction of section 87 and the repeal of section 26 of the 2015 Amendment Act to be violative of Article 14 of the Constitution of India.

Notably, the SC made short work of the Respondents' contention that the cut-off date was not arbitrary by holding that the question before it was not whether the date was arbitrary but whether the non-bifurcation of court proceedings and arbitration proceedings with reference to the said date was arbitrary. The SC having struck down the said provision on the basis of Article 14, did not venture further into its constitutionality vis-à-vis Article 19(1)(g), 21 and 300-A.

The SC then clarified that the position in BCCI continues to hold good as on date, i.e., by filing a setting aside petition there would be no automatic stay against the enforcement of any arbitral award, irrespective of when the arbitration was commenced.

Conclusion

It is well known that over INR 38,000 crores¹⁰ is held up in litigation in the roads sector itself as the sums due under arbitral awards have not been deposited on account of automatic stay available to the award debtor by simply filing a setting aside petition under section 34. This malady is spread across various other sectors as well and not just limited to cases where the governmental agencies are award debtors. **The decision of the SC will therefore provide much needed relief to award holders who no longer need to wait the average six to seven years before realizing the awarded amounts.** In the short term, this would perhaps inject much needed liquidity in strained sectors and alleviate the balance sheets of several companies.

On a separate note, it would be interesting to see the effect of this decision on other amendments brought in by the 2015 Amendment Act and not just the key provision, i.e. section 36(3).

However, the **key takeaway is the paradigm shift in the attitude and approach of the judiciary towards arbitration in India** which bodes well for the future of arbitration in India.

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¹⁰ <https://indianexpress.com/article/india/highway-dispute-resolution-committee-in-a-month-nhai-chief-4627921/> Last accessed on 18 August 2019