



CRITICAL ANALYSIS OF THE CONSTITUTIONALITY OF SECTION 87 OF
ADR

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CRITICAL ANALYSIS OF THE CONSTITUTIONALITY OF SECTION 87 OF ADR

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1. ABSTRACT

Historically, the parties in favour of whom the arbitration award is passed have faced numerous challenges in realising the award. This further augmented with challenged of arbitration award debtors which ultimately lead to automatic stay of arbitration proceedings. On 27 November, 2019, the Court decided in the case titled Hindustan Construction Co. Ltd. v. Union of India. The Court held the vires of the newly inserted S. 87 of the Arbitration Act, 1996 to be unconstitutional since it was considered to be “manifestly arbitrary under article 14 of the Indian Constitution”. This judgment further provides an insight into the Interaction between the two laws i.e., the Constitutional Law of India and Arbitration Act, 1996(hereinafter “Act of

1996”). The paper seeks to provide an overview of the constitutionality of Section 87 of the 1996 Act and also its legislative history and will also discuss in detail about the Hindustan Construction case and its legal impact on arbitration proceedings.

2. INTRODUCTION

In the Hindustan Construction case, the Apex Court held that section 87 of the “Act of 1996” violated the vires and declared it as unconstitutional through an amendment in 2019. It was yet another watershed moment when it comes to Arbitration jurisprudence in India.

Section 87 of the Act of 1996 provided for the remedy of automatic stay of award if the award debtor had moved to court to initiate the proceedings setting aside the award against him under section 34 proceedings of the Act of 1996. The problem was sought to be addressed via the medium of the Act of 2015(“amendment Act,2015”) amendment to the Act of 1996 (“2015 Amendment Act”). This amendment removed the difficulty of automatic stay with respect to awards being challenged under Section 23of the Act of 1996.

Three judges' bench of the Supreme Court headed by Justice RF Nariman said that "it turns the clock back and pushes the firms into insolvency due to the delay in enforcement of awards".

3. BACKGROUND

• PRE- AMENDED ACT

The Supreme Court of India interpreted section 34 & 36 of the Act in NALCO v. Pressteel & Fabrication ® Ltd. & Anr (NALCO Judgement), and Fiza Developers and Inter-trade Pvt. Ltd. v. AMCI (India) Pvt. Ltd. (Fiza Judgement) it was held that an award would be enforced in the similar manner as it was a decree of the court but only after raising an application before the court to set aside the arbitral award had passed under section 34 of the Act of 1996. In simple words the court explained that under section 34 there was an implied prohibition on enforceability of the award till the application was disposed.

Herein is the provision of Section 36 of the Act of 1996 as it stood prior to 2015 amendment:

"Enforcement. -Where the time for making an application to set aside the arbitration 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 in the same manner as if it were a decree of the Court."

In clear terms by filling any application under section 34 to set aside an award would automatically put stay on the operation of the award. This further resulted in stay on payments thereunder making the award holder stand in position where he stands to be deprived from the true fruits of the resultant award. In simple words, he cannot recover the awarded amount in spite of having an award in his favor.

The court held similar view in the Fiza Developers case wherein the Court in regard to Section 36 of the Act prior to 2015 summarized that until any application which is filed under Section 34 had been dismissed, the award holder cannot take the benefit of the arbitral award.

• POSITION UNDER THE 2015 AMEDEMMENT ACT

In 2015, certain amendments were made to the act which created another problem. There was no clarity as to how to apply the amended Arbitration Act,2015. Further there was no clarity as to whether or not the enforcement proceedings which are stayed by the automatic stay provision would continue in cases which were pending at the commencement of the new amendment also it was unclear on the applicability of the application of the amended provisions and its application of the fact that whether still applies to the court proceedings that arose from the arbitral award given before the

commencement date of 23rd October , 2015.

With reference to Section 26, 2015 Amendment it was made certain that the new 2015 amendment will be applicable on arbitration proceedings, that had commenced before the date of implementation i.e., 23rd October 2015. Further, the Supreme Court in its following judgement in the BCCI case made it clear that section 26 of the 2015 amendment was prospective in nature. It clearly states that it would apply to all court proceedings irrespective of their commencement date.

While the BCCI Case was ongoing in the court, the amendment for the Arbitration and conciliation bill, 2018 was approved by the legislature. It consisted of Claus 87 which provided that the amendment act of 2015 shall be applicable only on those arbitral cases which commenced before the date of commencement which is i.e., October 23,2015. The Hon'ble Supreme Court advised the then government not to insert Section 87.

However, in 2019, the Amendment) Act of 2019 was passed which included Claus 87 and it further repealed S,26 of the Amendment Act 2015.

The constitution validity of section 87 of the arbitration act was challenged by the petitioners in the BCCI Case. The Judgment given in the BCCI Case clearly stated that there exist no premise to provide for an no

automatic stay on awards which was there before. With 2019 Amendment, the petitioners presented the challenge to BCCI case and further tested the constitutionality of section 87.

4. ARBITRATION AND CONCILIATION ACT 2019 – THE ADVENT OF SECTION 87

The 2019 amendment in the Act of 1996 made significant change in the arbitration laws of India. Many new important amendments were made by the 2019 amendment one of the major amendments being insertion of section 87. According to section 87, the Amendment of 2015 was to apply to the proceedings which existed prior to the implementation of the act and thus before its operation commenced. This also led to the 2019 Amendment deleting the erstwhile section 26 which was inducted by the 2015 Amendment.

The main impact of section 87 was that it totally nullified the BCCI judgment which was previously passed the Apex court in its consideration of the 2015 amendment act. This then led to the restoration of the previous provision of automatic stay on arbitral awards if any petition was being filed in the arbitration act under Sec 34 before the Cut-off Date i.e., October 23,2015.

• ARGUMENTS OF THE PETITIONER

The Petitioner argued: -

- 1) That the BCCI Judgment was not considered while introducing section 87 only the report submitted by Srikrishna Committee was taken as a reference. This overturned the judgment and did not even remove its the very basis.
- 2) That the section 87 is violative to the articles of Indian constitution - 14,19,21 and 300A making it disproportionate as well as arbitrary in nature.
- 3) That the constitutionality of the IBC is arbitrary and violates Article of the Indian Constitution

• **ARGUMENTS OF THE RESPONDENTS**

The respondent argued not to delete section 26 which was introduced by the 2015 Act and to insert section 87 by 2019 amendment in the Act. By considering the BCCI Judgment the respondent put forward the argument that the judgment given in BCCI was only declaratory in nature.

It further contended that the removal of section 26 deprives the very basis of the ruling held in BCCI Judgment. The respondent also argued that IBC was for the reorganization of corporate person and not for the recovery proceedings. Also, the petitioner cannot take the benefit of Section 3(7) of the IBC as the case involved a

statutory body i.e., the National Highway Authority of India.

And lastly, the parliament has the exclusive domain to set a cut-off date which is beyond the jurisdiction of the court.

• **RULING IN THE CASE OF HINDUSTAN CONSTRUCTION COMPANY CASE**

In the Hindustan construction case, the new amendment of 2019 was questioned before the Supreme court. The question was raised against the introduction of S. 87 and the consequential removal of sec 26 of 2015 amendment for violation of article 14 of the Indian constitution. As a result, the Supreme Court on 27th November 2019 passed a judgement in Hindustan Construction Company case and struck down sec 87 of the Arbitration Act and the deletion of section 26 of the arbitration and conciliation Act 2015.

A writ petition challenging several provisions was put before the Supreme Court under Article 32 of the Indian Constitution and brought before the court some major issues as under: -

- That whether the Amendment Act of 2019 hinders the very genesis on the basis of which the judgment was given in the BCCI Case by the Supreme Court?
- That whether the newly inserted Sec 87 of the Act of 2019 and the removal of

sec 26 from the amendment act of 2015 is in violation of article 14, 19(1) (g) , 21 & 300A of the Indian constitution ?

- That whether Article 14 & 19(1) (g) of the Indian constitution being violated of the IBC, 2016.

5. CONSTITUTIONALITY OF SECTION 87 OF THE ARBITRATION ACT

The hon'ble supreme court made the following observations which can be helpful in analyzing the constitutionality of section 87.

- Firstly, the 2019 amendment was not specifically made in reference to the BCCI Case but it was made specifically focusing on the pitfalls of sec 87 and also about the importance of having sec 26 in the Arbitration Act which was earlier deleted. In the case of BCCI, the basis finding was that the Section 87 may result into delay in the arbitral proceedings and also might increase the court's interference in the matters.
- Secondly, an appeal will not act as a stay unless the appellate court so orders as per CPC 1908 however when it comes to reviewing the arbitral laws the same rule is not applicable due to the concept of automatic stay. Now this further violates the article 14 of the Indian constitution making an

appropriate ground to stuck down section 87.

- Thirdly, the disease which was cured after a period of 19 years in 2015, section 87 was turning the clock backwards but also resulted in payments already made under the amended sec 36 being reversed. Therefore, the supreme court held that the decision given by the court in BCCI shall continue to apply.
- Fourthly, it was observed in the report given by Srikrishna Committee Report that the provisions of the IBC did not because as a result of an automatic stay, "the award holder may become insolvent by defaulting on payments to its creditors when such payments would have been ordinarily forthcoming from the arbitral awards."

Viewing all the circumstances, the supreme court decided to stuck down the insertion sec 87 and deletion of sec 26 of Arbitration and conciliation Act 2015 on the sole grounds of being manifestly arbitrary and violating the principles of article 14 of the Indian Constitution.

6. CONFLICT BETWEEN ARTICLE 14 & SECTION 87

The court declared section 87 as "manifestly arbitrary" as being violative to article 14 of the Indian constitution. Article 14 deals with equality before law so the

question here arises is whether unequal treatment of parties in court proceedings before and after the cut of date justified.

The supreme court held that there are two primary grounds on which section 87 is manifestly arbitrary: -

- First, it is beyond the objective of public interest aimed to achieve through the 1996 act.
- Secondly, it creates an inconsistency between appeals under CPC.

In the first case the court holds the view that the application of the 2015 amendment would defeat the objective of public interest in speedy disposal of arbitral matters. Now to adjudicate this matter it is import to check what rights of an individual are at stake and whether the speedy disposal of cases can dispense the public interest. For example, when an application is filed under section 34 before the Act of 2015 came into force and further, does the parties have a substantive right to resist the enforcement of such application. To support one's substantive right section 34 clearly talks about the grounds on which a person can use his substantive right to set aside an arbitral award like invalidity of the arbitration agreement or be it incapacity of the parties to the arbitral agreement. In the BCCI case it was declared that there was no substantive right available to resist the enforcement of an arbitral award, if the

court wanted to recognize such rights against enforcement, then it could have followed this approach.

Furthermore, in the CPC (code of civil procedure) the reliance on Order XLI Rule 5 is also misplaced. In CPC under Order XLI Rule 5, an appeal shall not prevent the execution of the judgement. Now the court has a question before itself that whether the previous position was arbitrary or whether the retrospective application of the amendment is arbitrary in nature. To prove section 87 as manifestly arbitrary there needs to sufficient valid grounds before the court. With this the court has strike down sec 87 of the 1996 act by using Article 14.

7. CONSTITUTIONALITY OF DELETION OF SECTION 26 OF 2015 AMENDMENT

Section 26 of the 2015 amendment specifically stated the prospective applicability of 2015 amendment. The Supreme Court, in the judgment made a strong differentiation between sec 26 of the 2015 amendment and Sec 87. The court found that sec 87 states that the proceedings of the court are "merely parasitical" and primary focused on the date of commencement of the proceedings to check whether the 2015 amendment is applicable or not.

The court held that in the BCCI case, section 26 is very well explained and that

the deletion of sec 26 of the 2015 amendment along with the insertion of Section 89 by 2019 amendment will reinforces the concept of automatic stay. The 2019 amendment mentioned the object and reasons behind introducing section 87 to the Act in para 6(vi).

8. CONSTITUTIONAL CHALLENGES TO THE IBC

It was held that as far as the statutory body, that is, NHAI was concerned, the Petitioner's argument as to deletion of the wording in Sec 3(7) of the IBC, 2016 or addition of certain words from Sec 3(23)(g) of the IBC into Sec 3(7) of the IBC was not acceptable. The National Highway Authority of India was a statutory body that functioned which duly served as functionary to the Central Government as well as under IBC or any other corporate body all these functions of government could not be taken over by a resolution professional. It was also impossible that such a statutory body could be ultimately wound-up under the provisions of IBC. Relying upon its judgment in the Pioneer Urban Case, the Court held that the IBC is "not meant to be a recovery mechanism", what it did in fact intend was the resolution of stressed assets. Also, the argument that an Order VIII-A type mechanism as under the CPC was not barred under IBC was totally rejected. It was observed that a

dispute must be between the parties as provided under the IBC. The IBC was not a debt recovery legislation wherein by some theory of indemnity or contribution debt owed to the Petitioners could be fastened on to public sector units.

9. ANALYSIS AND CONCLUSION

All in all, the current amendment in the arbitral laws of India has been very criticized and debated over. 2019 Amendment Act has been seen as a plague as the insertion of section 87 was uncertain and was not even considered keeping in view the Judgments of the Supreme Court despite of these judgments the government still went forward to amended the arbitral laws of India however such amendment was found to be arbitrary. To a large extend the supreme court in its BCCI Judgment resolved issues related application of the amendment introduced by the Act of 2015. To a far extend it is safe to say that the decision taken by the court in HCC case is sound in law. The case also gave a new shape to the arbitral laws and reinstated the faith and increased the scope of arbitration in India making India courts arbitration-friendly.

Even the judgement give in BCCI case says that the 2015 amendment Act have retrospective applicability which means all those arbitration proceedings which began

before or after the implementation i.e., October 23,2015. Further this judgement has removed all the Barriers that deprives the right of the award holder from the fruits of its award.

The judgement by far changed the arbitration regime in India with quick disposal of the pending cases pending before the courts.

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