



# Arbitration Weekly Update

October 26, 2018

## **Vedanta Ltd. v. Shenzhen Shandong Nuclear Power Construction Co. Ltd. 1 (October 11, 2018)**

### **INTRODUCTION**

In an international commercial arbitration seated in India, the tribunal awarded an increase in the rate of interest for the post award period if the award debtor failed to make payment of the award amount within a period of 120 days from the making of the award. The Award of Interest was such that if the amounts awarded were realized within 120 days from the making of the award, the sum would carry interest at the rate of 9%, and if the award debtor failed to make payment of the award amount within 120 days, the sum would carry further interest at the rate of 15 % till the date of realization of the award amount ("**Award of Interest**"). The issue which arose for consideration before the Supreme Court ("**SC**") was whether such an escalation in the rate of interest for the post-award period was maintainable.

### **BACKGROUND**

In an arbitration between Vedanta Ltd. ("**Vedanta**"), a company incorporated in India, and Shenzhen Shandong Nuclear Power Construction Co. Ltd ("**Shenzen**"), a company incorporated in China, the tribunal passed an Award dated November 9, 2017 ("**Award**") in favour of Shenzhen (Claimant therein). Under the Award, the tribunal awarded payment of the different heads of claim in two currencies i.e. Indian Rupees and in Euros. The same Award of Interest was made applicable to the Indian Rupee ("**INR**") and the Euro component of the Award. The tribunal also awarded costs to Shenzhen and rejected the counter claims filed by Vedanta.

Vedanta filed an application before the Delhi High Court ("**Delhi HC**"), under section 34 of the Arbitration and Conciliation Act, 1996 ("**Act**") to set aside the Award. By an order dated February 12, 2018, Ld. Single Judge of the Delhi HC held in favor of Shenzhen and rejected the said application. Subsequently, Vedanta filed an appeal before the division bench of the Delhi HC under section 37 of the Act. The division bench dismissed the appeal under an Order dated August 30, 2018 ("**Order**").

In the circumstances, Vedanta filed an appeal before the SC by way of a special leave petition. In the proceedings before the SC, Vedanta challenged the Award only to the extent of the Award of Interest.

### **OBSERVATION & FINDINGS OF THE COURT**

#### ***Applicability of section 31 (7) (b) of the Act***

The SC observed that in an international commercial arbitration, the rate of interest is governed by the law of the seat of arbitration, unless parties agree otherwise. Since this international commercial arbitration is seated in India, the rate of interest must be awarded in accordance with the provisions of the Act.

Section 31(7) (a) and section 31(7) (b) of the Act are with respect to interest for the pre-reference and post award period respectively. Upon examining the construction of section 31(7) of the Act, the SC observed that since section 31 (7)(a) begins with the words '*unless otherwise agreed by the parties*', interest for the pre-reference and *pendente lite* period is subject to the agreement between the parties, and in the absence of any agreement, the arbitral tribunal is vested with the discretion to award interest as it deems reasonable. Further, the SC noted that interest for the post award period is not subject to party autonomy or an agreement between the parties since the words '*unless otherwise agreed by the parties*', remains absent in section 31(7) (b). Therefore, the SC concluded that while the arbitral tribunal has discretion to award interest, the same must be "*exercised reasonably*".

#### ***Relevant considerations in an award for interest***

The SC observed that while the rate of interest must be compensatory in the form of a reparation granted to an award holder, it must not be punitive, unconscionable or unsurious in nature. Accordingly, the SC laid down the criteria which must be factored in while making an award for interest – (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*.

<sup>1</sup> Civil Appeal No. 10394 of 2018, Arising out of SLP (Civil) No. 25819 of 2018

Testing the above factors in the present circumstances, the SC held that “*dual rate of interest awarded seems to be unjustified.*”. The SC held that the rate of interest applicable if Vedanta failed to make payment of the award amount within 120 days (i.e. 15%) was “*exorbitant, from an economic standpoint, and has no co-relation with the prevailing contemporary international rate of Interest.*”

### **Conflict with Section 34(3) of the Act**

Upon conjointly reading the Award of Interest with section 34 (3) of the Act, the SC concluded that the Award of Interest is in contradiction with section 34 (3) which provides a maximum period of 120 days to file an application to set aside an award. The SC observed that if an award debtor is made to pay a higher rate of interest after the 120 days period, it would “*foreclose or seriously affect his statutory right to challenge the Award by filing objections under Section 34 of the said Act*” and an “*Award-debtor cannot be subjected to a penal rate of interest, either during the period when he is entitled to exercise the statutory right to challenge the Award, before a Court of law, or later.*”

### **Agreement between the parties excluded consequential damages**

In the contract between Vedanta and Shenzhen, the termination clause provided that in the event of termination, the purchaser would pay the supplier 105% of the cost incurred by the supplier as compensation and no consequential damages shall be payable by the purchaser to the supplier. In terms thereof, the tribunal awarded Shenzhen with 105% of the costs incurred under the contract. The SC observed that the since Shenzhen was awarded 105% of the costs in terms of the contract and given that parties agreed for no consequential damages to be payable, the award of interest at the rate of 9% on the Euro component of the claim was contrary to the contract as it would result in Shenzhen being awarded compensation.

With respect to the uniform rate of interest awarded on the INR and Euro component of the Award, the SC held that interest rates must differ depending on the currency and the tribunal has erroneously granted a uniform rate of interest on both the INR and Euro component in the Award. During the proceedings before the SC, a proposal was made to compute the interest component in accordance with LIBOR plus a margin. The SC concurred that LIBOR is an average interest rate calculated from time to time, based on inputs given by major banks in London as to their interest rates.

Based on the above findings, the SC struck down the portion of the Award of Interest which provided for interest at the rate of 15% on the post 120 days period from the date of the award. The SC clarified that a uniform interest at the rate of 9% would be applicable for the INR component till the date of realization of the Award and revised the rate of interest on the Euro component to interest at the LIBOR rate + 3% points (prevailing on the date of the Award) till the date of realization of the Award.

## **CONCLUSION**

The decision is welcome to the extent that it revised the rate of interest applicable on the Euro component to meet the tests of reasonability and addressed the implications of the Award of Interest on Section 34(3) of the Act. However, the SC completely struck down the applicability of a penal rate of interest upon the failure to make payment of the award amount in a stipulated time-period. Considering that banks and lending institutions have escalating rate of interests based on the payment schedule of the borrower, the SC may have extended the 120 days limit to rule out any conflict with section 34(3) of the Act and thereafter awarded a nominal elevation in the rate of interest to incentivize speedy realization of awards.

Further, while the SC held that the agreement between the parties excluded consequential damages and given that in any event, interest for the post award period is not subject to any agreement between the parties, has the SC implied that an award for interest can be equated on the same footing as an award for consequential damages?

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