

THE HIGH COURT OF DELHI AT NEW DELHI

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Judgment delivered on: 13.03.2012

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CM No.6431/2008 in OMP 52/2008

MUNICIPAL CORPORATION OF DELHI

... Petitioner

Versus

M/S BINDRA ASSOCIATES

... Respondent

Advocates who appeared in this case:

For the Petitioner : Ms Amita Gupta

For the Respondent : Ms Renuka Arora with Ms Rishi Beri

CORAM:-

HON'BLE MR JUSTICE BADAR DURREZ AHMED

JUDGMENT

BADAR DURREZ AHMED, J

1. By way of this application, the petitioner (Municipal Corporation of Delhi)(MCD) is seeking a review of the judgment dated 23.01.2008 in OMP No. 52/2008, limited to the question of alleged award of interest on interest for the pre-award period by the learned Arbitrator and its subsequent confirmation by this court by virtue of the said decision. The learned counsel for the petitioner submitted that this court ought to take note of the decision of the Supreme Court in the case of **State of Haryana v. S. L. Arora & Co.**: 2010 (1) Arb. LR 527 (SC), even though it was subsequent to the judgment of which review is sought. On the other hand, the learned counsel for the respondent submitted that the judgment dated 23.01.2008 makes it abundantly clear that the present

case is not one of interest on interest but one where the payments by the petitioner have been first appropriated towards the interest and then the principal amounts due from the petitioner to the respondent.

2. At this juncture, it ought to be pointed that the said OMP No.52/2008 was heard alongwith other connected matters and was disposed off by the said common judgment dated 23.01.2008. As an illustration, the facts of OMP No.48/2008 were taken in the context of the petitioner's argument that interest was being charged on interest. Paragraphs 15 and 16 of the said judgment are relevant and they are as follows:-

“15. The next issue is with regard to the question of interest being charged on interest. As an illustration, the facts in OMP 48/2008 are being taken. The arbitrator has, in that case, awarded interest as indicated below:

“So the total amount of interest under this claim as payable by the respondent to the claimant till the date of this award (31st Oct, 2006) comes to :-

Interest on Rs 1,15,647/- from 25.03.2000 = Rs 50,556/-
to 17.11.2003 @ 12% per annum

Interest on Rs 50,556/- from 18.11.03 = Rs 17,903/-
to 31.10.2006 @ 12% per annum

Interest on Rs 18,740/- from 25.8.2000 = Rs 10,859/-
to 24.6.05 @ 12% per annum

Interest on Rs 10868/- from 25.6.05 to = Rs 1,758/-
31.10.2006 @12% per annum

Total **Rs 81,076/-**

So a total amount of Rs 81,076/- is awarded to the claimant as interest on delayed payments and as pre-suit & pendente lite interest upto the date of this award.”

16. The computation given above shows that interest is being given on Rs 1,15,647/- being the principal amount due under the final bill. The interest has been calculated for the period from 25.03.2000 to 17.11.2003. The date of 25.03.2000 has been taken because it is one month subsequent to the issuance of the final bill or in other words the date on which the bill ought to have been paid. The date of 17.11.2003 has been taken because it is on that date that a sum of Rs 1,15,647/- was paid by the petitioner to the respondents. The interest for this duration has been computed on Rs 1,15,647/-. The second calculation is with regard to the interest on the sum of Rs 50,556/- from 18.11.2003 to 31.10.2006 (i.e. the date of the award). The learned counsel for the petitioner contended that the interest amount of Rs 17,903/- on the amount of Rs 50,556/- cannot be awarded as that would amount to granting interest on interest. I am unable to agree with this contention of the learned counsel for the petitioner. This is so because on 17.11.2003 an amount of Rs 1,66,203 had become due towards principal (Rs 1,15,647) and interest (Rs 50,556/-). The payment of Rs 1,15,647/- on 17.11.2003 would first be appropriated towards interest due and the balance would have to be appropriated from the principal. Since, the interest due was less than the payment made, a part of the payment made would also be appropriated against the principal amount due. Therefore, the payment of Rs 1,15,647/- on 17.11.2003, completely exhausted the interest due as on that date as also part of the principal which was due. The balance amount of Rs 50,556/- cannot be regarded as interest but as portion of the principal which was initially due. Therefore, the petitioner's contention that interest being charged on this amount of Rs 50,556/- would be interest on interest is not tenable. The same reasoning would apply for the computation of interest of Rs 1,758/- in respect of the security deposit amount.”

3. It is clear that in the judgment dated 23.01.2008, because of the manner of appropriation of the payments made by the petitioner, all the four amounts of interest (₹ 50,556/-, ₹ 17,903/-, ₹ 10,859/- and ₹

1,758/-) were regarded as interest on the principal amounts or on part thereof. As a result, the petitioner's contention that the learned arbitrator had awarded interest on interest had been rejected. It must also be made clear that in the present case (OMP No. 52/2008) the interest amounts were similarly calculated by the learned arbitrator as would be clear from the following computation:-

Interest on Rs 1,53,342/- from 25.9.99 to 4.10.2001 @ 12% per annum	= Rs 37,244/-
Interest on Rs 37,244/- from 5.10.2001 to 31.10.2006 @ 12% per annum	= Rs 22,664/-
Interest on Rs 15,990/- from 25.2.2000 to 8.8.2002 @ 12% per annum	= Rs 4,709/-
Interest on Rs 4,703/- from 9.8.2002 to 31.10.2006 @12% per annum	= Rs 2,385/-
Total	Rs 67,001/-

4. Thus, as per the judgment dated 23.01.2008, in the present case, the interest amounts of ₹ 37,244/- and ₹ 22,664/- were considered as interest on the principal amount of ₹ 1,53,342/- against the final bill and on ₹ 37,244/- which was the remaining part of the principal amount after appropriation of the sum of ₹ 1,53,342/- which was paid on 4.10.2001, first towards the interest amount of ₹ 37,244/- and then towards the principal amount to the extent of ₹ 1,16,098/-. To make things clear, the respondent had completed the work on 25.08.1999. As per the contract between the parties, the payment under the final bill became due after one month of the completion of the work. The final bill amount was ₹ 1,53,342/- and payment ought to have been made by the petitioner on

25.09.1999 (one month after the completion of the work). But the payment was delayed and a sum of ₹ 1,53,342/- was paid only on 04.10.2001. Therefore, the learned arbitrator, holding that the respondent was entitled to interest on the final bill amount on account of the delay in payment computed an amount of ₹ 37,244/- as interest thereon @ 12% p.a. for the period 25.09.1999 to 04.10.2001. However, it seems that the sum of ₹ 1,53,342/- was first appropriated towards the interest amount of ₹ 37,244/-. As such, the balance amount of ₹ 1,16,098/- (₹ 1,53,342/- minus ₹ 37,244/-) was then appropriated towards the principal amount of the final bill, leaving a balance principal amount of Rs 37,244/- (₹ 1,53,342/- minus ₹ 1,16,098/-). This balance amount of ₹ 37,244/- was not the interest amount but was part of the principal amount which remained unpaid on 04.10.2001. And, the interest thereon for the period 05.10.2001 to 31.10.2006 (date of the award) of ₹ 22,664/- was regarded as interest on the balance principal amount and not as interest on interest. The position with regard to the security deposit amount of ₹ 15,990/- is similar. Looked at in this manner, as per the judgment dated 23.01.2008, the interest amounts were not by way of interest on interest.

5. This would be the appropriate point to consider the decision of the Supreme Court in the case of ***S.L. Arora (supra)***. It must be noted straightaway that the questions which arose for consideration in that case, as mentioned in paragraph 7 of the decision, were – (1) Whether Section 31(7) of the Arbitration and Conciliation Act, 1996 authorises and enables an arbitral tribunal to award interest on interest ***from the date of award?*** and (2) Whether the arbitral award granted ***future interest from the date of award***, only on the principal amount found due to the

respondent or on the aggregate of the principal and interest up to the date of award? From this, it is immediately clear that the Supreme Court in the case of **S.L. Arora** (*supra*) was considering the post award interest. In the present case, the question is of pre-award interest.

6. In the backdrop of the two questions which the Supreme Court was considering, it held [in paragraph 14] that:-

“Section 31(7) makes no reference to payment of compound interest or payment of interest upon interest. Nor does it require the interest which accrues till the date of the award, to be treated as part of the principal from the date of award for calculating the post-award interest...”

“..In the absence of any provision for interest upon interest in the contract, the arbitral tribunals do not have the power to award interest upon interest, or compound interest, either for the pre-award period or for the post-award period.”

It is obvious that though the Supreme Court was concerned with interest in the post-award scenario, it did hold that in the absence of a provision for interest on interest in the contract, an arbitral tribunal would not have the power to award interest on interest “*either for the pre-award period or for the post-award period*”. In the case at hand, no provision of the contract has been pointed out as would enable the charging of interest on interest or compound interest. Consequently, the learned arbitrator did not have the power to award interest on interest even for the pre-award period. But, the question is – did the arbitrator award interest on interest? According to the view taken by this court in the said judgment dated 23.01.2008, the learned arbitrator has not awarded any interest on interest for the pre-award period. That view was founded on the normal rule of appropriation of a payment towards a debt, in the sequence of

appropriation, first against the outstanding interest amount and, then, against the principal amount. The questions which, therefore, need to be answered are – (1) What is this rule of appropriation? and (2) Does it apply to the facts of the present case?

7. As pointed out in **Gurpreet Singh v. Union of India: (2006) 8 SCC 457**, “[a]ppropriation is the act of setting apart or assigning a thing or substance to a particular use or person to the exclusion of others; application to a special use or purpose”. The Supreme Court also noted that there were three specialized meanings to the term, one of them being ‘appropriation of payments’, which generally entailed that if a debtor makes a payment to a creditor and does not specify which debt the payment is in settlement of, the creditor may appropriate it to any of the debts outstanding on the debtor’s account.

8. Sections 59 to 61 of the Indian Contract Act, 1872 deal with appropriation of payments when there are several debts. The said provisions are as under:-

“59. Application of payment where debt to be discharged is indicated.-- Where a debtor, owing several distinct debts to one person, makes a payment to him, either with express intimation, or under circumstances implying, that the payment is to be applied to the discharge of some particular debt, the payment if accepted, must be applied accordingly.

60. Application of payment where debt to be discharged is not indicated.-- Where the debtor has omitted to intimate, and there are no other circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion

to any lawful debt actually due and payable to him from the debtor, whether its recovery is or is not barred by the law in force for the time being as to the limitations of suits.”

61. Application of payment where neither party appropriates.--Where neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are or are not barred by the law in force for the time being as to the limitation of suits. If the debts are of equal standing, the payment shall be applied in discharge of each proportionably.”

9. As observed in ***Gurpreet Singh*** (*supra*), the rule of appropriation as applied in India was summed up in the full bench decision of the Madras High Court in ***Garimella Suryanarayana v. Gada Venkataramana Rao***: ***AIR 1953 Mad 458*** in the following manner:-

“5. The principles governing appropriation of payments made by a debtor are under the general law well settled. When a debtor makes a payment, he has a right to have it appropriated in such manner as he decides and if the creditor accepts the payment, he is bound to make the appropriation in accordance with the directions of the debtor. This is what is known in England as the rule in *Clayton case* [(1816) 1 Mer 572: 35 ER 781] and it is embodied in Section 59, Contract Act. But when the debtor has not himself made any appropriation, the right devolves on the creditor who can exercise it at any time, vide *Cory Bros & Co. v. Owners of the Turkish Steamship ‘Mecca’* [1897 AC 286: (1895-99) All ER Rep 933 (HL)] and even at the time of the trial: vide *Seymour v. Pickett* [(1905) 1 KB 715]. That is, Section 60, Contract Act. It is only when there is no appropriation either by the debtor or the creditor that the Court appropriates the payments as provided in Section 61, Contract Act.”

10. But, the provisions of sections 59 to 61 of the Indian Contract Act, 1872 apply only to situations where there are several distinct debts and not where only one debt is due. This is also made clear in **Gurpreet Singh** (*supra*) as under:-

“13. It has to be noted that Sections 59 to 61 of the Contract Act get attracted only when more than one debt is due from a debtor to the creditor. The sections would not get attracted when there is only one debt due...”

Consequently, the provisions of sections 59 to 61 of the Indian Contract Act, 1872 would not govern the case at hand because, here, we are not concerned with several distinct debts but with a situation where the principal and interest are due on a single debt. Therefore, the answer lies elsewhere.

11. In **Industrial Credit & Development Syndicate v. Smithaben H. Patel**: (1999) 3 SCC 80, the Supreme Court made it clear that “*the principal and interest due on a single debt ... cannot be held to be several distinct debts*”. In that very decision, the Supreme Court approved, *inter alia*, the following passage from a Full Bench decision of the Lahore High Court in **Jia Ram v. Sulakhan Mal**: AIR 1941 Lah 386:-

“..It will be seen that these rules have no application to a case in which only one debt is due and at the time of payment, besides the principal sum secured, interest has also accrued due. In such cases, the rule of English Law, laid down as far back as 1702 in *Chase v. Box* [(1702) 2 Freeman 261; 22 ER 1197] is that

‘if a man is indebted to another for principal and interest and payeth the money generally, it shall be applied in the first place to sink the interest before any

part of the principal should be sunk’.

In *Parr’s Banking Co. Ltd v. Yates* [(1898) 2 QB 460]

Lord Rigby, J. described it as ‘the old and well-settled rule’ that where both

‘principal and interest are due the sums paid on account must be applied first to interest. That rule, where it is applicable is only common justice. To apply the sums paid to principal where interest has accrued upon the debt, and is not paid, would be depriving the creditor of the benefit to which he is entitled under his contract, and would be most unreasonable as against him’.

Fisher in his standard work on the *Law of Mortgages* (Edn. 7), p.620, while dealing with the question of appropriation of payments towards a mortgage debt, states the law as follows:

‘Where the debtor claims to be discharged by reason of payments which were not specially made in respect either of the principal or the interest of the mortgage, the rule is that a general payment shall be applied in the first place to sink the interest, before any part of the principal is discharged.’”

12. In **Meka Venkatadri Appa Rao v. Raja Parthasarathy Appa Rao**: AIR 1922 PC 233, it was held as follows:-

13. “The question then remains as to how, apart from any specific appropriation, these sums ought to be dealt with. There is a debt due that carries interest. There are moneys that are received without a definite appropriation on the one side or on the other, and the rule which is well-established in the ordinary cases is that in those circumstances the money is first applied, in payment of interest and then when that is satisfied in payment of the capital.”

14. That decision was immediately followed by another Privy Council decision in the case of **Rai Bahadur Seth Nemichand v Seth**

Radha Kishen: AIR 1922 PC 26 wherein the position as regards appropriation towards principal debt and interest thereon was re-stated as under:-

15. “Now the law as to payments being applied to principal or interest was laid down by the Board in the case of *Meka Venkatadri Appa Row Bahadur Zemindar Garu v. Raja Parthasarathy Appa Row Bahadur Zemindar Garu* [AIR 1922 PC 233], decided only a few days ago. Shortly re-stated, it is this. A creditor to whom principal and interest are owed is entitled to appropriate any indefinite payment which he gets from a debtor to the payment of interest. A debtor might in making a payment stipulate that it was to be applied only to principal. If he did so, the creditor need not accept the payment on these terms, but then he must give back the money or the cheque by which the money is proffered. If he accepts it, he would be bound by the appropriation proposed by the debtor.”

16. Thus the settled position in law with regard to appropriation of payments towards principal and interest is that if a debtor, in discharge of his debt towards the principal amount and interest thereon, makes an indefinite payment or a payment on account, without indicating or specifying as to whether the payment was to be appropriated against the principal or the interest, the creditor is entitled to apply the payment first towards the interest due and the left over amount, if any, against the principal. On the other hand, if, while making a payment, the debtor specifies that it be applied only to the principal, there are two options available to the creditor – (1) he need not accept the payment on the terms specified by the debtor or (2) he may accept the payment on the terms stipulated by the debtor. If he adopts the former route, the creditor would

have to return the money to the debtor. However, if he chooses the second option, he would be bound by the manner of appropriation suggested by the debtor.

17. Let me now consider the facts of the present case. The key issue is the manner in which the petitioner made the payment of ₹ 1,53,342/-. Was it an indefinite on account payment? True, when the said payment was made, the petitioner had not expressly stated that it was to be appropriated towards the principal sum but, it must be kept in mind that at point of time there was no mention of the interest either. More importantly, the sum of ₹ 1,53,342/- was the exact amount of the final bill raised by the respondent. It is that exact amount which had been paid by the petitioner. Consequently, the said payment cannot be regarded as an indefinite or as an on account payment. It has to be regarded as a specific payment towards the exact final bill amount. This fact had escaped the attention of this court when the judgment dated 23.01.2008 was delivered. It is because of this that this court, considering the payment to be in the nature of an indefinite payment, felt that part of payment could first be appropriated towards interest and then only the left over towards the principal amount. Consequently, this court held that the balance amount of ₹ 37,244/- was not interest but the balance of the principal amount. But, as I have stated above, this was a mistake. It is now evident that the payment was for the exact amount of the final bill and, therefore, it cannot be regarded as an indefinite payment. As a result, it has to be considered as a payment towards the final bill and not towards the interest which had been occasioned by the delay in payment. Having accepted the final bill amount, the respondent did not have any option in

the manner in which the said payment was to be appropriated. The payment has to be regarded as payment of the principal sum. As such, the entire balance amount of ₹ 37,244/- was the interest amount. The obvious follow up of this is that no further interest would accrue on the said amount of ₹ 37,244/- till the date of the award, as that would clearly amount to interest on interest, which, in the absence of a provision for interest on interest in the contract, could not have been awarded by the learned arbitrator, in view of the Supreme Court decision in **S.L. Arora** (*supra*).

18. The same logic would apply to the issue of security deposit. Hence, the learned arbitrator could not have awarded the amounts of ₹ 22,664/- and ₹ 2,385/- and to that extent the judgment dated 23.01.2008 as also the award stand modified.

19. The application stands allowed to the degree mentioned above.

BADAR DURREZ AHMED, J

March 13, 2012

HJ