

Reasoning to be justified by Arbitral Tribunal in fixation of interest rate

*Executive Engineer vs Gokul Chandra Kanungo*



*Court:* Supreme Court of India

*Decided on:* 30<sup>th</sup> September, 2022

*Judges:* Hon'ble Justice B.R. Gavai, Hon'ble Justice B.V. Nagarathna

By- Tishya Singh

## Facts

On 16<sup>th</sup> December 1971, the parties of this suit entered into an agreement to construct a 3km long road in the stretch of NH-6. The work was agreed to be completed in one year, but it was only completed after six years. A dispute arose between the parties because of the payment due to the respondent.

The respondent filed a suit under Section-20 of the Arbitration Act, 1940 to seek reference of the dispute of arbitration. The suit was decreed in the favour of the respondent and the respondent was directed to file the original copy of the agreement. The respondent failed to comply with this order.

During this time, the Arbitration Act of 1940 was repealed and replaced by the Arbitration and Conciliation Act, 1996.

To this, the respondent filed an application to dispose the suit in the trial court and requested to appoint an Arbitrator as compliance to the act of 1996. This application was dismissed by the trial court. The respondent moved to the High Court under section-11 of the 1996 Act to appoint an Arbitrator, which was allowed by the High Court and an Arbitrator was duly appointed.

The Arbitrator allowed the claim of the respondent and allowed future interest on 18% p.a. in a pendente lite order. The appellant was not satisfied with this order and challenged the award under Section- 34 and Section- 37 of the Arbitration and Conciliation Act, 1996 in District Court and High Court respectively, but both were rejected. Therefore, the petitioner appealed in the Supreme Court.

## Grounds of Challenge

Appellant challenged the award of the Arbitrator on the grounds-

1. Respondent was in a deep slumber for 12 years and did not raise any claims.
2. Respondent failed to comply to the steps of commencement of arbitration as he did not submit original copy of agreement.
3. The interest of 18% p.a. is grossly high and 5 times the principal amount.

The respondent countered the submissions by raising the following arguments:

1. The arbitrator has been given discretion under Section 31(7)(a) of the 1996 Act to award any rate of interest as it deems is fit. Moreover, the rate of interest has been armed by the trial court as well as the High Court, therefore, no interference is called for.

## Analysis

The Supreme Court was of the view that in spite of the fact that Section 31(7)(a) gives the arbitrator the freedom to include interest in the total amount of the award, the section also requires the arbitrator to provide justification for doing so and that it is the duty of the Arbitrator to justify the inclusion of interest.

According to the Supreme Court's interpretation of the award, the arbitrator's decision to provide both pendente lite and future interest at the rate of 18% p.a. was not justified according to the provisions. It was further ruled that because the respondent failed to take any action to assert his claims for a period of 12 years, the arbitrator was not permitted to award interest for the time following the completion of the work until the filing of the lawsuit. As a result, the respondent was denied interest for the aforementioned period due to his own conduct.

The Court then determined that the arbitrator made a second error by awarding interest for the years 1990 to 2000. The defendant did not adhere to the need of retaining the original agreement, but instead, after a lapse of 10 years, led an application for the appointment of an arbitrator, the Court noted, paying attention that the suit under Section 20 of the 1940 Act was decreed in 1990.

The Court determined that no interest could be paid for the time when the respondent was directly at fault for lapses because, had it quickly followed the initial agreement, the arbitration proceedings would have been long over.

The Supreme Court then made a decision regarding the interest rate. It made reference to a number of judgements where the rate of interest was lowered as a result of significant time passing. As a result, in order to fully uphold the law, the Court used Article 142 of the Indian Constitution to lower the interest rate from 18% per annum to 7.5% per annum. The Court determined that there had been a significant amount of time that had passed and that the award holder had made numerous attempts to delay payment, making it appropriate to use Article 142's discretion to reduce the rate of interest. As a result, the Court decreased the interest rate to 7.5% per annum and set aside the award to the degree that it allowed interest from 1977 to 2000. Therefore, the case was decided to side with the petitioner and Supreme Court's ratio decidendi was established that a proper reasoning and justification should be given by the Arbitral Tribunal in case of fixing the interest rates and the award holder is not entitled to the interest if they cause any delay.