IBC process: The multi-layered arbitration mess

By: The Financial Express
Published: December 9, 2019 12:27:45 AM

SC did well to invalidate Section 87 of the Act, but whether govt will pay dues or respect Arbitration Act remains to be seen

X

While the Supreme Court (SC) has just ruled in favour of HCC in a case that will have a bearing on the entire infrastructure sector, it is not clear how soon HCC will get the funds, or whether the government has learned any lessons from this.

One of the manifestly unfair aspects of the insolvency resolution process—this is not, though, the fault of the Insolvency and Bankruptcy Code (IBC)—has always been the fact that, while various arms of the government don't pay their dues to private firms for a long time, government-owned banks are free to take these same companies to the insolvency courts when they don't get paid; a good example of this is Ajit Gulabchand, whose Lavasa city project was taken by the banks to IBC for non-payment of dues while his Hindustan Construction Company (HCC) is owed over Rs 6,000 crore by the government's National Highways Authority of India (NHAI). While the Supreme Court (SC) has just ruled in favour of HCC in a case that will have a bearing on the entire infrastructure sector, it is not clear how soon HCC will get the funds, or whether the government has learned any lessons from this.

Though the government is keen to promote India as a global arbitration hub, and also to use arbitration to clear a large part of the 3-crore-plus cases in various courts (or at least the ones relating to commercial contracts), its own conduct is less than exemplary, and that is what the HCC case was all about.

While the spirit of arbitration, globally, has been that arbitration awards are binding on both parties—unless there has been some fraud in the awards process—the government has violated this principle on most occasions. In the case of firms like Vodafone and Cairn Energy (on the foreign side) and Reliance Industries (on the Indian side) who invoked international arbitration when their dispute with the government could not be resolved amicably, the government used every trick in the book to delay this. This ranged from arguing, in the case of Vodafone and Cairn, that a tax dispute could not be arbitrated to delaying, in the case of Reliance, the appointment of arbitrators.

In other cases, such as the Antrix-Devas one (Antrix is the commercial arm of ISRO), where a global arbitration went against the government, the award was challenged in a local court, and that is where matters stand. While the government

wanting to delay an award where it had to shell out money is still understandable, it tried to thwart an award in the Tata-Docomo case, where it had no financial stake; in this case, when the award went against the Tatas, the government argued that the Tata-Docomo contract was itself illegal, so the award was incorrect. Fortunately for the Tatas (who wanted to pay the damages!) and Docomo, the judge said that the award would be upheld, and if the Tatas paying Docomo meant the group was in violation of Fema, it could pay the penalty for that as well.

To return to the HCC story, the petition was about Section 87 that was inserted into the arbitration law a few months ago, and allowed an automatic stay on all arbitral awards handed out in proceedings that commenced before October 2015; all that it needed was for someone, like NHAI after it had lost the arbitration, to challenge it in court. HCC's lawyers, not surprisingly, argued that the section violated the Constitution, and even the principle of the arbitration law, since the award is no longer binding. For arbitration proceedings that started after October 2015, there was no confusion since the 2015 amendment in the law said that companies—or say an NHAI—had to argue in court to get a stay; it was no longer automatic, as was the case prior to October 2015.

What is amazing, as the SC ruled last week, is that the government brought in Section 87 despite the fact that there was an SC ruling—BCCI vs Kochi Cricket, 2018—which clarified 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 Arbitration Act, 1996, which was strengthened by the 2015 Amendment Act". Indeed, while the government brought in Section 87 citing the Justice Srikrishna panel recommendation, the SC said this was made in July 2017 whereas the BCCI case ruling was later; the government, then, had to go by what the court said.

What is unfortunate, however, is that while the SC removed a big obstacle for firms like HCC that are trying to get back their dues via arbitration courts, the court seems to have agreed with the Solicitor General in that a writ petition filed under Article 32 of the Constitution cannot be converted into a recovery proceeding; in other words, HCC will have to go back to each high court where NHAI got a stay, and get it to enforce each individual arbitration award.
While there is a 2016 NITI Aayog circular that says 75% of the award must be paid immediately even in the case of a stay order, there is a catch. Since the 75% has to be deposited with the court, the company that won the arbitration award gets no relief. While challenging the HCC figures on how much was due to it, the government affidavit itself said the "PSUs had already paid/deposited a substantial amount (approximately 83.30%) payable by them under the arbitral awards"; deposited is the operative term here. If the money has to be got by the company, it needs to give a bank guarantee for the amount, and an additional amount of 10% also needs to be given; but, many of the companies are too financially stressed to be able to get a bank guarantee.

So, if this SC ban on the automatic stay is really to help, not only will courts have to be strict about granting stays on arbitration awards—only if there is prima facie evidence of fraud in the award should this be given—the government will have to ensure that banks are even willing to provide guarantees in such cases; it is not clear how firms who can't afford the bank guarantees are to be helped. Also, if PSUs or government bodies/departments are to keep challenging arbitration awards as a matter of course, as they do now, it defeats the purpose; that will require a near-complete change in mindset on the part of the government.