

Interest Barring Clauses need to be strictly construed

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Every judgment is based on its peculiar facts and circumstances and, therefore, decision in one case cannot *ipso facto* be applied to another. It is a matter of common knowledge that legal practitioners/ arbitration consultants, without proper application of mind and in a mechanical manner, and without analyzing the implications involved, apply the dictum of the judgment even to those cases whose facts and circumstances are totally different.

A recent judgment delivered on 25.09.2012 by a 3-Judge Bench of the Supreme Court in the matter of *Tehri Hydro Development Corporation Ltd. vs. Jai Prakash Associates Ltd.*, 2012(4) Arb LR 88, is being quoted before the Courts as well as the arbitral tribunals in support of the contention that the arbitral tribunal is barred from awarding interest in all cases irrespective of the wording of the so-called prohibitory clauses contained therein. It is true that a cursory reading of the prohibitory clauses in the aforesaid case would convince most of the people that what the Supreme Court has decided can be applied to nearly all cases. But this is not so. In order to appreciate the dictum of the Supreme Court, it is necessary to reproduce hereunder for ready reference the clauses which were under consideration in the aforesaid case:-

“1.2.14. No claim for delayed payment due to dispute etc. – The Contractor agrees that no claim for interest or damages will be entertained or payable by the Government in respect of money or balances which may be lying with the Government owing to any disputes, differences or misunderstandings between the parties or in respect of any delay or omission on the part of the Engineer-in-charge *in making intermediate or final payments or in any other respect whatsoever.*”

“1.2.15 Interest on money due to the contractor – No omission on the part of the Engineer-in-charge to pay the money due upon the measurement or otherwise shall vitiate or make void the contract, nor shall the contractor be entitled to interest upon any guarantee or *payments in arrears nor upon any balance which may on the final settlement of his accounts be due to him.*” (Emphasis supplied)

An analysis of the aforesaid clauses would reveal that the bar for grant of interest is applicable for the following:-

- (i) in respect of money or balances which may be lying with the Government; or
- (ii) such unpaid money which may be lying with the Government due to disputes, differences or misunderstanding between the parties; or
- (iii) any delay or omission in making intermediate or final payment, or in any other respect whatsoever; or
- (iv) payments in arrears or money which may become due on final settlement of accounts.

The expression “*in respect of money or balances which may be lying with the Government*” is in the present tense, i.e. the amount should stand quantified at the stage when arbitration clause is invoked. If so, then arbitral tribunal shall have no jurisdiction to award interest. If the amount claimed by the contractor is left to be determined by arbitral tribunal, as a consequence of rejection of the claim by the Government, then it cannot be said that the money was “*lying with*

the Government". In that event, the arbitral tribunal shall have jurisdiction to award interest. Another situation foreseen by the aforesaid clauses is money payable by way of arrears or which may become due on final settlement of accounts. As per the facts of the aforesaid case, the claim by the respondent-contractor was on account of final bill for Rs. 10,17,461.09 for work done. Since the said amount was duly quantified and found favour with the arbitral tribunal, the same stood covered by the expression "*in respect of money or balances which may be lying with the Government*". Thus, the arbitral tribunal was prohibited from awarding interest on the amount which stood quantified on the date when the matter was referred to the arbitral tribunal. It is highly doubtful if prohibition to award interest by the arbitral tribunal shall cover other matters for adjudication like extra claims, damages on account of prolongation of contract etc., which already stand rejected by the Government since it cannot, by any stretch of imagination, be said that the amount was "*lying with the Government*."

It was, therefore, in the said peculiar facts and circumstances that the Supreme Court in para 17 of the above-said case held that clauses 1.2.14 and 1.2.15 "imposed a clear bar on either entertainment or payment of interest in any situation of non-payment or delayed payment of either the amounts due for work done or lying in security deposit".

Reference to certain earlier judgments of the Supreme Court on this issue was also made in the aforesaid judgment. These are:-

- *Sayed Ahmed and Co. vs. State of UP*, (2009)12 SCC 26;

- *Madhani Const. Corp. Pvt. Ltd. vs. Union of India*, (2010)1 SCC 549;
- *Shree Kamatchee Amman Constructions vs. Divisional Railway Manager*, (2010)8 SCC 767; &
- *Union of India vs. Krafte Engg. & Leasing Pvt. Ltd.*, (2011)7 SCC 279

All the above cases were decided by 2-Judge Benches. It will be noticed that in each of the aforesaid cases, the award of interest on the awarded amount was set aside because of the prohibition clause contained in the contract between the parties.

In *Sayeed Ahmed and Co. vs. State of UP*, (2009)12 SCC 26, the clause prohibiting award of interest was as follows:-

“No claim of interest or damages will be entertained by the Government with respect to any money or balance which may be lying with the Government **or any become due** owing to any dispute, difference or misunderstanding with the Engineer-in-charge on the one hand and the contractor on the other hand or with respect to any delay on the part of the Engineer-in-charge in making periodical or final payment or in any other respect whatsoever.”

The aforesaid clause is *para materia* with the clauses under consideration in the case of *Tehri Hydro* case, except for the words “*or any become due*”. These are significant words which have made all the difference. The words “*or any become due*” clearly connote that amount which may become due as a result of an award made by the arbitral tribunal, or which otherwise becomes payable to the contractor. But for the expression “*or any become due*”, the award of interest to the contractor would not have been set aside by the Supreme Court.

[Para 19 of the judgment in *Sayeed Ahmed's* case]

In the matter reported as *Madhani Const. Corp. Pvt. Ltd. vs. Union of India*, (2010)1 SCC 549, clause prohibiting award of interest was as follows:-

“No interest will be payable upon the earnest money or the security deposit or amounts payable to the contractor *under the contract* but Government securities deposited in terms of such clause (1) of the clause will be repayable with interest accrued.

“That the contractor will have no claim for interest or damages whatsoever on any amount of such withholding or retention under the lien referred to supra or duly notified as such to the contractor.”

A bare reading of the aforesaid clause would reveal that the clause is the same as in the earlier two cases, except for the words “*or amounts payable to the contractor under the contract*”. There would have been no difficulty in allowing interest to the contractor but for the words “*under the contract*”. This expression clearly means that all payments, whether existing or which may ultimately become due under the contract, would not qualify for interest.

The clause under consideration of the Supreme Court in *Shree Kamatchee Amman Constructions vs. Divisional Railway Manager*, (2010)8 SCC 767, being the same as in *Madhani Const.* case does not call for any additional comments.

Another judgment which was considered by the Supreme Court in the *Tehri Hydro* case was that of *Union of India vs. Krafter Engg. & Leasing Pvt. Ltd.*, (2011)7 SCC 279. The clause relating to interest in this matter was as under:-

“No interest will be payable on the 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". (Emphasis supplied)

Again, the expression "*amounts payable to the contractor under the contract*" is of paramount importance. The words "*under the contract*" also find mention in the clause considered in *Madnani Const.* case, and thus, the comments made in respect of *Madnani Const.* case apply to *Krafter Engg.* case as well.

Interest clause in *State of UP vs. Harish Chandra & Co, (1999)1 SCC 63*

The judgment in *Harish Chandra's* case was rendered by a 3-Judge Bench of the Supreme Court. However, the same was not considered by the Supreme Court in *Tehri Hydro Development* case. The clause relating to interest in the said case was as under:-

"1.9 No claim for delayed payment due to dispute etc. – No claim for interest or damages will be entertained by the Government with respect to any moneys or balances which may be lying with the Government owing to any dispute, difference or misunderstanding between the Engineer-in-charge in making periodical or final payments or in any other respect whatsoever."

In para 10 of the judgment, in clear and unequivocal terms, states:-

"A mere look at the clause shows that the claim for interest by way of damages was not to be entertained by the Government with respect to only a specified type of amount, namely, any moneys or balances which may be lying with the GovernmentThe words 'or in any other respect whatsoever' also referred to the dispute pertaining to the moneys or balances which may be lying with the Government pursuant to the agreement meaning thereby security deposit or retention money or any other amount which might have been with the Government and refund of which might have been withheld by the Government. The claim for damages or claim for payment for the work done and which was

not paid for would not obviously cover any money which may be said to be lying with the Government.....”

Another important aspect of the matter is that the aforesaid clause was considered by the Supreme Court in *Sayeed Ahmed and Co. vs. State of UP*, (2009)12 SCC 26. In para 18 of the said judgment, it was held:-

“...Having regard to the restricted wording of that clause, this Court held that it did not bar award of interest on a claim for damages or a claim for payment for work done and which was not paid. This Court held that the said clause barred award of interest only on amounts which may be lying with the Government by way of security deposit, retention money or any other amount, refund of which was withheld by the Government.”

In para 19 of *Sayeed Ahmed's* judgment, it was held that “the decision in *Harish Chandra* will not assist the appellant in any manner.”

In para 34 of *Madhani Const.* case, the Supreme Court held as under:-

“...Considering the said clause, the Court held that the prohibition in the said clause does not prevent the contractor from raising the claim of interest by way of damages before the arbitrator on the relevant items placed for adjudication.”

In view of clear, unequivocal and unambiguous wording of the clause relating to interest in *Harish Chandra's* case, the said judgment was relied upon in *Madhani Const.* and *Sayeed Ahmed's* case. Therefore, the dictum of the 3-Judge Bench of the Supreme Court in *Harish Chandra's* case holds good even as on date, i.e. there is nothing in the aforesaid clause, when compared with the clauses referred to in the judgments cited hereinbefore, which would stand in the way of the arbitral tribunal from awarding interest to the contractor. It is

stated that the judgment in the case of *Tehri Hydro Development* case, therefore, has to be read alongwith the judgment rendered by a co-equal bench in *Harish Chandra's* case to understand as to when a clause can be said to prohibit payment of interest.

In case of clauses prohibiting payment of interest, relevant factors which should be kept in mind are the length of litigation and falling value of money. Generally, it takes 15-20 years in India before a litigant passes through various stages of litigation – arbitration, challenge to award, appeals, execution etc. – and tastes the fruits of litigation. In the said time, the value of money due to him greatly depletes. Thus, to award him the same amount which was due to him 20 years ago without any additional compensation by way of interest is nothing but unfairness writ large. The Supreme Court in *Secretary, Irrigation Department, Government of Orissa v. G.C. Roy*, AIR 1992 SC 732 had correctly observed that : “A person deprived of the use of money to which 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.”

Although the law in India does not provide for striking down of unfair and unconscionable conditions of contract, however, in the absence of the same, rules of fairness, equity and fairplay ought to be applied while interpreting blatantly one-sided and unfair conditions of contract, such as clauses prohibiting payment of interest.