Section 87 introduced in the ACA by the 2019 amendments violate Article 14 (Supreme Court of India)

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Hindustan Construction Company v. Union of India

Court: Supreme Court of India | **Case Number**: WP (C) No. 1074 of 2019 | **Citation**: 2019 SCC OnLine SC 1520 | **Bench**: RF Nariman, Aniruddha Bose & V Ramasubramanian JJ | **Date**: 27 November 2019

A. Background— The amendments in 2015 and 2019

The Arbitration and Conciliation Act, 1996 ("ACA") was amended in 2015, with effect from 23 October 2015. Section 26 of the Amendment Act, 2015 indicated whether the amendments were prospective or retrospective, but Section 26 received more than one interpretation in the High Courts across the country. The government-appointed Justice BN Srikrishna Committee gave a report on 30 July 2017 referring to the uncertain position. Eventually, on 15 March 2018, the Supreme Court in *BCCI* v. *Kochi Cricket Pvt. Ltd*., (2018) 6 SCC 287[1] declared the law concluding that the 2015 amendments were prospective and will apply (a) only to those arbitral proceedings which commenced on or after 23 October 2015, and (ii) to all court proceedings commenced on or after 23 October 2015 (irrespective of when the underlying arbitral proceedings commenced).

The ACA was amended again in 2019. Two amendments are relevant to this context: –

(a) Section 26 of Amendment Act, 2015 was omitted with effect from the start (that is, 23 October 2015).

(b) A new provision, Section 87, was introduced in the ACA which provided that the 2015 amendments will apply: (i) only to those arbitral proceedings which commenced on or after 23 October 2015; (ii) and only to those court proceedings where the underlying arbitration commenced after 23 October 2015.

B. Why exactly were the petitioners aggrieved with the 2019 amendments?

Under the pre-2015 law, as declared by the Supreme Court in several judgments interpreting Section 36 of the ACA (which relates to enforcement), filing an application to set aside an award amounted to an automatic stay on enforcement of that award. The 2015 amendments did away with the automatic stay regime by amending Section 36 and providing that filing a set-aside application does not by itself amount to stay of enforcement, unless the court by an order stays the operation of the award.

Another ancillary provision was inserted—while considering the application for grant of stay the court "shall…have due regard to the provisions for grant of stay of a money decree" set out under the Code of Civil Procedure, 1908 ("CPC"). The CPC provisions contemplate that the applicant who seeks the stay furnishes security for due performance of such decree as may ultimately be binding upon him.

[1] RF Nariman & Navin Sinha JJ.

The petitioner in the lead petition was a construction company. The main respondents were government bodies/companies. The government bodies/companies apparently owe huge sums of money to the petitioner(s) under various award. Their main grievance was that in the 'automatic-stay' regime they suffered a "double-whammy": due to automatic-stay, award-holders like them may become insolvent by defaulting on payment to their suppliers, when such payments would be forthcoming from arbitral awards in cases where there is no stay, or even in cases where conditional stays are granted.[2] Additionally, the award-holder may not bear the fruits of undergoing a long litigation as a result of the automatic stay.

C. The court's decision[3]

C1. The law: does Section 36 actually contemplate automatic stay?

Though the challenge related to the 2019 amendments, the court first considered Section 36[4] of the ACA and those judgments which had ruled that the section impliedly and automatically prohibited enforcement if a set-aside application is filed.

The court held that there is no such implied prohibition in Section 36. It added that the previous Supreme Court judgments on this point wrongly read the provision and ignored Sections 9, 35 and the second part of Section 36.

The following previous judgments were held *per incuriam*: - *National Aluminum Company Ltd. (NALCO)* v. *Pressteel & Fabrications (P) Ltd.*, (2004) 1 SCC 540; *National Buildings Construction Corporation Ltd.* v. *Lloyds Insulation India Ltd.*, (2005) 2 SCC 367; *Fiza Developers and Inter-Trade Pvt. Ltd.* v. *AMCI (India) Pvt. Ltd.*, (2009) 17 SCC 796.

The court's reasoning was as follows: –

(a) The UNCITRAL Model Law is important in understanding the provisions of the ACA since the ACA is explicitly based upon it [citing also to *Chloro Controls (I) Pvt. Ltd.* v. *Seven (sic Severn) Trent Water Purification Inc.*, (2013) 1 SCC 641].

(b) The Model Law provides for "two bites at the cherry" doctrine (referring to Articles 34 and 35 of the UNCITRAL Model Law) [The award-debtor can challenge the award in a set-aside proceeding, and also resist enforcement on permitted grounds].

(c) Section 36 of the ACA does not follow that doctrine. It is to only make clear that when an award made in India becomes final and binding–either because the time for making a set-aside application has expired, or the application was filed but rejected–it shall straightaway be enforced under the CPC. This becomes clear when Sections 36 and 35 are read together.[5]

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[2] How would such petitioners/award-holders benefit monetarily (unless permitted to withdraw the money deposited as pre-condition to stay of enforcement) is not specifically articulated.

[3] The court also considered (i) the constitutionality of the Insolvency and Bankruptcy Code, and (ii) the validity of NITI Aayog's Office Memorandum No. 14070/14/2016-PPPAU of 05 September 2016. Both challenges were rejected.

[4] "36. Enforcement- Where the time for making an application to set aside the arbitral award under section 34 has expired, or such application having been made, it has been refused, the award shall be enforced under the Code of Civil Procedure, 1908 (5 of 1908) in the same manner as if it were a decree of the Court." The courts earlier read the provision to mean that pre-conditions for enforcement (unless the time to make a set-aside application expires, or unless it is refused) indicated there was an implied prohibition on enforcement till the Section 34 application was pending. Hence, an automatic stay on enforcement on mere filing of that application.

[5] 35. Finality of arbitral awards. – Subject to this Part an arbitral award shall be final and binding on the parties and persons claiming under them respectively.

(d) To state that an award when challenged under Section 34 becomes inexecutable because of the language of Section 36, and to infer something negative from that section, is plainly incorrect [disagreeing with *NALCO*, *National Buildings* and *Fiza* cases].

(e) Also, this construction omits to consider the rest of Section 36, which deals with applications under Section 34 that have been dismissed, which leads to an award being final and binding and thus enforceable as a decree.

(f) Such construction also does not consider the opening words of Section 9 of the ACA which specifically enables a party to apply to a Court for reliefs "…after the making of the arbitration award but before it is enforced in accordance with Section 36". *NALCO case* where the court ruled that once a Section 34-application is filed the court had no discretion to pass any interlocutory order, flies in the face of these opening words.

(g) Thus, the reasoning of the judgments in *NALCO* and *Fiza Developers* are *per incuriam* in not noticing Sections 9, 35 and the second part of Section 36 of the ACA. *NALCO* has been followed in *National Buildings* but in following a *per incuriam* judgement, it also does not state the law correctly.

(h) Given the fact that the judgments in *NALCO*, *National Buildings*, and *Fiza Developers* have laid down the law incorrectly, it is also clear that the amended Section 36 is clarificatory in nature, and merely restates the position that the unamended Section 36 does not stand in the way of the law as to grant of stay of a money decree under the provisions of the CPC.

C2. Removal of the basis of the *BCCI* judgment by the Amendment Act of 2019

One of the challenges to Section 87 was that it was enacted without even a mention of the *BCCI* judgment. Further that, the basis of a judgment of the Supreme Court can only be removed if there is a pointed reference to that judgment, which was not the case here. Rejecting this argument, the court held: –

(a) The 2019 Amendment Act removes the basis of *BCCI* by omitting from the very start Section 26 of the 2015 Amendment Act.

(b) Since this is the provision that has been construed in the *BCCI* judgment, there can be no doubt that one fundamental prop of *BCCI* has been removed by retrospectively omitting Section 26.

C3. Constitutional challenge to the 2019 Amendment Act

The court then examined the "constitutional validity" of the introduction of Section 87 into the ACA and deletion of Section 26 (of the 2015 Amendment Act) against Articles 14, 19(1)(g), 21 and Article 300-A of the Constitution of India.

It held that introduction of Section 87 and deletion of Section 26 violated Article 14 of the Constitution of India[6] and it therefore unnecessary to examine the challenge based on Articles 19(1)(g), 21 and 300-A of the Constitution.

In conclusion it held that the *BCCI* judgment, and thus the 2015 amendments too, will continue to apply to all court proceedings initiated after 23 October 2015.

[6] Equality before law: "The state shall not deny to any person equality before the law.

Its reasons were these: –

Firstly, bringing the 2019 amendments on the basis of the Srikrishna Committee Report, but not referring to the *BCCI* judgment, latter in time, is manifestly arbitrary, unreasonable and against public interest: –

(a) The Srikrishna Committee Report (which forms the basis of the 2019 amendments) is of 30 July 2017, which is long before this Court's judgment in *BCCI.* Whatever uncertainty there may have been because of the interpretation by different High Courts disappeared after the *BCCI* judgment.

(b) To thereafter delete Section 26 (of the 2015 Amendment Act) 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, which was enacted pursuant to a detailed Law Commission report which found various infirmities in the working of the original 1996 statute. One of the objects of the ACA and the 2015 Amendment Act was to ensure speedy proceedings and minimal interference of courts. Section 87 however, would result in a completely opposite reaction as it would increase court interference and delays in disposal of arbitration proceedings.

(c) Also, it is not understood as to how "uncertainty and prejudice would be caused, as they may have to be heard again", resulting in an 'inconsistent position'.[7]

(d) To refer to the Srikrishna Committee Report without at all referring to the *BCCI* judgment even after it pointed out the pitfalls of following such a provision, would render Section 87 and the deletion of Section 26 of the 2015 Amendment Act manifestly arbitrary, having been enacted unreasonably, without adequate determining principle, and contrary to the public interest sought to be sub served by the ACA and the 2015 amendments.

(e) A key finding of the *BCCI* judgment is that the introduction of Section 87 would result in a delay of disposal of arbitration proceedings, and an increase in the interference of courts in arbitration matters, which defeats the very object of the ACA, which was strengthened by the 2015 Amendment Act.

Secondly, Section 87 turns the clock backwards, places the well-considered 2015 amendments on a backburner, and therefore is contrary to the object of ACA and 2015 amendments, and arbitrary too: –

(a) Section 87 places the amendments made in the 2015, particularly Section 36, on a backburner. It leads to an anomaly. For this reason, too, Section 87 must be struck down as manifestly arbitrary under Article 14.

(b) Order XLI Rule 5 of the CPC applies in a civil court in an ordinary full-blown appeal.[8] Those appeals are a re-hearing of the original action. But it would not apply to review of arbitral

[7] This is what the Srikrishna Committee Report had said: "The committee feels that permitting the 2015 Amendment Act to apply to pending court proceedings related to arbitrations commenced prior to 23 October 2015 would result in uncertainty and prejudice to parties, as they may have to be heard again. It may also not be advisable to make the 2015 Amendment Act applicable to fresh court proceedings in relation to such arbitrations, as it may result in an inconsistent position. Therefore, it is felt that it may be desirable to limit the applicability of the 2015 Amendment Act to arbitrations commenced on or after 23 October 2015 and related court proceedings."

[8] Under Order XLI, among others, an appeal shall not operate as a stay of proceedings under a decree or order appealed from except so far as the Appellate Court may order, nor shall execution of a decree be stayed by reason only of an appeal having been preferred from the decree; but the Appellate Court may for sufficient cause order

awards under Section 34 in cases of automatic stay, which is a summary proceeding where review on merits is not permissible.[9]

(c) When the mischief of the misconstruction of Section 36 was corrected after a period of more than 19 years by legislative intervention in 2015, to now work in the reverse direction and bring back the mischief itself results in manifest arbitrariness.

(d) Retrospective resurrection of the automatic-stay regime not only turns the clock backwards contrary to the object of the ACA but also results in payments already made under the amended Section 36 to award-holders in a situation of no-stay or conditional-stay now being reversed.

Thirdly, the Srikrishna Committee Report did not refer to the provisions of the Insolvency Code: –

(a) The award-holder may become insolvent by defaulting on its payment to its suppliers, when such payments would be available from arbitral awards if there is no stay, or even in cases where conditional stays are granted.

(b) It would take several years of litigation for the award-holder to realise its fruits, but as a result of the automatic-stay, it would be faced with immediate payment to its operational creditors. Non-payment would expose the award-holders to the rigors of the Insolvency Code.

stay of execution of such decree. Also, conditions of grant of stay are strict—the court must be satisfied that substantial loss may result to the party applying for stay of execution unless the order is made; the application for stay has to be made without unreasonable delay; and security has to be given by the applicant for the due performance of decree or order as may ultimately be binding upon him.

[9] For the summary proceeding point, citing to *Canara Nidhi Ltd.* v. *M. Shashikala*, 2019 SCC OnLine SC 1244; for the review on merits point, citing to *Ssangyong Engineering & Construction Co. Ltd.* v. *NHAI* ,2019 SCC OnLine SC 677.