

Ambit of Arbitration under MSMED Act, 2006

The Hon'ble Supreme Court of India had an occasion to deal with interesting issues relating to the arbitration proceedings initiated under Micro, Small and Medium Enterprises Development Act, 2006 ("**MSMED Act**") in two cases of M/s Silpi Industries Vs Kerala State Road Transport Corporation & Khyaati Engineering Vs. Prodigy Hydro Power Pvt. Ltd, decided vide a common judgment on 29.06.2021¹. The said two appeals arose out of two different proceedings relating to two different contracts executed between the different set of parties.

First Case was related to a contract executed between Silpi Industries (a "seller" under MSMED Act) and Kerala State Road Transport Corporation (a "buyer" under MSMED Act) whereby buyer had awarded a contract for supply of thread rubber for tyre rebuilding to the seller. The seller was to receive 90% payment on supply of the material and the balance 10% was to be paid subject to final performance report.

Second Case was related to a contract executed between Khyaati Engineering Appellant (claimed to be a "seller" under MSMED Act) and Prodigy Hydro Power Pvt. Ltd (claimed to be a "buyer" under MSMED Act) where the seller was awarded the work of supplying and installation of hydro-mechanical equipment for 2 x 3 MW Baner-II SHP. In this contract, seller claimed that it had performed the contract and the project was commissioned on 27.06.2015. However, buyer refused to make payment on the ground the seller had breached the terms and conditions of the contract for supply of hydro-mechanical instrument. Accordingly, buyer



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¹ Civil Appeal No. 1570-1578 of 2021 and Civil Appeal No. 1620 -1622 of 2021 vide common judgment dated 29.06.2021.

invoked arbitration clause in the contract, nominated its own arbitrator and approached the Hon'ble High Court of Madras ("**MHC**") for appointment of second arbitrator on seller's failure to appoint its arbitrator.

Both the sellers in the two cases were the Appellants and buyers were the Respondent before the Supreme Court of India and have been referred to as such in this article.

Proceedings relating to the two cases before the matter reached the Hon'ble Supreme Court of India ("SC"):

In the *First Case*, the Appellant approached the Facilitation Council and initiated conciliation proceedings under the MSMED Act, making claim for payment of balance amount of 10% payment against the Respondent. As the conciliation failed, Appellant referred the dispute to arbitration pursuant to provisions of Section 18(3) of the MSMED Act. The Respondent raised counter claims. Several issues arose in the matter before the arbitrator including the applicability of Limitation Act and maintainability of counter claims in an arbitration proceeding initiated under the MSMED Act. The Arbitrator decided the claims of the Appellant in its favour. Such an award, on being challenged, was ultimately set aside by the Hon'ble Kerala High Court ("**KHC**") that remanded the matter for fresh adjudication.

In the *Second Case*, the Appellant initiated conciliation proceeding before the Facilitation Council on 20.03.2017 for payment of its dues by the Respondent. Though, the Respondent initially appeared before the Council, however, filed an application under Section 11(6) of the Arbitration and Conciliation Act, 1996 ("**1996 Act**") praying for appointment of second arbitrator to adjudicate upon the dispute between the parties. The MHC allowed the application of the Respondent and appointed a former Judge of MHC as the second Arbitrator in the matter.

Issues before the Hon'ble Supreme Court of India ("SC") and the Final Verdict:

Challenging the aforesaid two orders passed by the KHC and MHC respectively, Appellants in both these matters, approached the SC.

The SC decided both the cases vide a common judgment on the basis that only two issues arose for consideration in both the matters: –

- (i) Whether the provisions of Indian Limitation Act, 1963 is applicable to arbitration proceedings initiated under Section 18(3) of Micro, Small and Medium Enterprises Development Act, 2006 ?; and
- (ii) Whether, counter claim is maintainable in such proceedings?

For answering the aforesaid issues, the Hon'ble Supreme Court went into background of promulgation of MSMED Act of 2006 which replaced the earlier enactment, namely, Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993.

In so far as the first issue is concerned, the SC answered the same in affirmation and held that Limitation Act would apply to the arbitration proceedings initiated under MSMED Act. This conclusion of the Hon'ble Apex Court is primarily based on interpretation of provision contained in Section 18 (3) of the MSMED Act. The main reliance of the Apex Court was on the expression used in the Section 18(3) of the MSMED Act to the effect that the provisions of 1996 Act shall apply to the dispute as if arbitration was in pursuance of an agreement referred to in Sub-section (1) of Section 7 of that Act. Therefore, the SC noted that since the arbitrations under MSMED Act are to be conducted pursuant to the provisions of 1996 Act, which provides under Section 43, that Limitation Act shall apply to the arbitrations as it applies to proceedings in court, as a necessary corollary, the provision of Limitation Act would also apply to arbitration proceedings initiated pursuant to the provisions of MSMED Act.

As regards the second issue, regarding maintainability of counter claim in an arbitration proceedings initiated as per provisions of MSMED Act, the Apex Court again answered the same in affirmation for the following reasons:

- (i) Section 18 (3) of the MSMED Act clearly provides that the provisions of 1996 Act would apply as if there was an agreement between the parties under sub-section (1) of Section 7 of the 1996 Act. Further, Section 23 (2A) of the 1996 Act gives right to the Respondent to submit a counter claim in support of his case.
- (ii) If the counter claims of the Buyer are held to be not maintainable in the proceedings initiated under the MSMED Act, it will lead to parallel proceedings before the various forums, which may lead conflicting findings by different forums.
- (iii) MSMED Act provides various beneficial provisions in favour of a Seller, like deemed acceptance of the products supplied by the Seller on lapse of certain period after delivery, applicability of higher rate of interest if payment not made within time prescribed therein, deposit of 75% of the awarded amount if the award made pursuant to arbitration proceedings under MSMED Act is to be challenged. The

Hon'ble Apex Court held that all these beneficial provisions cannot be given a go bye because of the buyer having counter claims, which are not adjudicable in the arbitration proceedings under the MSMED Act.

- (iv) MSMED Act is a special statute and 1996 is general Act. It was held that even if there was an agreement between the parties for resolution of disputes by arbitration, if the seller is covered by the MSMED Act, the seller can certainly approach the competent authority to make its claim under the said Act. If any agreement between the parties is there, same is to be ignored in view of the statutory obligation and mechanism provided under the MSMED Act.

In the *Second Case*, the SC after considering the facts and circumstances thereunder found that reference to conciliation under MSMED Act was made after the contract was signed and supply was made. The Hon'ble Court also noted that the Appellant therein did not have registration under the MSMED Act on the date the supply of goods and services were made by the Appellant. The SC held that to seek the benefit of provisions under MSMED Act, the seller should have registered under the provisions of the Act, as on the date of entering into the contract. In these circumstances, the Hon'ble Court held that the MHC was right in appointing the second arbitrator as the proceeding could not be governed under the MSMED Act but were to be governed pursuant to arbitration agreement executed between the parties.

CONCLUSION:

By this judgment, the Hon'ble Court has cleared the confusion that arises in cases where seller is covered under the MSMED Act and there is also a separate arbitration clause in their agreements. Issue then arises, which arbitration forum will be the correct forum to approach i.e., the one pursuant to the MSMED Act or the adhoc arbitration to be constituted as provided in the arbitration clause. This issue gets settled by the authoritative pronouncement of the SC in this judgment. Yet another important issue that came to be decided in these cases is that to avail the benefit of the provision of MSMED Act, the entity should be registered under the said Act on the date of signing of the agreement from which the disputes have arisen. This judgment also addresses the issue regarding maintainability of counter claim under MSMED Act by adopting the principle of purposive construction, which would certainly help in reducing the changes of multiple proceedings before different forums leading to the possibilities of conflicting views.

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