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GARG BUILDERS V BHARAT HEAVY ELECTRICALS LIMITED: SUPREME COURT HOLDS THAT AN ARBITRATOR CANNOT GRANT PENDENTE LITE INTEREST IF THE CONTRACT BARS PAYMENT OF INTEREST

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INTRODUCTION

In the recent case of Garg Builders v Bharat Heavy Electricals Limited [Civil Appeal No. 6261 of 2021], a two-judge bench of the Supreme Court of India (Supreme Court) held that an arbitrator cannot grant pendente lite interest when the contracting parties have freely and expressly opted out of receiving interest under the contract.

The Supreme Court's verdict holds special significance since (i) it analysed the scope of the interest barring clause under the contract between the parties vis-à-vis Section 28 of the Indian Contract Act, 1872 (Contract Act); and (ii) it reinforced the well-founded principle that an arbitrator is a creature of contract, and its powers cannot traverse beyond the purview of the contract.

BACKGROUND

Garg Builders (the Appellant) entered a contract dated 24 October 2008 (Contract) with Bharat Heavy Electricals Limited (the Respondent) for construction of a boundary wall at the Respondent's power plant in Delhi. Under Clause 17 of the Contract, the parties agreed that the Respondent shall not pay any interest on the earnest money deposit, security deposit, or on any monies (emphasis supplied) due to the Appellant under the Contract.

Soon thereafter, disputes arose between the parties which were referred to a sole arbitrator (Arbitrator). Under the arbitral award, the Arbitrator awarded pendente lite and future interest at the rate of 10% p.a. on the value of the award amount to the Appellant from the date of filing the claim petition (i.e., 2 December 2011) till the date of realisation of the award amount (Award).

The Respondent challenged the Award under Section 34 of the Arbitration & Conciliation Act, 1996 (A&C Act) before the Delhi High Court, on various grounds. One such ground was that the Arbitrator travelled beyond the terms of the Contract in awarding pendente lite interest on the Award since the same was expressly barred under the Contract. Accordingly, a Single Judge Bench of the Delhi High Court vide order dated 10 March 2017 set aside the Award to the extent of award of pendente lite interest. The aforesaid order dated 10 March 2017 was upheld by the Division Bench of the Delhi High Court vide order dated 19 September 2017 (Impugned Order).

Aggrieved by the Impugned Order, the Appellant filed an appeal before the Supreme Court.

THE SUPREME COURT'S DECISION

The Supreme Court's judgment can be broadly sectioned into three parts.

First, the Supreme Court dealt with the law relating to the award of interest under the A&C Act. It observed that the A&C Act and its provisions give paramount importance to the contract entered into between parties. Accordingly, the power of the arbitral tribunal under Section 31(7)(a) of the A&C Act to grant pre-reference and pendente lite interest on an award is subject to any agreement to the contrary. The Supreme Court held that Clause 17 of the Contract categorically barred the payment of interest on all monies due to the Appellant. The Supreme Court rightly observed that the words “moneys [*sic*] due to the Appellant” will include the amount awarded by the Arbitrator.

Thereafter, the Supreme Court referred to and relied upon various judicial pronouncements in relation to powers of the arbitral tribunal to award interest under the A&C Act and observed that the legal position in that regard was settled. The ratio of the aforesaid case laws was to the effect that if a contract expressly barred granting of pre-award interest, the arbitrator cannot grant such interest.

Lastly, the Supreme Court determined whether Clause 17 of the Contract is ultra vires Section 28 of the Contract Act. Under Section 28 of the Contract Act, *inter alia*, a contract shall be void if (i) it absolutely restricts a party from enforcing its contractual rights by the usual procedure before ordinary courts; or (ii) it limits the time within which contractual rights may be enforced. Exception I to Section 28 of the Contract Act upholds the legal validity of a contract whereby parties agree to refer disputes arising out of such contract to arbitration. After taking note of Section 28 of the Contract Act, the Supreme Court analysed whether contracts barring payment of interest extinguish the rights of parties. In doing so, it referred to the provisions of the Interest Act, 1978 (Interest Act). Section 3(3) of the Interest Act allows parties to contract out of receiving interest. In light of the above, the Supreme Court concluded that when there is express statutory permission for parties to contract out of receiving interest, and they have done so without vitiation of free consent, it is not open for the arbitrator to grant pendente lite interest. In these circumstances, the Supreme Court held that Clause 17 of the Contract was not ultra vires Section 28 of the Contract Act.

COMMENT

A key takeaway from this judgment is the emphasis on party autonomy. If two parties consensually and expressly contract out of payment of interest, then the parties’ intention must be given effect to. The present case reinforces the principle that an arbitral tribunal must exercise its powers within the contractual framework, since, the tribunal is, in essence, a creature of contract.

In light of the above, when drafting an interest barring clause under a contract, contracting parties may consider explicitly mentioning the stipulation that grant of pre-reference and pendente lite interest shall be prohibited under the provisions of the contract. This may aid parties in mitigating future risks and uncertainties and effectively enforce their rights under the contract. It will also ensure that the arbitral tribunal is expressly and strictly bound by the terms of the contract as there is no scope for ambiguity.

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