Arbitral Award Granting Higher Rate Of Interest Isn't Against Public Policy Of India: Supreme Court

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Introduction

In a recent case titled ***Sri Lakshmi Hotel Pvt. Ltd. vs. Shriram City Union Finance Ltd.***, the Supreme Court has held that an arbitral award which imposes a high or even exorbitant rate of interest, in line with current commercial practices, does not breach the fundamental policy of Indian law or offend basic notions of morality or justice under Section 34 of the Arbitration and Conciliation Act, 1996 ("**the Act**").

Brief Facts

The Appellants, Sri Lakshmi Hotel Pvt. Ltd. and its Managing Director, had taken two loans from Sriram City Union Finance Ltd. ("**Respondent No. 1**") in 2006 totalling about INR 1.57 crores. The interest stipulated in both agreements was 24% *p.a.*. Although the appellants paid around INR 44.66 lakhs till April 2007, they stopped making further payments. Multiple demand notices were sent. The borrowers replied to these demand notices but did not dispute the principal amount at that time. The appellants vide the letter dated 25.01.2008, objected to the interest rate of 24% *p.a.* and contended that only 12% *p.a.* was payable on the loan amount. In 2008, the appellant issued a cheque for a "*full and final settlement*", but the cheque bounced.

Thereafter, the parties invoked Arbitration. By the award dated 27.12.2014, the sole arbitrator awarded INR 2.21 crores plus 24% interest *p.a.* from the date of claim till realisation. The appellants then filed a petition under Section 34 of the Act before the Single Judge of the High Court. On 16.11.2017, the Single Judge dismissed it, holding that the arbitrator had properly appreciated the facts and the terms of the contract.

Since the appellants did not pay the decretal amount, Respondent No.1 filed a petition under Section 7 of the Insolvency and Bankruptcy Code ("**IBC**") before the NCLT, Chennai. The NCLT admitted the petition on 28.02.2019 and appointed an IRP. As no resolution plan was submitted, the IRP moved an application under Section 33(2) of IBC for liquidation. On 17.07.2019, the NCLT ordered liquidation of Appellant No.1.

The Appellants filed an appeal under Section 37 of the Act against the dismissal of the Section 34 application. The Division Bench dismissed it and affirmed the findings of the Single Judge and the arbitrator. Aggrieved, the appellants approached the Supreme Court.

Issue

The main issue before the Supreme Court was whether interest at the rate of 24% as provided in the agreements between the parties could be said to be against 'public policy'; and whether the High Court had committed any error in dismissing the Section 37 appeal, which had the effect of affirming the order passed in the Section 34 proceedings.

Observations

The Supreme Court noted at the outset that although the arbitral award had been passed quite some time back, the respondent was still unable to recover the entire dues. It observed that even if post-award interest were recalculated at the default rate of 18%, the recovery position would not materially improve.

The Supreme Court observed that grant of post-award interest under Section 31(7)(b) is mandatory. Under this provision, the arbitrator has discretion only with respect to the rate of post-award interest. If the arbitrator does not fix any rate, the statutory rate of 18% *p.a.* would be applicable. Here, since the contracts themselves provided for 24% *p.a.*, the arbitrator merely gave effect to what the parties had already agreed.

The Supreme Court further noted that the transaction was purely commercial and high-risk. The borrowers had already defaulted in repaying a previously availed loan facility, and a higher contractual rate of 24% had been agreed upon. The Supreme Court held that since the Section 34 and Section 37 courts had upheld the agreements, interference would amount to re-appreciation of evidence, which is expressly barred under the proviso to Section 34(2A) of the Act. It remarked that although an interest rate of 24% may appear 'exploitative' or 'unfair' at first glance, such a rate reflects market risks in commercial lending.

With respect to the issue *whether the high rate of interest is against the 'public policy of India',* the Supreme Court held that on a plain reading of clauses (ii) and (iii) of Explanation 1 to Section 34(2)(b), it could not be said that merely imposing a high or even exorbitant rate of interest, in line with current commercial practices, amounted to a breach of the fundamental policy of Indian law or offended basic notions of morality or justice.

It observed that the fundamental policy of Indian law does not refer to every violation of a statute but only to fundamental principles on which Indian law is based. Any disagreement about the rate of interest clearly falls outside the scope of challenge under "public policy", unless the rate awarded is so perverse or so unreasonable that it shocks the conscience of the Court. Without such shocking unreasonableness, there is no warrant for interference with an arbitral award granting interest.

Accordingly, the Supreme Court refused to interfere with the impugned order of the High Court.

Comment

The Supreme Court has taken a fairly practical approach. In commercial lending disputes, especially where the borrower already has a history of default, lenders often load higher risk into the interest component. So, to say later that such contractual rate suddenly becomes "*immoral*" or against public policy doesn't really hold water. The Supreme Court has basically reminded that once parties freely sign on the dotted line, and the arbitrator has only applied the same term, Section 34 courts shouldn't try to sit in appeal over what is essentially a business bargain. The Court has rightly cautioned that unless the rate is so absurd that it shocks the conscience, the ground of "*public policy*" cannot be stretched to rewrite the contract.

This judgment is a signal for borrowers to be careful before crying foul on interest terms that they themselves accepted at the negotiation stage. The Court has clearly read Explanation 1 to Section 34(2)(b) in a narrow way, reaffirming that "fundamental policy of Indian law" is not a catch-all to challenge every harsh clause. Some might argue that 24% *p.a.* is steep, but the Court has treated it as a commercial reality rather than something per se illegal. The ratio also strengthens the finality of arbitral awards, because if courts begin reducing interest routinely, it will open the gates for re-appreciation of evidence which the Act plainly prohibits.

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