KHAITAN &CO
Advocates since 1911

UPDATE

ERGO

Analysing developments impacting business

SUPREME COURT LAYS DOWN GUIDELINES TO DETERMINE THE INTEREST PAYABLE ON ARBITRAL AWARDS IN INTERNATIONAL COMMERCIAL ARBITRATIONS

25 October 2018

On 11 October 2018, the Supreme Court of India (Supreme Court), in Vedanta Limited *v* Shenzen Shandong Nuclear Power Construction Company Limited (Civil Appeal No. 10394 of 2018), laid down the guidelines to be followed by arbitrators while awarding interest in an arbitral award pursuant to an international commercial arbitration. These guidelines take into account international best practices and the law of the seat of arbitration. Importantly, the Supreme Court has provided that such interest cannot be penal in nature, despite the interest awarded being a form of reparations.

Background

The dispute pertains to four contracts (EPC contracts) between the purchaser, Vedanta Limited (Appellant) and the supplier, Shenzen Shandong Nuclear Power Construction Company Limited, a company incorporated in China (Respondent). The EPC contracts contained four identical arbitration agreements which designated Mumbai, India as the seat of arbitration. The contracts contained detailed clauses regarding the suspension and termination of the contract and the compensation payable to the Respondent in the event of such termination However, the EPC Contracts did not contain provisions regarding the award of interest on compensation payable. When a dispute arose regarding the EPC Contracts, the Respondent initiated arbitration proceedings against the Appellant. These proceedings constituted an international commercial arbitration governed by Part I of the Arbitration and Conciliation Act, 1996 (Act).

The arbitral tribunal's award contained separate sums of money payable under each claim (Award Amount). Under the first claim, a portion of the Award Amount was designated in Indian Rupees, while the rest was designated in Euros. Additionally, the arbitral award imposed an interest rate of 9% on the Award Amount payable from the date of the arbitral award, subject to the condition that the Award Amount is paid by the Appellant to the Respondent within 120 days of the date of the award. The arbitral award further stipulated that if the Award Amount was not paid to the Respondent within this 120 day period, the interest on the Award Amount would be payable at the rate of 15% till the date the amount was paid / date of realization.

The arbitral award was challenged by the Appellant before a single bench of the High Court of Delhi (High Court) under Section 34 of the Act. The single bench of the High Court dismissed the challenge. Thereafter, the Appellant filed an appeal before the division bench of the High Court under Section 37 of the Act. The appeal was dismissed by the division bench of the High Court. Ultimately, the Appellants preferred a special leave petition (SLP) before the Supreme Court. The contentions of the SLP were restricted to the rate of interest awarded on the Award Amount.

Analysis of the Supreme Court's Judgment

The Supreme Court modified the interest rates awarded by the arbitral tribunal considerably, keeping in mind Section 31(7)(b) of the Act and internationally recognized norms regarding interest rates in arbitral awards. Over the course of its analysis of Section 31(7) of the Act, the Supreme Court observed that an award of interest compensates a party for its forgone return on investment, or for money withheld without justifiable cause. It went on to differentiate between the interest as referred to in Section 31(7)(a) of the Act, which pertains to the time period when the case is *pendente lite*, and Section 31(7)(b) of the Act, which deals with interest on award amount after the date of the award. The Supreme Court observed that the crucial difference between the sub-clauses was the discretion accorded to the tribunal. While Section 31(7)(a) of the Act left the determination to the discretion of the arbitral tribunal, Section 31(7)(b) of the Act denies the tribunal such discretion and mandates that the rate of interest be 2% higher than the current rate of interest, as on the date of the award.

Accounting for the above, the Supreme Court did not uphold the interest rates stipulated by the arbitral award on the following two grounds:

Ground One

The Supreme Court held that the dual interest rate of 9% and 15% is penal, as opposed to being compensatory in nature. The Supreme Court observed that the increase in the interest amount was steep, and that the time period it was based on was arbitrary because 120 days is the time within which an appeal to an arbitral award may be filed, as per Section 34 of the Act. A penal rate of interest cannot be imposed during the statutory time period of an appeal, or afterwards.

The Supreme Court further observed that there are no standard rules for the award of interest in international commercial arbitration, and the process is "riddled with consistencies". However, such awards must be made keeping in mind reasonableness and the following eight considerations:

"*(i) the 'loss of use' of the principal sum;*
(ii) the types of sums to which the Interest must apply;
(iii) the time period over which interest should be awarded;
(iv) the internationally prevailing rates of interest;
(v) whether simple or compound rate of interest is to be applied;
(vi) whether the rate of interest awarded is commercially prudent from an economic standpoint;
(vii) the rates of inflation and
(viii) proportionality of the count awarded as Interest to the principal sums awarded."

Therefore, the dual interest rate was rejected by the Supreme Court and a rate of 9% till the date of realization of the arbitral award was determined for the portion of the Award Amount to be paid in Indian Rupees.

Ground Two

The Supreme Court modified the impugned arbitral award because it imposed a flat interest rate on two sums of different international currencies. Interest at the rate of 9% for the award amount in Euros was observed to be unduly high, and in the nature of compensation, which was not provided for in the EPC contracts. The Supreme Court modified the arbitral award and mandated that interest on the Euro component of the Award Amount be paid as per LIBOR with a margin of 3%. In doing so, the Supreme Court acknowledged the importance of LIBOR, which is the average interest rate calculated on the interest rates paid by various banks in London on the amount they pay after borrowing from other banks.

Comment

This judgment adds to the catena of recent judgments by the Supreme Court that aim at strengthening India's capacity to deal with international commercial arbitrations and the improvement of the international community's perception of the same. A judgment which lays down clear guidelines regarding the levy of interest on arbitral awards contributes significantly towards streamlining the substantive and procedural considerations to be used by arbitrators while granting awards. Furthermore, reference to international benchmarks such as LIBOR not only align arbitration law in India to global best practices, but also ensure that the tenets of reasonableness and non-arbitrariness are adhered to. This allays the concerns of the school of thought that believes that the globalization of India's arbitration regime cannot account for due process.

- *Chakrapani Misra (Partner), Sairam Subramaniam (Senior Associate) and Rajeswari Mukherjee (Associate)*

For any queries please contact: editors@khaitanco.com.

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com