



June 2023

## **The High Court of Delhi holds that contractual provision against payment of interest does not bar the arbitrator from granting interest**

In a recent decision in *M/s Mahesh Construction v. Municipal Corporation of Delhi & Anr*,<sup>1</sup> the High Court of Delhi (the "**High Court**") has held that a general provision in the contract prohibiting payment of interest on delayed payments does not bar an arbitrator from exercising his power to grant interest under Section 31(7) of the Arbitration and Conciliation Act, 1996 (the "**Arbitration Act**"). The arbitrator can also award interest for all the 3 (three) periods: pre-reference, pendente lite, and post-award. The High Court clarified for such provision to apply to the arbitrator, the relevant contractual provision must explicitly mention the arbitrator.

### **Brief Facts**

The Municipal Corporation of Delhi ("**MCD**") floated tenders for de-silting certain drains, and a work order was issued to M/s Mahesh Construction (the "**Appellant**"). A dispute arose between the parties regarding non-payment of dues, which was referred to arbitration. The arbitral tribunal (the "**Tribunal**") allowed the Appellant's claim. The Tribunal also awarded interest for 3 (three) periods: pre-reference, pendente lite, and post-award.

The MCD challenged the arbitral award before the trial court, contending that the Appellant failed to fulfill its contractual obligations, resulting in unpaid payments. The MCD also contested the award of interest.

The MCD's application to set aside the arbitral award was granted, prompting the Appellant to file an appeal before the High Court under Section 37 of the Arbitration Act.

### **Key Issue**

The primary issue before the High Court was whether a contract clause prohibiting payment of interest on delayed payments prevents an arbitrator from granting interest.

### **Findings and Analysis**

The High Court allowed the appeal by holding that:

- 1) The scope of judicial intervention is limited and confined to the grounds mentioned under Section 34 of the Arbitration Act. The High Court referred to *NHAI v. M/s. BSC-RBM-Pati Joint Venture*<sup>2</sup> and *Union of India v. Sikka*

<sup>1</sup> FAO 212/2010

<sup>2</sup> 2018 SCC OnLine Del 6780

*Engineering Company*<sup>3</sup> and observed that “the law regarding this position of law is well settled and the Court hearing objections under section 34 of the Arbitration Act is not required to judge the arbitral award as if it were sitting in appeal. However, out of judicial habit the Courts tend to act like appellate courts and blur the distinction between the two very distinct jurisdictions”.

It also referred to *Associate Builders v. Delhi Development Authority*,<sup>4</sup> which held that “arbitral tribunal is the master of both quality and quantity of evidence to reach a finding of fact”.

- 2) The High Court then addressed the issue of the Tribunal’s power to grant interest. It held that the Tribunal could grant interest under Section 31(7) of the Arbitration Act, even if there is a specific contract clause prohibiting interest on delayed payments.

The Court explained that such a clause in the contract operates only against the parties unless it explicitly bars the arbitrator from awarding interest. The Court supported its conclusion by referring to *Reliance Cellulose Products Ltd v. ONGC*<sup>5</sup> reasoned that *interest is compensatory in nature and is parasitic on the principal amount*.

The High Court, thus, allowed the appeal, and set aside the trial court’s order, and upheld the arbitral award passed by the Tribunal.

## JSA Comment

This judgement raises concern regarding the efficacy of contractual provision against payment of interest on delayed payment.

Clause (a) of sub-section (7) of section 31 of the Arbitration Act starts with the phrase “Unless otherwise agreed by the parties”.

It is therefore very clear that the arbitral tribunal’s power to award interest is subject to the agreement between the parties. The arbitrator cannot exercise the power under Section 31(7) to award interest if the parties have imposed a bar against it in the contract. In effect, the judgement holds that even though the parties may have, by agreement, barred claim of interest against each other, such bar will not apply to arbitral tribunal unless parties have specifically barred the tribunal.

The judgement places undue emphasis on semantics and disregards the intention of the parties expressed in the contract. It, thus, arguably impinges on party autonomy in contracts and their ability to limit the powers of arbitrator, which is central to arbitration law.

Considering the judgment, we may add a note of caution for the drafters. If the parties intend to bar the arbitral tribunal from awarding interest, it will be prudent to specifically provide for such bar in the contract.

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<sup>3</sup> 2019 SCC OnLine Del 8788

<sup>4</sup> (2015) 3 SCC 49

<sup>5</sup> (2018) 9 SCC 266

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