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## **SUPREME COURT ON WAIVER OF INTEREST UNDER CONTRACT ACT**

### **A. Introduction**

In *Garg Builders* case,<sup>1</sup> the Supreme Court (SC) opined on 4<sup>th</sup> October 2021 that an arbitrator cannot grant *pendente lite* interest<sup>2</sup> in the event of an express bar in the contract on payment of interest.

### **B. Facts**

1. The respondent Bharat Heavy Electricals Limited (BHEL) had floated tender for construction of a boundary wall (the “Project”). The appellant Garg Builders (GB) submitted its bid for the Project, which was accepted by BHEL.
2. The parties entered into a contract for the Project (“Contract”), which, *inter alia* contained a clause barring interest as follows: “Clause 17: No Interest shall be payable by BHEL on Earnest Money Deposit, Security Deposit or any moneys due to the contractor.”
3. A contractual dispute arose between the parties. GB filed an arbitration petition where, apart from claiming various amounts under different heads, it *inter alia* claimed pre-reference *pendente lite* and future interests.
4. After hearing the parties’ contentions, the arbitrator concluded that there is no prohibition in the Contract about payment of interest for the pre-suit, *pendente lite* and future periods. Therefore, *pendente lite* and future interests were awarded to GB on the award amount from the date of filing of the claim petition till the date of realisation.
5. BHEL challenged the award before the Delhi High Court (HC) on various grounds *inter alia* that *pendente lite* interest on the award amount was expressly barred in the Contract.
6. The HC set aside the arbitral order to the extent of the award of *pendente lite* interest. GB appealed against the HC order challenging the denial.

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<sup>1</sup>*Garg Builders Vs. Bharat Heavy Electricals Limited* MANU/SC/0775/2021.

<sup>2</sup> Interest that accrues during pendency of the suit.

### C. Parties' Contentions

1. GB's counsel contended that Clause 17 of the Contract barring payment of interest to GB on any sum due is *ultra vires* and against the provisions of Section 28 of the Indian Contract Act, 1872 (ICA).<sup>3</sup>
2. BHEL's counsel contended that if the Contract itself expressly bars payment of interest, then it is not open for the arbitrator grant *pendent lite* interest.

### D. Analysis and Conclusion

The SC, after analyzing rival contentions, held as follows:

1. Exception I to Section 28 of the ICA recognises an agreement to refer a matter to arbitration as a condition precedent before going to courts. No cause of action then accrues until the arbitrator has made the award. Only the amount awarded in such arbitration is recoverable in respect of the dispute so referred.
2. Further and more importantly, interest payments in general are governed by the Interest Act, 1978 ("**Interest Act**") in addition to the specific statutes that govern an impugned matter. Section 3(3)(a)(ii) of the Interest Act prescribes that it will not apply to situations where the payment of interest is "*barred by virtue of an express agreement.*"<sup>4</sup>
3. Thus, when there is *an express statutory permission* for the parties to contract out of receiving interest and they have done so without any vitiation of free consent, it is not open for the arbitrator to grant *pendente lite* interest.
4. It was thus held that Clause 17 of the Contract is not *ultra vires* Section 28 of the ICA.

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<sup>3</sup> **Section 28: Agreements in restraint of legal proceedings, void.**- *Every Agreement is void to the extent that any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights.*"

Exception 1 *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.*"

<sup>3</sup> *Sree Kamatchi Amman Constructions v. The Divisional Railway Manager (Works), Palghat and Ors.* MANU/SC/0625/2010.

<sup>4</sup>“(3) Nothing in this section,—

(a) shall apply in relation to—

(i) \*\*\*

(ii) any debt or damages upon which payment of interest is barred, by virtue of an express agreement;”