A UNION OF INDIA

*v.*

M/S. KRAFTERS ENGINEERING & LEASING (P) LTD.

(Civil Appeal No. 2005 of 2007)

JULY 12, 2011

B

**[P. SATHASIVAM AND A.K. PATNAIK, JJ.]**

*Arbitration Act, 1940 – Jurisdiction of arbitrator to award interest when contract prohibits it – Held: In such a case,* C *arbitrator cannot award interest for the amount payable to the contractor under the contract – However, where there is no prohibition as regards the grant of interest, arbitrator has the power to award interest pendente lite – On facts, the bar under clause 1.15 of the General Conditions of the Contract between* D *the parties prohibiting payment of interest on amount payable to contractor under the contract, is absolute and interest cannot be awarded without rewriting the contract – Thus, the award of the arbitrator granting interest in respect of the amount payable to the contractor under the contract is set aside.*

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**Respondent was awarded a works contract. Certain disputes arose between the parties. On an application by the respondent, an arbitrator was appointed but since the arbitrator could not deliberate the matter within the time limit, the respondent invoked the jurisdiction of Umpire.** F **The Umpire gave award for certain claims and rejected certain claims. The appellant challenged the award given by the Umpire as regards the grant of interest. The High Court dismissed the arbitration petition as also the appeal.**

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**The question which arose for consideration in the instant appeal was whether the arbitrator has jurisdiction to grant interest despite the agreement prohibiting the same.**

H

**Allowing the appeal, the Court**

**HELD: 1.1 Where the parties had agreed that no interest shall be payable, the arbitrator cannot award interest for the amounts payable to the contractor under the contract. Where the agreement between the parties does not prohibit grant of interest and where a party claims interest and the said dispute is referred to the arbitrator, he shall have the power to award interest *pendente lite*. In such a case, it must be presumed that interest was an implied term of the agreement between the parties. However, this does not mean that in every case, the arbitrator should necessarily award interest *pendente lite*. In the absence of any specific stipulation or prohibition in the contract to claim or grant any such interest, the arbitrator is free to award interest. [Para 14] [210-G-H; 211-A-B]**

**1.2 In light of the above said principle and in view of Clause 1.15 of the General Conditions of the Contract between the parties whereby it prohibits payment of interest on the amount payable to the contractor under the contract, the arbitrator ceases to have the power to grant interest. It is clarified that the Arbitration Act, 1940 does not contain any specific provision relating to the power of arbitrator to award interest. However, in the Arbitration and Conciliation Act, 1996, there is a specific provision with regard to award of interest by the arbitrator. The bar under clause 1.15 is absolute and interest cannot be awarded without rewriting the contract. Thus, the award of the arbitrator granting interest in respect of the amount payable to the contractor under the contract as well as the order of the Single Judge and the Division Bench of the High Court confirming the same are set aside. [Paras 15 and 16] [211-C-E]**

*Secretary, Irrigation Department, Government of Orissa and Ors. vs. G.C. Roy* **(1992) 1 SCC 508: 1991 (3) Suppl.**

A **SCR 417;** *Executive Engineer, Dhenkanal Minor Irrigation Division, Orissa and Ors. vs. N.C. Budharaj (deceased) by LRs. and Ors.* **(2001) 2 SCC 721: 2001 (1) SCR 264;** *Sayeed Ahmed and Company vs. State of Uttar Pradesh and Ors.* **(2009) 12 SCC 26: 2009 (10) SCR 841;** *Sree Kamatchi*
B *Amman Constructions vs. Divisional Railway Manager (Works), Palghat and Ors.* **(2010) 8 SCC 767: 2010 (10) SCR 487 – relied on.**

*Board of Trustees for the Port of Calcutta vs. Engineers-De-Space Age* **(1996) 1 SCC 516: 1995 (6) Suppl. SCR 327;**
C *Madnani Construction Corporation Private Limited vs. Union of India and Ors.* **(2010) 1 SCC 549: 2009 (16) SCR 216;** *Union of India vs. Saraswat Trading Agency and Ors.* **(2009) 16 SCC 504: 2009 (10) SCR 1063 – referred to.**

D **Case Law Reference:**

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|---|---|---|
| **2009 (10) SCR 841** | **Relied on.** | **Para 10** |
| **1995 (6) Suppl. SCR 327** | **Referred to.** | **Para 10, 14** |
| **2009 (10) SCR 1063** | **Referred to.** | **Para 11** |
| **2010 (10) SCR 487** | **Relied on.** | **Para 13** |
| **2009 (16) SCR 216** | **Referred to.** | **Para 14** |
| **1991 (3) Suppl. SCR 417** | **Relied on.** | **Para 14** |
| **2001 (1) SCR 264** | **Relied on.** | **Para 14** |

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CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2005 of 2007.

G From the Judgment & Order dated 24.4.2006 of the High Court of Judicature at Bombay in Appeal No. 219 of 2006 in Arbiration Petition No. 274 of 2005.

A.S. Chandhiok, ASG, Sonia Mathur, Ritesh Kumar, Piyush Sanhi, D.S. Mahra for the Appellant.

H

Ramesh Babu, M.R. Arun Francis, G. Prakash, Amarjit Singh Bedi for the Respondent. A

The Judgment of the Court was delivered by

**P. SATHASIVAM, J.** 1. This appeal by Union of India arises out of the final judgment and order dated 24.04.2006 passed by the High Court of Judicature at Bombay in Appeal No. 219 of 2006 in Arbitration Petition No. 274 of 2005 whereby the Division Bench of the High Court dismissed their appeal. B

2. **Brief facts:** C

(a) On 16.05.1988, the respondent was awarded with a contract for the work of Provision of Signaling Arrangements at "C" Class Stations on Igatpuri-Bhusawal Section and 2 "C" Stations on Bhusawal-Badnera Section of Bhusawal Division of Central Railway at the cost of Rs.18,10,400/-. On completion of the contract, the respondent raised certain disputes/claims by filing Suit No. 2822 of 1993 before the High Court and demanded for adjudication through arbitration. The High Court directed the General Manager of the Central Railway to appoint an arbitrator and refer the disputes for adjudication. Since the Arbitrator appointed could not deliberate the matter within the time limit, the respondent invoked the jurisdiction of the Umpire. The Umpire, by order dated 26.04.2005, gave award for Claim Nos. 1, 3, 6, 8, 9, 10, 11, 12 & 13 and rejected Claim Nos. 2, 5, 7 & 14 and mentioned that a bank guarantee towards security deposit against claim No. 4 is to be returned. D E F

(b) Challenging the award given by the Umpire for Claim Nos. 11 & 13, the appellant herein filed Arbitration Petition No. 274 of 2005 before the High Court. The learned Single Judge of the High Court, vide order dated 06.12.2005 dismissed their petition. G

(c) Aggrieved by the order passed by the learned single Judge, the appellant herein filed an appeal being Arbitration Appeal No. 219 of 2006 before the Division Bench of the High H

A Court. The Division Bench, by impugned order dated 24.04.2006, dismissed the appeal. Challenging the said order, the Union of India preferred this appeal by way of special leave before this Court.

B 3. Heard Mr. A. S. Chandhiok, learned Additional Solicitor General for the Union of India and Mr. Ramesh Babu M.R., learned counsel for the respondent.

4. Before the High Court as well as before us, the appellant projected their case only with regard to interest that was granted C by the arbitrator and confirmed by the High Court. Therefore, the only point for consideration in this appeal is whether an arbitrator has jurisdiction to grant interest despite the agreement prohibiting the same?

D 5. Though the appellant has challenged the award of the Umpire in respect of Claim Nos. 11 and 13, they are mainly concerned about grant of interest; hence there is no need to traverse all the factual details except the required one which we have adverted to. According to Mr. A.S. Chandhiok, learned ASG, in view of clause 1.15 of the General Conditions of the E Contract between the parties, the arbitrator does not have the power to award interest pendente lite. The said clause reads as under:

> "1.15 Interest on Amounts - No interest will be payable F upon the Earnest Money or the Security Deposit or amounts payable to the Contractor under the Contract but Government Securities deposited in terms of clause 1.14.4 will be repayable with interest accrued thereon."

According to the learned ASG, in view of the above-mentioned G clause, no interest is payable on the amount payable to the Contractor under the contract. On the other hand, Mr. Ramesh Babu M.R., learned counsel appearing for the respondent submitted that irrespective of the bar in the contract arbitrator has power to award interest for which he strongly relied on the H decision of this Court in *Board of Trustees for the Port of*

*Calcutta vs. Engineers-De-Space-Age,* (1996) 1 SCC 516 and *Madnani Construction Corporation Private Limited vs. Union of India and Others,* (2010) 1 SCC 549.

6. We have already extracted the relevant clause wherein the words "amounts payable to the Contractor under the contract" are of paramount importance. If there is no prohibition in the arbitration agreement to exclude the jurisdiction of the arbitrator to entertain a claim for interest on the amount due under the contract, the arbitrator is free to consider and award interest in respect of the period. If there is a prohibition in the agreement to pay the interest, in that event, the arbitrator cannot grant the interest. Clause 1.15 prohibits payment of interest on the amount payable to the contractor under the contract.

7. It is not in dispute that the provisions of the Arbitration Act, 1940 alone are applicable to the case on hand. Now, let us consider various decisions of this Court dealing with similar prohibition in the agreement for grant of interest. In *Secretary, Irrigation Department, Government of Orissa and Others vs. G.C. Roy,* (1992) 1 SCC 508, the Constitution Bench had considered Section 29 of the Arbitration Act, 1940 which deals with interest pendente lite. After analyzing the scheme of the Act and various earlier decisions, the Constitution Bench considered the very same issue, namely, whether an arbitrator has power to award interest pendente lite and, if so, on what principle. The relevant paragraphs are extracted hereunder:-

> **"43.** The question still remains whether arbitrator has the power to award interest pendente lite, and if so on what principle. We must reiterate that we are dealing with the situation where the agreement does not provide for grant of such interest nor does it prohibit such grant. In other words, we are dealing with a case where the agreement is silent as to award of interest. On a conspectus of aforementioned decisions, the following principles emerge:
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> (i) A person deprived of the use of money to which

A he is legitimately entitled has a right to be compensated for the deprivation, call it by any name. It may be called interest, compensation or damages. This basic consideration is as valid for the period the dispute is pending before the arbitrator as it is for the period prior
B to the arbitrator entering upon the reference. This is the principle of Section 34, Civil Procedure Code and there is no reason or principle to hold otherwise in the case of arbitrator.

C (ii) An arbitrator is an alternative form (sic forum) for resolution of disputes arising between the parties. If so, he must have the power to decide all the disputes or differences arising between the parties. If the arbitrator has no power to award interest pendente lite, the party claiming it would have to approach the court for that purpose, even
D though he may have obtained satisfaction in respect of other claims from the arbitrator. This would lead to multiplicity of proceedings.

(iii) An arbitrator is the creature of an agreement. It
E is open to the parties to confer upon him such powers and prescribe such procedure for him to follow, as they think fit, so long as they are not opposed to law. (The proviso to Section 41 and Section 3 of Arbitration Act illustrate this point). All the same, the agreement must be in conformity
F with law. The arbitrator must also act and make his award in accordance with the general law of the land and the agreement.

(iv) Over the years, the English and Indian courts have acted on the assumption that where the agreement
G does not prohibit and a party to the reference makes a claim for interest, the arbitrator must have the power to award interest pendente lite. Thawardas has not been followed in the later decisions of this Court. It has been explained and distinguished on the basis that in that case
H there was no claim for interest but only a claim for

unliquidated damages. It has been said repeatedly that observations in the said judgment were not intended to lay down any such absolute or universal rule as they appear to, on first impression. Until Jena case almost all the courts in the country had upheld the power of the arbitrator to award interest pendente lite. Continuity and certainty is a highly desirable feature of law.

(v) Interest pendente lite is not a matter of substantive law, like interest for the period anterior to reference (pre-reference period). For doing complete justice between the parties, such power has always been inferred.

**44.** Having regard to the above consideration, we think that the following is the correct principle which should be followed in this behalf:

Where the agreement between the parties does not prohibit grant of interest and where a party claims interest and that dispute (along with the claim for principal amount or independently) is referred to the arbitrator, he shall have the power to award interest pendente lite. This is for the reason that in such a case it must be presumed that interest was an implied term of the agreement between the parties and therefore when the parties refer all their disputes — or refer the dispute as to interest as such — to the arbitrator, he shall have the power to award interest. This does not mean that in every case the arbitrator should necessarily award interest pendente lite. It is a matter within his discretion to be exercised in the light of all the facts and circumstances of the case, keeping the ends of justice in view."

8. In *Executive Engineer, Dhenkanal Minor Irrigation Division, Orissa and Others vs. N.C Budharaj (deceased) by LRs and Others,* (2001) 2 SCC 721, another Constitution Bench considered payment of interest for pre-reference period in respect of cases arising when Interest Act, 1839 was in force.

A The following conclusion in para 26 is relevant which reads thus:

> "26. For all the reasons stated above, we answer the reference by holding that the arbitrator appointed with or without the intervention of the court, has jurisdiction to award interest, on the sums found due and payable, for the B pre-reference period, in the absence of any specific stipulation or prohibition in the contract to claim or grant any such interest. The decision in Jena case taking a contra view does not lay down the correct position and stands overruled, prospectively, which means that this C decision shall not entitle any party nor shall it empower any court to reopen proceedings which have already become final, and apply only to any pending proceedings. No costs."

D (Emphasis supplied).

9. In the earlier paras, we have referred to the stand taken by the learned counsel for the respondent and reliance based on the decision reported in *Board of Trustees for the Port of Calcutta* (supra). It is true that in that decision, this Court has E held that arbitrator has jurisdiction to interpret the clauses of the contract and to decide whether interest pendente lite could be awarded by him. The short question that arose in that case was that the arbitrator had awarded interest pendente lite notwithstanding the prohibition contained in the contract against F the payment of interest on delayed payments. Ultimately, the two-Judge Bench of this Court has concluded that irrespective of the terms of the contract, the arbitrator was well within his jurisdiction in awarding interest pendente lite. It is useful to point out that the ratio in that decision was considered by this Court G in *Sayeed Ahmed and Company vs. State of Uttar Pradesh and Others*, (2009) 12 SCC 26. While considering the very same issue, particularly, specific clause in the agreement prohibiting interest pendente lite, this Court considered the very same decision i.e. *Board of Trustees for the Port of Calcutta* H (supra). After adverting to the clause in the *Board of Trustees*

*for the Port of Calcutta* (supra) and the Constitution Bench in *G.C. Roy's* case (supra), this Court concluded as under:

> "23. The observation in Engineers-De-Space-Age that the term of the contract merely prohibits the department/ employer from paying interest to the contractor for delayed payment but once the matter goes to the arbitrator, the discretion of the arbitrator is not in any manner stifled by the terms of the contract and the arbitrator will be entitled to consider and grant the interest pendente lite, cannot be used to support an outlandish argument that bar on the Government or department paying interest is not a bar on the arbitrator awarding interest. Whether the provision in the contract bars the employer from entertaining any claim for interest or bars the contractor from making any claim for interest, it amounts to a clear prohibition regarding interest. The provision need not contain another bar prohibiting the arbitrator from awarding interest. The observations made in the context of interest pendente lite cannot be used out of contract.
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> 24. The learned counsel for the appellant next contended on the basis of the above observations in Engineers-De-Space-Age, that even if Clause G1.09 is held to bar interest in the pre-reference period, it should be held not to apply to the pendente lite period, that is, from 14-3-1997 to 31-7-2001. He contended that the award of interest during the pendency of the reference was within the discretion of the arbitrator and therefore, the award of interest for that period could not have been interfered with by the High Court. In view of the Constitution Bench decisions in G.C. Roy and N.C. Budharaj rendered before and after the decision in Engineers-De-Space-Age, it is doubtful whether the observation in Engineers-De-Space-Age in a case arising under the Arbitration Act, 1940 that the arbitrator could award interest pendente lite, ignoring the express bar in the contract, is good law. But that need

A not be considered further as this is a case under the new Act where there is a specific provision regarding award of interest by the arbitrator."

10. Considering the specific prohibition in the agreement B as discussed and interpreted by the Constitution Bench, we are in respectful agreement with the view expressed in *Sayeed Ahmed and Company* (supra) and we cannot possibly agree with the observation in *Board of Trustees for the Port of Calcutta* (supra) in a case arising under the Arbitration Act, C 1940 that the arbitrator could award interest pendente lite ignoring the express bar in the contract.

11. In *Union of India vs. Saraswat Trading Agency and Others*, (2009) 16 SCC 504, though it was under the Arbitration and Conciliation Act, 1996, this Court has considered D elaborately about the legal position in regard to interest after adverting to all the earlier decisions and basing reliance on clause 31 of the agreement held:

"**33.** In the case in hand Clause 31 of the agreement is E materially different. It bars payment of any interest or damage to the contractor for any reason whatsoever. We are, therefore, clearly of the view that no pre-reference or pendente lite interest was payable to the respondent on the amount under Item 3 and the arbitrator's award allowing F pre-reference and pendente lite interest on that amount was plainly in breach of the express terms of the agreement. The order of the High Court insofar as pre-reference and pendente lite interest on the amount under Item 3 is concerned is, therefore, unsustainable."

G 12) At the end of the argument, learned counsel for the respondent heavily relied on the recent decision of this Court in *Madnani Construction Corporation Private Limited* (supra) which arose under the Arbitration Act, 1940. There also, Clause 30 of SCC and Clause 52 of GCC prohibits payment of interest. H Though the Bench relied on all the earlier decisions and

considered the very same clause as to which we are now discussing, upheld the order awarding interest by the arbitrator de hors to specific bar in the agreement. It is relevant to point out that the decision of *Madnani Construction Corporation Private Limited* (supra) was cited before another Bench of this Court in *Sree Kamatchi Amman Constructions vs. Divisional Railway Manager (Works), Palghat and Others,* (2010) 8 SCC 767, wherein the decision in Madnani Construction Corporation Private Limited (supra) was very much discussed and considered. After adverting to all the earlier decisions including the Constitution Bench judgments, this Court has analyzed the effect of *Madnani Construction Corporation Private Limited* (supra). The following discussion and ultimate conclusion are relevant:

> "17. In Madnani the arbitrator had awarded interest pendente lite, that is, from the date of appointment of arbitrator to the date of award. The High Court had interfered with the same on the ground that there was a specific prohibition in the contract regarding awarding of interest. This Court following the decision in Engineers-De-Space-Age reversed the said rejection and held as follows: (Madnani case, SCC pp. 560-61, para 39)
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> "39. In the instant case also the relevant clauses, which have been quoted above, namely, Clause 16(2) of GCC and Clause 30 of SCC do not contain any prohibition on the arbitrator to grant interest. Therefore, the High Court was not right in interfering with the arbitrator's award on the matter of interest on the basis of the aforesaid clauses. We therefore, on a strict construction of those clauses and relying on the ratio in Engineers find that the said clauses do not impose any bar on the arbitrator in granting interest."
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> 18. At the outset it should be noticed that Engineers-De-Space-Age and Madnani arose under the old Arbitration Act, 1940 which did not contain a provision similar to

A Section 31(7) of the new Act. This Court, in Sayeed Ahmed held that the decisions rendered under the old Act may not be of assistance to decide the validity of grant of interest under the new Act. The logic in Engineers-De-Space-Age was that while the contract governed the B interest from the date of cause of action to date of reference, the arbitrator had the discretion to decide the rate of interest from the date of reference to date of award and he was not bound by any prohibition regarding interest contained in the contract, insofar as pendente lite period C is concerned. This Court in Sayeed Ahmed held that the decision in Engineers-De-Space-Age would not apply to cases arising under the new Act. We extract below, the relevant portion from Sayeed Ahmed: (SCC p. 36, paras 23-24)

D "23. The observation in Engineers-De-Space-Age that the term of the contract merely prohibits the department/employer from paying interest to the contractor for delayed payment but once the matter goes to the arbitrator, the discretion of the arbitrator is not in any E manner stifled by the terms of the contract and the arbitrator will be entitled to consider and grant the interest pendente lite, cannot be used to support an outlandish argument that bar on the Government or department paying interest is not a bar on the arbitrator awarding interest. F Whether the provision in the contract bars the employer from entertaining any claim for interest or bars the contractor from making any claim for interest, it amounts to a clear prohibition regarding interest. The provision need not contain another bar prohibiting the arbitrator from G awarding interest. The observations made in the context of interest pendente lite cannot be used out of contract.

24. The learned counsel for the appellant next contended on the basis of the above observations in Engineers-De-Space-Age, that even if Clause G 1.09 is held to bar H

interest in the pre-reference period, it should be held not to apply to the pendente lite period, that is, from 14-3-1997 to 31-7-2001. He contended that the award of interest during the pendency of the reference was within the discretion of the arbitrator and therefore, the award of interest for that period could not have been interfered with by the High Court. In view of the Constitution Bench decisions in G.C. Roy and N.C. Budharaj rendered before and after the decision in Engineers-De-Space-Age, it is doubtful whether the observation in Engineers-De-Space-Age in a case arising under the Arbitration Act, 1940 that the arbitrator could award interest pendente lite, ignoring the express bar in the contract, is good law. But that need not be considered further as this is a case under the new Act where there is a specific provision regarding award of interest by the arbitrator."

*The same reasoning applies to the decision in* Madnani *also as that also relates to a case under the old Act and did not independently consider the issue but merely relied upon the decision in* Engineers-De-Space-Age.

19. Section 37(1) of the new Act by using the words "unless otherwise agreed by the parties" categorically clarifies that the arbitrator is bound by the terms of the contract insofar as the award of interest from the date of cause of action to the date of award. Therefore, where the parties had agreed that no interest shall be payable, the Arbitral Tribunal cannot award interest between the date when the cause of action arose to the date of award.

20. We are of the view that the decisions in Engineers-De-Space-Age and Madnani are inapplicable for yet another reason. In Engineers-De-Space-Age and Madnani the arbitrator had awarded interest for the pendente lite period. This Court upheld the award of such interest under the old Act on the ground that the arbitrator had the discretion to decide whether interest should be awarded

A or not during the pendente lite period and he was not bound by the contractual terms insofar as the interest for the pendente lite period. But in the instant case the Arbitral Tribunal has refused to award interest for the pendente lite period. Where the Arbitral Tribunal has exercised its B discretion and refused award of interest for the period pendente lite, even if the principles in those two cases were applicable, the award of the arbitrator could not be interfered with. On this ground also the decisions in Engineers-De-Space-Age and Madnani are C inapplicable..."

13. Inasmuch as we have already expressed similar view as mentioned above and conveyed our inability to apply the reasoning in *Madnani Construction Corporation Private Limited* (supra), we fully endorse the view expressed in *Sree* D *Kamatchi Amman Constructions* (supra).

14. In the light of the above discussion, following conclusion emerge:

E Reliance based on the ratio in Board of Trustees for the Port of Calcutta (supra) is unacceptable since the said view has been overruled in *Sayeed Ahmed and Company* (supra) and insofar as the ratio in *Madnani Construction Corporation Private Limited* (supra) which is also unacceptable for the reasons mentioned in the earlier paras, we reject the stand F taken by the counsel for the respondent. On the other hand, we fully accept the stand of the Union of India as rightly projected by Mr. A.S. Chandhiok, learned ASG. We reiterate that where the parties had agreed that no interest shall be payable, the arbitrator cannot award interest for the amounts payable to the G contractor under the contract. Where the agreement between the parties does not prohibit grant of interest and where a party claims interest and the said dispute is referred to the arbitrator, he shall have the power to award interest pendent elite. As observed by the Constitution Bench in G.C. Roy's case (supra), H in such a case, it must be presumed that interest was an

implied term of the agreement between the parties. However, this does not mean that in every case, the arbitrator should necessarily award interest pendente lite. In the subsequent decision of the Constitution Bench, i.e., *N.C. Budharaj's* case (supra), it has been reiterated that in the absence of any specific stipulation or prohibition in the contract to claim or grant any such interest, the arbitrator is free to award interest.

15. In the light of the above principle and in view of the specific prohibition of contract contained in Clause 1.15, the arbitrator ceases to have the power to grant interest. We also clarify that the Arbitration Act, 1940 does not contain any specific provision relating to the power of arbitrator to award interest. However, in the Arbitration & Conciliation Act, 1996, there is a specific provision with regard to award of interest by the arbitrator. The bar under clause 1.15 is absolute and interest cannot be awarded without rewriting the contract.

16. For the aforesaid reasons, we set aside the award of the arbitrator granting interest in respect of the amount payable to the contractor under the contract as well as the order of the learned Single Judge and the Division Bench of the High Court confirming the same.

17. Consequently, the appeal is allowed to the extent pointed out above with no order as to costs.

N.J. Appeal allowed.