

8th March, 2022

“POWER TO GRANT INTEREST-SCOPE OF SECTION 31(7)(A)” CASE STUDY OF GARG BUILDERS VS. BHARAT HEAVY ELECTRICALS LIMITED 2021

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1. **Introduction**
 - 1.1 The Supreme Court in *Garg Builders vs. Bharat Heavy Electricals Limited 2021 SCC OnLine SC 855*, has dealt with the question as to whether interest *pendente lite* (i.e. interest pending adjudication of disputes) can be granted on the amount of an Award when the agreement contains terms barring payment of interest. The powers of Arbitrator within the scope of Section 31(7)(a) of the Arbitration and Conciliation Act, 1996 (the said Act) was also discussed in detailed by the Hon'ble Court.
 - 2.7 The Ld. Single Judge set aside the Award only to the extent of imposition of *pendente lite* interest on the ground that the Arbitrator travelled beyond the terms of the contract in granting interest on the awarded amount.
2. **Brief Facts**
 - 2.1 The Appellant (Garg Builders) participated in a tender for construction floated by the Respondent (BHEL) and was successful.
 - 2.8 The order was upheld by the Ld. Division Bench and the appeal of Garg Builders was dismissed.
 - 2.2 Clause 17 of the Contract entered between the parties provided that no interest would be payable by BHEL on Earnest Money Deposit, Security Deposit or any moneys due to Garg Builders.
 - 2.9 Thereupon, Garg Builders approached the Hon'ble Supreme Court
 - 2.3 Disputes arose between the parties and the matter was referred to arbitration.
 3. **Issues**
 - 3.1 Whether the Arbitrator can travel beyond the terms of the contract?
 - 3.2 Whether Clause 17 was ultra vires in view of Section 28 of the Indian Contract Act, 1872 (ICA)?
 - 2.4 Garg Builders (claimants before the Arbitrator), inter-alia, also prayed for pre-reference, *pendente lite* and future interest. In other terms, interest was claimed from the date when the amount was due till payment thereof.
 4. **What is interest pendente lite?**
 - 4.1 *Pendente lite* is a Latin term where *lite* literally translates to litigation. *Pendente lite* refers to litigation which is pending decision or pending before a court of law or is in the process of adjudication and final decision in such litigation has not been passed yet.
 - 4.2 The interest component granted to a party on a sum awarded, decreed or allowed, for the period during which the litigation was pending becomes interest *pendente lite*.
 - 4.3 Interest is also granted for pre-reference period which is the period between the date on which the cause of action arose/amount became due and the date on which reference was made to the arbitrator or matter filed before the court.
 - 2.5 Arbitrator interpretation and relying on Clause 17 concluded that since the payment of pre-suit, *pendente lite* or future interest was not restricted in the said Clause, the claim for interest cannot be denied and awarded the same.
 5. **Scope of section 31(7) of the said Act**
 - 2.6 BHEL (respondent before the Arbitrator) filed an application under Section 34 of the Act for setting aside the Arbitration Award.

5.1 Section 31(7)(a) states that where an arbitral award is for payment of money, the Arbitral Tribunal may grant preference and *pendete lite* interest, unless the parties have agreed otherwise.

5.2 The section allows a party to waive the claim over right to interest.

6. Section 28 of Indian Contract Act, 1872 (ICA)

6.1 Section 28 (Agreements in restraint of legal proceedings, void) of the ICA provides that agreements which restrict a person from initiating legal proceedings or enforcing his rights are void to such extent.

6.2 Exception 1 to Section 28 clarifies that contracts which mandate parties to refer the dispute to arbitration are an exception to the provision. Reference to arbitration does not restrict the rights of a person, rather dictates the forum and means for adjudication of the disputes.

6.3 The Interest Act, 1978 deals with law relating to payment of interests. Section 3(3) thereunder provides that parties are allowed to waive claim of interest by way of express agreement.

6.4 By entering into the contract, the appellant in this case, had thus agreed to such waiver.

6.5 The court held that since waiving of interest by means of an agreement has been approved by the legislature both under the Interest Act as well as the Arbitration and Conciliation Act, 1996, such clauses cannot be termed as void.

7. Observations

7.1 In *Sayeed Ahmed and Company vs. State of Uttar Pradesh [(2009) 12 SCC 26]* and *Sree Kamatchi Amman Constructions vs. Divisional Railway Manager (Works) Palghat [(2010) 8 SCC 77]*, the court held that Section 31(7) allows the arbitrator to decide granting interest but same cannot be awarded if it is barred by the contract, which have been agreed by the parties.

7.2 In *Sri Chittaranjan Maity vs. Union of India [(2017) 9 SCC 611]*, the Hon'ble Supreme Court had categorically held that when a contract prohibits payment of interest, the Arbitrator must refrain from awarding the interest. The decision was also relied in *Ambica Construction vs. Union of India [(2017) 14 SCC 323]* wherein the court had held that mere bar on payment of interest shall not be sufficient to deny right of interest to a party.

7.3 It was observed by the court in *Sri Chittaranjan Maity (supra)* that since *Ambica Construction (supra)* arose out of the Arbitration and Conciliation Act, 1940, the same cannot be taken into consideration in a matter arising out of Arbitration and Conciliation Act 1996.

7.4 The court observed that *Raveechee and Company vs. Union of India (2018) 7 SCC 664* would have no application since the same was also based on the 1940 Act.

8. Decision

8.1 The Supreme Court held interpreting the foreplay between Section 28 of the ICA and clause 17 of the contract held that reference to arbitration does not violate Section 28 and upon reference to Arbitration, parties governed by Section 31(7)(a) which empowers parties to waive their right to interest.

8.2 Infact Section 3(3) of the Interest Act, 1978 also explicitly allows parties to waive their right for interest.

8.3 Thus, the Hon'ble Court held that once the parties agreed to waive interest through a contract which had a valid consent, it was not upon the Arbitrator to grant any interest.

8.4 The Hon'ble Court also observed that the Arbitration and Conciliation Act, 1996 gives paramount importance to the contract entered between the parties and any act of Arbitrator travelling beyond the contractual terms is liable to be set aside.

8.5 Hon'ble Court declaring clause 17 not to be ultra vires, thus upheld the order of the Ld. Single Judge as well as Ld. Division Bench setting aside the Award towards claim for interest.

9. Conclusion

9.1 Hon'ble Court upheld the sanity of the written contract between the parties, which is a welcome step since it has become a general practise in arbitration proceedings to ignore fine words of the contract, on one pretext or the other.

9.2 The judgment clearly establishes that the parties are expressly permitted by statute to contract waving right to receive interest. However, the party attempting to enjoy/claim interest despite there being such waiver in the contractual terms may proceed to take defence under consent being not free.

9.3 But till such time, it is apparent that clauses containing waiving right for receipt of interest are nowhere in contradiction to law and thus enforceable.

A copy of the judgment is annexed hereto at **page 3 to 6.**

2021 SCC OnLine SC 855

In the Supreme Court of India
(BEFORE S. ABDUL NAZEER AND KRISHNA MURARI, JJ.)

Garg Builders ... Appellant(s);
Versus

Bharat Heavy Electricals Limited ... Respondent(s).

Civil Appeal No. 6216 of 2021 (Arising out of S.L.P. (C.) No. 16320 of 2018)

Decided on October 4, 2021

The Judgment of the Court was delivered by

S. ABDUL NAZEER, J.:— Leave granted.

2. This appeal is directed against the Order of the Division Bench of the High Court of Delhi dated 19.09.2017 in FAO(OS) (COMM) No. 120/2017 whereby it has upheld the judgment of the learned Single Judge in OMP (COMM) No. 28 of 2017 dated 10.03.2017, resulting in denial of *pendente lite* interest on the award amount to the appellant.

3. The respondent floated a tender for construction of boundary wall at its 2 × 750 MW Pragati III Combined Cycle Power at Bawana, Delhi (hereinafter referred to as 'the project'). The appellant submitted its bid for the project which was accepted by the respondent. Pursuant to which, the respondent issued a Letter of Intent (LOI) to the appellant dated 09.09.2008. Subsequently, on 24.10.2008 the parties entered into a contract which, *inter alia*, contained the interest barring clause which is reproduced hereunder:

"Clause 17 : No interest shall be payable by BHEL on Earnest Money Deposit, Security Deposit or on any moneys due to the contractor."

4. The disputes arose between the parties with respect to the aforesaid contract and subsequently the appellant filed a petition under Section 11 of the Arbitration and Conciliation Act, 1996 (for short, "the 1996 Act") before the Delhi High Court wherein the Court vide Order dated 16.09.2011 appointed Hon'ble Mr. Justice M.A. Khan (Retd.) as the sole Arbitrator to adjudicate the disputes. The appellant in the claim petition, apart from claiming various amounts under different heads, *inter alia* claimed pre-reference, *pendente lite* and future interest at the rate of 24% on the value of the award. Learned Arbitrator after hearing the contentions of both the parties concluded that there is no prohibition in the contract dated 24.10.2008 and LOI dated 09.09.2010 about payment of interest for the pre-suit, *pendente lite* and future period. Therefore, he awarded *pendente lite* and future interest at the rate of 10% p.a. to the appellant on the award amount from the date of filing of the claim petition i.e. 02.12.2011 till the date of realization of the award amount.

5. The respondent challenged the said award under Section 34 of the 1996 Act before the Delhi High Court in O.M.P. (COMM.) 28/2017 on various grounds, *inter alia*, on the ground that the learned Arbitrator being creature of the arbitration agreement travelled beyond the terms of the contract in awarding *pendente lite* interest on the award amount as the same was expressly barred in terms of the contract. The learned Single Judge vide his final judgment and order dated 10.03.2017 held as under:

"The Arbitrator fell in error in holding that the aforesaid clause only prescribed pre-reference interest and not *pendente lite* interest. As stated earlier, in terms of Section 31(7)(a) of the Act, the power of the arbitral tribunal to award pre award interest is contingent to the parties not agreeing to the contrary. Pre-award interest includes both pre-reference interest as well as *pendente lite* interest. Thus, the

conclusion of the Arbitrator that award of *pendente lite* interest was not prescribed by clause 17 of the Agreement is not sustainable.

Accordingly, the impugned award to the extent of award of *pendente lite* interest is set aside. The petition is disposed of. No orders as to costs."

6. As noticed above, the Division Bench of the High Court has upheld the judgment and order of the Learned Single Judge in the impugned order.

7. On 03.07.2018, this Court issued notice observing as under:

"Learned counsel for the petitioner has placed reliance on an order of this Court in *Ambica Construction v. Union of India*, (2017) 14 SCC 323."

8. We have heard learned counsel for the parties and perused the materials on record. Mr. Sanjay Bansal, learned counsel for the appellant, contended that the learned Arbitrator had taken a plausible view, in terms of the Clause 17 of the Contract and held that the said clause does not bar the payment of interest for *pendente lite* period. This argument was advanced in view of judgment of this Court in *Ambica Construction v. Union of India*¹, wherein the appellant was entitled for the payment of interest for the *pendente lite* period. He has also relied on another judgment of this Court in *Raveechee and Company v. Union of India*² in support of his contentions. Further, it was argued by the learned counsel that the Clause 17 of the Contract barring payment of interest to the contractor on any sum due to the contractor, is *ultra vires* and against the provisions of Section 28 of the Indian Contract Act, 1872.

9. On the other hand, Mr. Pallav Kumar, learned counsel for the respondent, submitted that Section 31(7)(a) of the 1996 Act gives paramount importance to the contract entered into between the parties and categorically restricts the power of an arbitrator to award pre-reference and *pendente lite* interest when the parties themselves have agreed to the contrary. He argued that if the contract itself contains a specific clause which expressly bars the payment of interest, then it is not open for the arbitrator to grant *pendente lite* interest. It was further argued that *Ambica Construction* (supra) is not applicable to the instant case because it was decided under the Arbitration Act, 1940 whereas the instant case falls under the 1996 Act. It was further argued that Section 3 of the Interest Act confers power on the Court to allow interest in the proceedings for recovery of any debt or damages or in proceedings in which a claim for interest in respect of any debt or damages already paid. However, Section 3(3) of the Interest Act carves out an exception and recognizes the right of the parties to contract out of the payment of interest arising out of any debt or damages and sanctifies contracts which bars the payment of interest arising out of debt or damages. Therefore, Clause 17 of the Contract is not violative of any the provisions of the Indian Contract Act, 1872. In light of the arguments advanced, the learned counsel prays for dismissal of the appeal.

10. We have carefully considered the submissions of the learned counsel for both the parties made at the Bar. The law relating to award of *pendente lite* interest by Arbitrator under the 1996 Act is no longer *res integra*. The provisions of the 1996 Act give paramount importance to the contract entered into between the parties and categorically restricts the power of an arbitrator to award pre-reference and *pendente lite* interest when the parties themselves have agreed to the contrary. Section 31(7) (a) of the 1996 Act which deals with the payment of interest is as under:

"31(7)(a) Unless otherwise agreed by the parties, where and insofar as an arbitral award is for the payment of money, the arbitral tribunal may include in the sum for which the award is made interest, at such rate as it deems reasonable, on the whole or any part of the money, for the whole or any part of the period between the date on which the cause of action arose and the date on which the award is made."

11. It is clear from the above provision that if the contract prohibits pre-reference

and *pendente lite* interest, the arbitrator cannot award interest for the said period. In the present case, clause barring interest is very clear and categorical. It uses the expression "any moneys due to the contractor" by the employer which includes the amount awarded by the arbitrator.

12. In *Sayed Ahmed and Company v. State of Uttar Pradesh*³ this Court has held that a provision has been made under Section 31(7)(a) of the 1996 Act in relation to the power of the arbitrator to award interest. As per this section, if the contract bars payment of interest, the arbitrator cannot award interest from the date of cause of action till the date of award.

13. In *Sree Kamatchi Amman Constructions v. Divisional Railway Manager (Works), Palghat*⁴ it was held by this Court that where the parties had agreed that the interest shall not be payable, the Arbitral Tribunal cannot award interest between the date on which the cause of action arose to the date of the award.

14. *Bharat Heavy Electricals Limited v. Globe Hi-Fabs Limited*⁵ is an identical case where this Court has held as under:

"16. In the present case we noticed that the clause barring interest is very widely worded. It uses the words "any amount due to the contractor by the employer". In our opinion, these words cannot be read as *ejusdem generis* along with the earlier words "earnest money" or "security deposit"."

15. In *Sri Chittaranjan Maity v. Union of India*⁶ it was categorically held that if a contract prohibits award of interest for pre-award period, the arbitrator cannot award interest for the said period.

16. Therefore, if the contract contains a specific clause which expressly bars payment of interest, then it is not open for the arbitrator to grant *pendente lite* interest. The judgment on which reliance was placed by the learned counsel for the appellant in *Ambica Construction* (supra) has no application to the instant case because *Ambica Construction* was decided under the Arbitration Act 1940 whereas the instant case falls under the 1996 Act. This has been clarified in *Sri Chittaranjan Maity* (supra) as under:

"16. Relying on a decision of this Court in *Ambica Construction v. Union of India*, (2017) 14 SCC 323, the learned Senior Counsel for the appellant submits that mere bar to award interest on the amounts payable under the contract would not be sufficient to deny payment on *pendente lite* interest. Therefore, the arbitrator was justified in awarding the *pendente lite* interest. However, it is not clear from *Ambica Construction* (supra) as to whether it was decided under the Arbitration Act, 1940 (for short "the 1940 Act") or under the 1996 Act. It has relied on a judgment of Constitution Bench in *State of Orissa v. G.C. Roy*, (1992) 1 SCC 508. This judgment was with reference to the 1940 Act. In the 1940 Act, there was no provision which prohibited the arbitrator from awarding interest for the pre-reference, *pendente lite* or post-award period, whereas the 1996 Act contains a specific provision which says that if the agreement prohibits award of interest for the pre-award period, the arbitrator cannot award interest for the said period. Therefore, the decision in *Ambica Construction* (supra) cannot be made applicable to the instant case."

17. The decision in *Raveechee and Company* (supra) relied on by the learned counsel for the appellant is again under the Arbitration Act 1940 which has no application to the facts of the present case.

18. Having regard to the above, we are of the view that the High Court was justified in rejecting the claim of the appellant seeking *pendente lite* interest on the award amount.

19. This takes us to the next question as to whether Clause 17 of the Contract is *ultra vires* in terms of Section 28 of the Indian Contract Act, 1872. According to Section 28, a contract is void to the extent it restricts absolutely a party from

enforcing his rights by usual proceedings in ordinary courts or if it limits the time within which he may enforce his rights. Exception I to this section contains a rule that a contract by which two or more persons agree that any dispute which has arisen or which may arise between them in respect of any subject or class of subjects shall be referred to arbitration is not illegal. The question, therefore, is whether the contracts barring payment of interest extinguish the rights of the parties. Exception 1 to Section 28 reads as under:

“Exception 1 : Saving of contract to refer to arbitration dispute that may arise. - This section shall not render illegal a contract, by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shall be referred to arbitration, and that only the amount awarded in such arbitration shall be recoverable in respect of the dispute so referred.”

20. Exception I to Section 28 saves contracts where the right to move the Court for appropriate relief is restricted but where the parties have agreed to resolve their dispute through arbitration. Thus, a lawful agreement to refer the matter to arbitration can be made a condition precedent before going to courts and it does not violate Section 28. No cause of action then accrues until the Arbitrator has made the award and the only amount awarded in such arbitration is recoverable in respect of the dispute so referred. Section 31(7)(a) of the 1996 Act which allows parties to waive any claim to interest including *pendente lite* and the power of the Arbitrator to grant interest is subject to the agreement of the parties.

21. It is pertinent to note that interest payments are governed in general by the Interest Act, 1978 in addition to the specific statutes that govern an impugned matter. Section 2(a) of the Interest Act defines a “Court” which includes both a Tribunal and an Arbitrator. In turn, Section 3 allows a “Court” to grant interest at prevailing interest rates in various cases. The provisions of Section 3(3) of the Interest Act, 1978 explicitly allows the parties to waive their claim to an interest by virtue of an agreement. Section 3(3)(a)(ii) states that the Interest Act will not apply to situations where the payment of interest is “barred by virtue of an express agreement”.

22. Thus, when there is an express statutory permission for the parties to contract out of receiving interest and they have done so without any vitiating of free consent, it is not open for the Arbitrator to grant *pendent lite* interest. We are of the considered opinion that Clause 17 of the contract is not *ultra vires* in terms of Section 28 of the Indian Contract Act, 1872.

23. In the result, the appeal fails and is accordingly dismissed. Having regard to the facts and circumstances of the case, we direct the parties to bear their own costs.

24. Pending application, if any, shall also stand disposed of.

¹ (2017) 14 SCC 323

² (2018) 7 SCC 664

³ (2009) 12 SCC 26

⁴ (2010) 8 SCC 767

⁵ (2015) 5 SCC 718

⁶ (2017) 9 SCC 611