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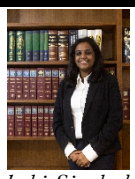

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ARBITRAL INTEREST RATE & PARTY AUTONOMY

The Supreme Court of India (**SC**), on December 04, 2025, in the *BPL Limited* case,[1] addressed critical aspects regarding the sanctity of contractual interest rates in commercial transactions and the scope of Section 31(7)(a) of the Arbitration and Conciliation Act, 1996 (**Act**).

Brief Facts

BPL Limited (**BPL**) and BPL Display Device Ltd (**BDDL**) (collectively, **Companies**) together approached Morgan Securities and Credits Private Limited (**MSCPL)** for a bill discounting facility. The mutually-agreed terms in the sanction letters provided for a normal interest rate of 36% p.a. with monthly rests, which would be reduced to a concessional rate of 22.5% p.a. if payments were made on due dates.

By 2004, a sum of about INR 25 crore became due against various bills of exchange, which the Companies defaulted on. Due to this, MSCPL invoked arbitration. During arbitration, the claim against BDDL was dropped as it had entered into liquidation proceedings. The sole arbitrator awarded MSCPL against BPL the principal sum along with interest at the contractual rate of 36% p.a. with monthly rests for the pre-award period. BPL challenged the award, contending that the interest rate was usurious, unconscionable, and amounted to 'penal interest on penal interest' which was allegedly opposed to public policy.

Both BPL and the Respondent challenged the Arbitral Award before a Single Judge of the Delhi High Court (**SJ**). The SJ:

- Set aside the award regarding one specific bill of exchange for about INR 75 lakhs ruling it was barred by limitation because partial payments made in 2005 were not adjusted against it.
- Upheld the 36% p.a. contractual interest rate, stating that interest granted according to agreed terms cannot be set aside by invoking general principles of equity or fairness.
- Affirmed the arbitrator's decision to discharge a surety from liability.

Dissatisfied with the SJ's order, BPL appealed before the Division Bench of the High Court of Delhi (**DB**). The DB dismissed the appeal and ruled that while the 36% interest rate was on the higher side, it was not so unreasonable as to shock the conscience of the court or violate public policy.

Aggrieved by this, BPL approached the SC.

[1] *BPL Limited v. Morgan Securities and Credits Private Limited*, 2025 LiveLaw (SC) 1169.

SC's Judgement & Reasoning

It dismissed the appeal, upholding the concurrent findings of the Arbitrator and the SJ and DB.[2] Its reasoning focused on several fundamental commercial and legal pillars:

- Primacy of Party Autonomy:[3] The SC emphasized that Section 31(7)(a) of the Act with the expression "*Unless otherwise agreed by the parties...*" qualifies the entire provision. This means that if parties have mutually agreed upon a specific interest rate in a written contract, the Arbitral Tribunal loses its discretion to award what it deems a reasonable rate and must strictly adhere to the agreed terms.
- Nature of Commercial Transactions:[4] The SC distinguished a bill discounting facility from a traditional loan, noting it is a short-term financing option for immediate liquidity. Consequently, it held that the Usurious Loans Act, 1918 does not apply to such purely commercial transactions between sophisticated corporate entities.
- Compounding Interest and Public Policy:[5] The SC rejected the argument that compounding interest (*i.e.*, interest on interest) is opposed to public policy in a commercial context. It noted that high interest rates reflect the lender's risk and the necessity of redeploying capital in the business cycle. For large corporates with equal bargaining power, such terms cannot be termed unconscionable or *in terrorem* (meaning "by way of threat") after the benefits of the contract have been reaped.
- Inapplicability of *Contra Proferentem*:[6] The SC ruled that the *maxim verba chartarum fortius accipiuntur contra proferentem* (interpreting ambiguity against the drafter) has no application in bilateral commercial contracts where the terms are clear and unambiguous.
- Adoption of the Cavendish Test:[7] Moving away from a rigid 'genuine pre-estimate of loss' test, the SC leaned towards the modern 'legitimate interest' test. It held that a clause is not penal if it protects a legitimate business interest and the detriment imposed is not out of all proportion to that interest.

The SC concluded that while the courts may protect vulnerable parties, it cannot rewrite the terms of a voluntary commercial agreement between parties of equal bargaining strength just because the interest rate appears humungous in hindsight.

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[2] Paragraph 141 of the Judgement.
[3] Paragraphs 52 and 64 of the Judgement.
[4] Paragraph 50 of the Judgement.
[5] Paragraph 140 of the Judgement.
[6] Paragraphs 114 to 131 of the Judgement.
[7] Paragraphs 107 and 108 of the Judgement.