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SUPREME COURT'S DECISION ON STRIKING DOWN SECTION 87 OF THE ARBITRATION & CONCILIATION ACT AS "MANIFESTLY ARBITRARY"

CASE NOTE

Hindustan Construction Company Ltd. v. Union of India & Ors.

On 27th November, 2019 the Hon'ble Supreme Court of India (comprising the Hon'ble Mr. Justice R. F. Nariman, Hon'ble Mr. Justice Suryakant and the Hon'ble Mr. Justice V. Ramasubramanian) in ***Hindustan Construction Company Ltd. v. Union of India & Ors.,***[1] has reiterated the dictum of *BCCI vs Kochi Cricket Pvt. Ltd.*[2] ("**BCCI**") and held that deletion of Section 26 of the Arbitration & Conciliation (Amendment) Act, 2015 ("**2015 Amendment Act**") and introduction of Section 87 in its place in the Arbitration & Conciliation (Amendment) Act, 2019 ("**2019 Amendment Act**") is wholly without justification and contrary to the object sought to be achieved under the 2015 Amendment Act and the object of the Arbitration & Conciliation Act, 1996 ("**the Act**").

Background of Writ under Article 32 of the Constitution of India

Petitioner being an infrastructure construction company was facing a challenge to execute Awards passed in its favour against Government bodies such as NHAI, NTPC and the PWD. On one hand the Petitioner is liable to be paid an amount of Rs.6700 crores by the Government bodies, on the other hand the Petitioner owed large sums to operational creditors amounting to over Rs.100 crores.

The Petitioner claimed to be subjected to a double whammy because Government bodies are exempt from the Insolvency & Bankruptcy Code 2016 ("**IBC**").

The Challenge

The Writ Petition sought to challenge :

i. Constitutional validity of Section 87 of the Act as inserted in the 2019 Amendment Act and brought into force w.e.f 30th August 2019
ii. The repeal of Section 26 of the 2015 Amendment Act w.e.f 23rd October 2015
iii. Provisions of the IBC which result in discriminatory treatment being meted out to the Petitioner

[1] 2019 SCC Online SC 1520
[2] (2018) 6 SCC 287

Ratio of BCCI Judgment & Observations of the Supreme Court on proposed introduction of Section 87 in the 2018 Amendment Bill

Interpretation of Section 26 of the Amendment Act

Para 25 of the Judgment the Hon'ble Court gives its interpretation to both parts of Section 26 of the Amendment Act, 2015 separated by the word "but" and held that: *"The scheme of Section 26 is thus clear: that the Amendment Act is prospective in nature, and will apply to those arbitral proceedings that are commenced, as understood by Section 21 of the principal Act, on or after the Amendment Act, and to Court proceedings which have commenced on or after the Amendment Act came into force."* which means that the Amendment Act shall apply to (i) Arbitral proceedings commenced after 23.10.15 and (ii) Court proceedings commenced after 23.10.15.

Section 26 of the Amendment Act, 2015

26. Nothing contained in this Act shall apply ***to the arbitral proceedings commenced****, in accordance with the provisions of* ***section 21 of the principal Act****, before the commencement of this Act unless the parties otherwise agree* ***but*** *this Act shall apply* ***in relation to arbitral proceedings commenced*** *on or after the date of commencement of this Act.*

Observations of the Hon'ble Supreme Court on Section 87 of the proposed Arbitration & Conciliation (Amendment) Bill, 2018 in BCCI Judgment

The Hon'ble Court in paragraph 29 of the Judgment goes on to state that the proposed Amendment cannot be looked into at this stage for the interpretation of Section 26 of the Amendment Act for two reasons (i) Section 87 as ultimately enacted, may not be in the form that is referred to the Press Release (ii) A Bill introducing a new and different provision of law can hardly be the basis for interpretation of a provision of law as it stands.

If the Government proposes to enact Section 87 it will defeat the object of the 1996 Act

Section 87 as introduced by Section 13 of the 2019 Amendment Act w.e.f 30th August 2019 reads as follows:

87. Unless the parties otherwise agree, the amendments made to this Act by the Arbitration and Conciliation (Amendment) Act, 2015 shall

(a) not apply to—

(i) arbitral proceedings commenced before the commencement of the Arbitration and Conciliation (Amendment) Act, 2015;

(ii) court proceedings arising out of or in relation to such arbitral proceedings irrespective of whether such court proceedings are commenced prior to or after the commencement of the Arbitration and Conciliation (Amendment) Act, 2015;

(b) apply only to arbitral proceedings commenced on or after the commencement of the Arbitration and Conciliation (Amendment) Act, 2015 and to court proceedings arising out of or in relation to such arbitral proceedings

Issues before the Supreme Court

Whether the 2019 Amendment Act removes the basis of the BCCI Judgment ?

The Petitioner relied on the Judgments of the Apex Court which held that a Courts decision must always bind unless the conditions on which it is based are so fundamentally altered that the decision could not have been given in the altered circumstances[3]. The Petitioner further submitted that introduction of Section 87 amounts to encroachment on the judicial powers as held in *Goa Foundation vs State of Goa*[4]

Held

Yes. Section 15 of the 2019 Amendment Act removes the basis of BCCI Judgment by omitting from the very inception Section 26 of the 2015 Amendment Act. There can be no doubt that the fundamental proposition of the BCCI Judgment has been removed by retrospectively omitting Section 26 altogether from the very day when it came into force i.e 23rd October 2015.

[3] Shri Prithvi Cotton Mills Ltd & Anr. Vs Broad Borough Municipality & Ors. (1969) 2SC 283 and State of Tamil Nadu vs Arooran Sugars Ltd. (1997) 1 SCC326

[4] (2016) 6SCC 602

Examination of Constitutional Challenge to the 2019 Amendment Act

I. The Srikrishna Committee Report dated 30th July 2017, which is long before the BCCI Judgment recommended the introduction of Section 87 owing to the fact that there were conflicting High Court Judgments on the reach of the 2015 Amendment Act. Whatever uncertainty may have been because of the interpretation by different High Courts disappeared as a result of the BCCI Judgment. To thereafter delete Section 26 altogether from the 2015 Amendment Act and introduce Section 87 in its place **was wholly without jurisdiction and contrary to the object sought to be achieved by the 2015 amendment Act** which found various infirmities in the working of the original 1996 statute.

II. The Amendment Act 2019 only referred to the Srikrishna Committee Report (without at all referring to this Court's Judgment) even after the Judgment pointed out the pitfalls of following such an interpretation, **would render Section 87 and the deletion of Section 26 of the 2015 Amendment Act manifestly arbitrary.**

III. The Apex Court has held in a catena of judgments that Courts cannot interfere with an Arbitral Award on merits. Therefore the anamoly of Order XLI rule 5 of the CPC applying in case of a full blown Appeal and not being applicable by reason of Section 36, when it comes to review of arbitral awards, **is itself a circumstance which militates against the enactment of Section 87, placing the amendments made in 2015 on a backburner.**

IV. The mischief of misconstruction of Section 36 was corrected after a period of more than 19 years by legislative intervention in 2015, **bringing back the mischief itself results in manifest arbitrariness**. The retrospective resurrection of an automatic stay not only turns the clock backwards contrary to the object of the 1996 act and the 2015 Amendment Act but also results in payments already made under the amended Section 36 to award holders be returned to the judgement debtor.

V. **The Srikrishna Committee Report did not refer to the provisions of the IBC and the consequences of applying Section 87** i.e the award holder may become insolvent by defaulting on its payment to its suppliers, when such payments would be forthcoming from arbitral awards in cases where there is no stay or even in cases whether conditional stays are granted.

The result is that the BCCI Judgment will continue to apply so as to make applicable the salutary amendments made by the 2015 Amendment Act to all Court proceedings initiated after 23rd October 2015.

Constitutional Challenge to the Insolvency Code

The Petitioner suggested that in order to recover the monies from Government bodies, the definition of 'corporate person' contained in Section 3(7) of the IBC should be read without the words "with limited liability" contained in the definition or have Section 3(23)(g) of the IBC which is the definition of 'person' read into the aforesaid provision.

A Government Body which performs governmental function, obviously cannot be taken over by a resolution professional under the IBC or by any other corporate body. Nor can such authority ultimately be wound up under the IBC.

Further Following the Judgment of *Mobilox Innovations (P) Ltd. v. Kirusa Software (P) Ltd.*[5] the Apex Court held 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 outside the clutches of the IBC. Therefore, the Government bodies who owe the Petitioner moneys under the Award (which are challenged) will fall outside the clutches of the IBC.

The Court held that the challenge to the provisions of the IBC, was wholly devoid of merit

Conclusion on facts

There is a factual dispute between the parties relating to (i) the exact quantum of the arbitral awards in favour of the Petitioner due from the government bodies (ii) the amounts which have already been paid and/or deposited by the Government bodies in favour of the Petitioner (iii) whether the stay orders of the competent courts were passed in respect of the arbitral awards, and if so whether they were under the automatic stay mode or not. It is settled law that when exercising its jurisdiction under Article 32 of the Constitution, the Court cannot embark on a detailed investigation of disputed facts.[6]

[5] (2018) 1 SCC 353

[6] Gulabdas & Co. vs Asstt. Collector of Customs AIR 1957 SC 733, Surendra Prasad Khugsal vs Chariman MMTC 1994 Supp. (1) SCC 87, Sumedha Nagpal vs State of Delhi (2000) 9 SCC 745

Concept of Manifest Arbitrariness

Manifest Arbitrariness in a legislation is ground for a constitutional Court to strike it down as violative of Article 14 of the Constitution of India. The test to determine 'manifest arbitrariness' is to decide whether the enactment is drastically unreasonable and/or capricious, irrational or without adequate determining principle.

In the 1996 Mc Dowell case[7], the Apex Court took a view that statutes cannot be struck down on the ground of arbitrariness. It was held in that judgment as follows

"No enactment can be struck down by just saying that it is arbitrary or unreasonable. Some or other constitutional infirmity has to be found before invalidating an Act. An enactment cannot be struck down because the Court thinks it unjustified. Parliament and legislatures, composed as they are of the representatives of the people, are supposed to know and be aware of the needs of the people and what is good and bad for them. The Court cannot sit in judgment over their wisdom."

This doctrine saw its revival in the judgment of Justice Nariman in Triple talaq case[8] when the Court observed that Mc Dowell case was per incuriam as it did not notice judgments of Constitution Bench in *Ajay Hasia vs Kahlid Mujib Sehravardi*[9] and that of a co-ordiante bench in *K.R Lakshmanan (Dr.) v State of Tamil Nadu*[10].

This doctrine has been again later invoked in his Judgments striking down criminalisation of homosexuality and adultery in *Navtej Singh Johar vs Union of India*[11]

Though unsuccessful, the challenge made against the constitutional validity of *IBC in Swiss Ribbons vs Union of India*[12], was largely relying on this doctrine.

[7] State of AndhraPradesh vs Mc Dowell & Co. (1996) 3 SCC 709
[8] Shayara Bano vs Union of India (2017) 9 SCC 1
[9] (1981) 1 SCC 722
[10] (1996) 2 SCC 226
[11] (2018) 1 SCC 791
[12] (2019) 4 SCC 17

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