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Understanding the conflict between MSME and Arbitration Act

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ABSTRACT

Since the MSMED Act and the Arbitration and Conciliation Act both talk about arbitration, there was bound to be a dispute between the provisions of the two Acts. The Arbitration Act is the primary statute for arbitration and arbitral proceedings, thus, it is inevitable that the MSMED Act relies on the procedural provisions of the Act. Nonetheless, the later Act also seeks to override the provisions of the Arbitration and Conciliation Act by giving certain special incentives to the MSMEs alone.

One of the differences between the Acts is the difference in the mandatory pre-deposit percentage. Under the MSMED Act, when a dispute is filed, the pre-deposit is 75% while under the Arbitration and Conciliation Act; the pre-deposit is 100% of the amount in terms of the decree/order/award for entertaining an application for setting aside the Award. Like this, there are several other differences on the same issue in the two Acts. The major dispute is which of the two Acts prevail when there is the question of Micro, Small, and Medium Enterprises. The general rule is that specific laws prevail over general laws. However, the Arbitration and Conciliation Act, 1996, and the Micro, Small, and Medium Enterprises Development Act are special laws. Different High Courts have given different judgments on the issue. Some conclude that the MSMED Act will prevail over the Arbitration and Conciliation Act and some hold that the Arbitration Act will prevail over the MSMED Act. In the present paper, the author aims to further understand the conflict between the acts in the dissertation with the help of their respective legislation.

I. INTRODUCTION

The Micro, Small, and Medium Enterprises have not only generated employment in India but have also contributed to the growth of the Indian economy. The MSME sector is regulated by the Micro, Small, and Medium Enterprises Development (MSMED) Act, 2006. One of the main objectives of the Act is to promote the MSMEs and to protect them from the buyers who delay in payments and thus turn them into Non-performing Assets (NPA).² Thus, the Act

¹ Author is a LLM student at Gujarat National Law University, India.

² Devika Sharma, "Arbitration under MSME Act: What's the Status?", SCCONLINE, <https://www.sconline.com/blog/post/2020/06/19/arbitration-under-msme-act-whats-the-status/>

mandates the buyers to make a payment for the goods within forty-five days of buying the goods.³ Thus, for the protection of the MSMEs, the arbitration clause is added to the Act. However, the Arbitration and the Conciliation Act is the primary law for arbitration in India. Since both the laws are specific laws many times questions have been asked regarding which Act will prevail over the other in case of overlapping.

The conflict between the two Acts is whether the Arbitration Act can be superseded by the MSME Act or not. Thus, in other words, when there is a dispute between the two parties already having a valid arbitration agreement than can such an agreement is overridden by the arbitration provisions provided under the MSME Act.⁴ Generally speaking, the statutory provisions always have supremacy over any type of agreement. Moreover, according to section 24 of the MSME Act, if there is any inconsistency with sections 15-23 of the Act, then sections 15-23 will be applicable. However, the complexity, in this case, is that the presence of an arbitration agreement does not prove that there is any inconsistency with section 18 of the MSME Act.⁵

II. ARBITRATION UNDER MSME ACT

The major objective of the MSME Act is to, “provide for facilitating the promotion and development and enhancing the competitiveness of the micro, small and medium enterprises”.⁶

(A) Section 18

To understand the difference between the dispute mechanism between the MSME Act and the Arbitration and Conciliation Act, section 18 of the MSME Act play a vital role. Under this section, the dispute resolution mechanism of the MSME act is provided. Under section 18(1) of the Act, it is said that when there is a dispute then between parties concerning the amount due under section 17 of the MSME Act any of the involved parties can refer to the MSEFC.⁷ This section further states that, MSEFC can either start the conciliation proceedings themselves or refer it to any other competent institution or center. Such conciliation proceedings are governed by sections 65 to 81 of the Act. And when the conciliation proceedings terminate in a way that the parties were unable to resolve the dispute, the Facilitation Council can refer the

³ Section 15 of the MSME Act.

⁴ Kartikeya Awasthi, “Overriding effect of Arbitration and Conciliation Act, 1996 and MSME Act 2006 Part 2”, VIAMEDIATIONCENTRE, <https://viamediationcentre.org/readnews/OTk0/Overriding-effect-of-arbitration-and-conciliation-act-1996-and-MSEMD-Act2006-Part-2>

⁵ Ibid.

⁶ Vaishnavi Chillakuru, “The MSME Act and Arbitration Agreements: First Mover Advantage?”, INDIACORPLAW, <https://indiacorplaw.in/2020/08/the-msme-act-and-arbitration-agreements-first-mover-advantage.html>

⁷ Shreyansh Jain, “All you need to know about dispute resolution under MSME Act”, IPLEADERS, <https://blog.ipleaders.in/need-know-dispute-resolution-msme-act/>

same dispute for arbitration. Such arbitration proceedings can either be undertaken by the Council itself or it can refer it to any institution discharging ADR services.⁸

The arbitration proceedings are governed by the Arbitration and Conciliation Act, 1996 in such a way that the dispute was originally brought under section 7(1) of the Act. Furthermore, section 18(4) of the MSME Act says that either the MSEFC or the institute to which such arbitration proceedings were referred to by the MSEFC would have the last say on choosing the arbitrator or, in the case of conciliation, a conciliator. Moreover, section 18(5) of the MSME Act provides that such a dispute has to be resolved within ninety days from the date of the reference.

One of the major questions which arise is that since the arbitration clause here is governed by the Arbitration and Conciliation 1996, does the arbitral clause concerning the MSMEs dispute supersede the MSME Act. However, when section 24 of the MSME Act is taken into consideration, it is said that anything inconsistent with sections 15 to 23 of the Act, the sections will supersede.

(B) Section 19

According to section 19 of the MSME Act, any award given by the Facilitation Council in a proceeding under the Act can be set aside only when 75 percent of the award is deposited before filing the challenge in the Court. The award can be deposited in any manner such as a decree, or award, or any other manner according to the Court. When the pre-deposit is submitted to the Court, the Court will order such amount to be discharged to the supplier. Also, such a discharge must be according to some conditions.

The MSME Act was incorporated for the recovery of debts of MSMEs. However, a mandatory and fixed pre-deposit was incorporated further in the Act to show the intent that the MSMEs may be protected but they do not have bargaining power against the supplier.

(C) Micro and Small Enterprises Facilitation Council (MSEFC)

The MSEFC is established by the States and the Union Territories as per the provisions of MSME Act, 2006 for the settlement of disputes on getting referenced for or under applications filed for delayed payments. The provisions of the Act are sections 20 and 21 of the Act. As per the section 20 and 21 of the Act, the MSEFCs are to be established by the State Governments in their respective states. The composition of the council is also provided under these sections. As per the provisions, the Council shall comprise a Chairperson, office bearers

⁸ Ibid.

of association of the MSMEs, and the representatives of banks and financial institutions.⁹ Further, the Council shall also consist of persons who are experts in the industry, finance, law, trade, or commerce. It is to be noted that the Chairperson of the Council shall be the Director of industries.¹⁰

Nature of assistance: As per the provisions of the MSMED Act 2006, when an MSME files an application against the delayed payment, the Facilitation Council of the respective State will direct the buyer to pay the due amount, after the thorough examination of the application filed by the MSME. The defaulting buyer also will be direct to pay an added interest to the due amount.

Salient features: The MSEFC has to decide the issue within 90 days of the application or reference.¹¹ Any micro and small enterprise can apply to the Council; however, they need to have a valid UAM or Entrepreneur Memorandum (EM) Part II.¹²

For the easy filing of an application to the Facilitation Council, an online delayed payment monitoring system is launched by the Government of India. The system is called the MSME Samadhaan where any MSME which has a valid UAM (Udyog Aadhar Memorandum) can apply through this portal. After such an application is filed through the portal, the Facilitation Council has to examine it and they direct the defaulting buyer for the payment of the due amount to the MSME with an added interest.

III. THE ARBITRATION AND CONCILIATION ACT 1996 VERSUS MSME ACT

Currently, most commercial organisations tend to go for arbitration and since two laws are governing the same, it is always a question as to which law is to be applied when there is a clash. The Arbitration law is based on the principle to provide freedom to the parties to choose the method of settlement which the Arbitration and Conciliation provide under its provisions. Moreover, the Indian Courts have also assented to such norms. However, the MSME Act is a special law. It provides a fixed mechanism for the dispute settlement procedure.

The major question which arises here is that when there is a dispute regarding the MSMEs and a contract between the disputing parties explicitly has an arbitration clause or a separate arbitration agreement then whether such a clause or agreement will prevail or the MSME Act

⁹ Inder Chand Jain, "MSME Act 2006- How far it has succeeded in combating the menace of Delayed Payments", TAXGURU, <https://taxguru.in/corporate-law/msme-act-2006-succeeded-combation-menace-delayed-payments.html>

¹⁰ Ibid.

¹¹ "Facilitation Councils", <https://msme.gov.in/facilitation-councils>

¹² IBID.

will prevail.¹³ Regarding this issue, one of the general principles of law can be taken into consideration which is that special law overrides the general laws. Because both the laws are special laws, one has to see the way this principle is applied in the arbitral laws. Whether this principle is to be applied automatically or there are some exceptions to which it has to adhere to.

The dispute between the MSMED Act and the Arbitration and Conciliation Act is different from those disputed or overlapping Acts where there has been a clear distinction laid down.

Generally speaking, the reference of the conciliation or arbitration dispute to the MSEFC is just a two-tier mechanism. Thus, it can be easily said that a mere mechanism can be easily overridden by valid statutory provisions.¹⁴ However, as already mentioned earlier, section 24 of the MSME Act says that anything inconsistent with sections 15-23 of the MSME Act will be overridden by the mentioned sections.

Another question arises as to whether the presence of an arbitration agreement makes it inconsistent with section 18 of the MSME Act.

The major controversy regarding section 18 of the MSME Act arose when a large number of cases were filed in the courts to challenge the applicability of the said section on the arbitration agreement between the disputed parties (where the dispute arose with a supplier).

Section 18 of the MSME Act provides for a mechanism by which the MSME or the supplier can recover their debts or overdue payments from defaulting buyers.¹⁵ According to this section, both the supplier and the buyer can refer to the Facilitation Council for the resolution of the dispute. Further, the Council may either conduct the conciliation proceedings itself or can pass on to any competent institution for the same. Such an institution should carry on ADR services on terms of sections 65 to 81 of the Arbitration and Conciliation Act 1996.¹⁶ If conciliation fails then the Council can refer the dispute for arbitration.

As already mentioned, section 18(1) read with section 24 of the MSME Act provides that the abovementioned mechanism supersedes all the laws. However, there remains some ambiguity over the issue. The question quite often arises as to whether in the presence of an explicit

¹³ “Overlap between MSMED Act and Arbitration Act”, AMLEGALS, (Aug., 24, 2020), <https://amlegals.com/overlap-between-msmed-act-and-arbitration-act/>

¹⁴ Ibid.

¹⁵ Gagan Gupta & ANkit Swarup, “Micro, Small and Medium Enterprises Development Act, 2006: How much more the Parliament needs to travel”, LEGALSERVICEINDIA, <https://www.legalserviceindia.com/legal/article-3461-micro-small-and-medium-enterprises-development-act-2006-how-much-more-the-parliament-needs-to-travel.html>

¹⁶ Ibid.

arbitration agreement the MSME Act will still be applicable or will it completely override the arbitration agreement or will be overridden by the agreement. It would be quite unfair if the defaulting buyers get out of the strict laws of the MSME Act using the explicit arbitration agreement. This would defeat the whole purpose of the Act.

For the time being, the Courts have ruled out via different judgments that even when there is a separate arbitration agreement the supplier has to be competent under section 18 of the MSME Act to invoke the arbitration proceedings. To protect the MSMEs such a decision is taken. One such judgment was taken by the Allahabad High Court. In the case of **TBEA (India) Transformer Private Limited versus UP Micro and Small Enterprises & Ors.**, the Allahabad High Court held that if any arbitration clause or agreement exists, it will not prevail over section 18 of the MSME Act.

However, different Courts can provide different rulings, as the arbitration proceedings in India find their source in the Arbitration and Conciliation Act, 1996. An arbitration proceeding cannot be independent of the arbitration agreement. Thus, a clear non-obstante clause in sections 18 and 24 of the MSME Act is necessary.

Additionally, in section 19 of the MSME Act, the buyer has to deposit a mandatory 75 percent of the award amount in the Court before challenging the award. Furthermore, under section 19 of the MSME Act, subject to certain necessary conditions the Court has the power to pay the supplier any portion of the amount deposited by the buyer during the pendency of the proceedings. The question here is what if the MSME or the supplier file for the recovery of debt under the Arbitration and Conciliation Act and not as per the MSME Act. Thus, in this case, the appellate Court has the power to stay the grant of the arbitral award as per Order XLI Rule 5 of the Code of Civil Procedure, 1908. The court can put up any condition for the stay of the award.

On this, the Courts have different judgments. The Delhi High Court in the case of **AVR Enterprises versus Union of India**¹⁷ held that if the proceedings are not filed under the MSME Act, then the 75% pre-deposit provision will not be applicable. However, the Gujarat High Court had a different opinion in the case of **Saryu Plastics Private Limited & Ors. versus Gujarat Water Supply and Sewerage Board**¹⁸. As per the Gujarat High Court, the two mechanisms of pre-deposit in the two Acts should be done away with and a single mechanism should be introduced to ensure easy recovery.

¹⁷ CM(M) 769/2018

¹⁸ MANU/GJ/1526/2017

Moreover, regarding section 19 of the MSMED Act, one of the questions that arise is that even when the registered MSME has not invoked the arbitration under the MSMED Act, will section 19 be applicable when the arbitration proceedings are invoked under the Arbitration Act.

IV. INCONSISTENCIES BETWEEN THE ACTS

The MSMED Act contains a special provision regarding arbitration to be conducted under the Arbitration Act “as if the arbitration was in pursuance of an arbitration agreement referred to in subsection (1) of section 7 of the Act” in section 18(3) of the MSME Act.¹⁹ As per section 18 (3) of the MSMED Act, it is deemed that an arbitration agreement exists between the supplier even when there is no such agreement present. Furthermore, such an agreement is a valid agreement under section 7 of the Arbitration Act. One of the essential requirements for a valid arbitration agreement is that the parties must agree that for the resolution of future disputes they will seek the arbitration proceedings.

Prima facie, the language of section 18 of the MSME Act may seem that in case MSMEs are involved, any dispute and proceedings related to the dispute must be resolved as commercial disputes as per private agreements between the parties and not as arbitrations conducted under the statute.²⁰ Furthermore, it may be argued that the special status of the MSME Act will have its provisions overriding provisions of all the other statutes with the same subject matter.

Specifically, section 18 of the MSME Act reads, “...the provisions of the Arbitration and Conciliation Act, 1996 shall then apply to the dispute as if the arbitration was in pursuance of an arbitration agreement referred to in subsection (1) of section 7 of the Act”.²¹

Thus, section 18(3) says that those provisions of the Arbitration Act would apply to the proceedings under this section which apply to the proceedings filed under section 7 of the Arbitration Act. However, as per section 2(4) of the Arbitration Act, only part 1 of the Arbitration Act along with sections 40(1), 41, and 43 will apply to such proceedings. Thus, section 18(3) of the MSME Act and section 2(4) of the Arbitration Act provide contradictory and inconsistent provisions regarding the arbitration proceedings to be applicable under the MSMED Act. Furthermore, section 18(3) of the MSMED Act also says the for proceedings before the Facilitation Council, the provision under the Arbitration Act which is applicable for proceedings filed under section 7(1) of the Arbitration Act will also be applicable. However, section 43 of the Arbitration Act is not applicable in cases of MSME proceedings. Section 43

¹⁹ Shinoj Koshky & Purvi Khanna, “AN examination of the inapplicability of limitation to claims under the micro, small and medium enterprises Development Act, 2006”, 13 NUJS L. REV. 63 (2020), Pg 71.

²⁰ Ibid.

²¹ Ibid.

of the Arbitration Act is one of the provisions applicable for the proceedings under section 7(1).

V. APPLICABILITY OF SECTION 34 OF ARBITRATION ACT

Another question that arises is when there is an independent arbitration proceeding with one party being an MSME then would the award given under such proceeding be set aside when challenged under section 34 of the Arbitration Act. Section 34 of the Act provides that an arbitral award can only be challenged when such an arbitral award is set aside. There are several conditions provided by the section for setting aside the award. It is important to note that there are several enactments where there are provisions for statutory reference in India. In the case of **Registrar Co-operative Society versus Krishan Kumar Singhania**²², there was a conflict between the Arbitration Act and the Bengal Cooperative Societies Act. In this case, the Supreme Court held that the statutory reference will prevail.

However, when there is MSME as one party in arbitral proceedings, then whether the award can be set aside under section 34 of the Act or not remains undecided. One can look into the situation and decide based on various Court judgments. In the case of *Associated Builder versus Delhi Development Authority*, it was held that when the award is not in conformity with the Indian substantive law then it can be set aside. It is also to be noted that in this case, the award was set aside on the ground of the illegality of patents. If one takes the example of this case, the question which will arise is that can the awards which is given under independent arbitration proceedings in the face of statutory arbitrations be considered as one, not in conformity with the substantive laws existing in India.²³ It is further to be noted that section 18(1) of the MSME Act even though has a non-obstinate clause but it also says that the parties 'may' refer to a dispute.²⁴ This means that the section gives discretionary power to the parties and does not mandate the parties to refer to such a dispute. Furthermore, it may also be interpreted that the reference made to the Council is a discretionary exercise. Thus, accordingly one can say that section 34 of the Arbitration Act cannot set aside the Arbitral Award, but there is no set out rule for the same.

VI. CONCLUSION

The Micro, Small, and Medium Enterprises Development Act 2006 is a special law. It cannot

²² 1995 SCC (6) 482.

²³ Chandni Ghatak & Swapnil Tiwari, "Party autonomy v Statutory Arbitration under the MSME Act: The unsettled woe", BARANDBENCH, (Jun., 02, 2020), <https://www.barandbench.com/columns/party-autonomy-v-statutory-autonomy-under-the-msme-act-the-unsettled-woe/>

²⁴ qq

be denied. It was specially enacted so that the Micro, Small, and Medium Enterprises do not face inconsistencies and delays in payment which will reduce their development. So for such a law to be overridden by a general law would not be fair for the enterprises for this law was enacted. Furthermore, the MSME Act is not an unfair law. It does not provide any hidden or unfair advantages to the Small enterprises over other types of businesses.

These small, media, and micro-enterprises already have so many challenges which they have to face all the time, one of the biggest being financial problems. Also, if one looks into it as not a special law still it would be useless to have a law and get it overridden all the time. Moreover, as per the Constitution of India, one can positively discriminate against anyone if they are marginalised or disadvantaged. One can easily understand that positive discrimination for the development of Small, Micro, and Medium enterprises are neither unfair nor illegal.

Furthermore, at present times of COVID19, the biggest losses occurred to the MSMEs in India. Though the Government of India has launched various programs such as the Atmanirbhar Bharat package for the development and to cover the losses of the MSMEs, there are still cases where they are not being paid by the buyers. The defaulting buyers are to be governed under the MSMEs.

However, all said and done, the Arbitration and Conciliation Act, 1996 is also a special law. This act consolidates the procedures and provisions for the arbitration laws and proceedings in India. It is not a general law. Thus, this Act cannot be overridden by any other law. The Arbitration and Conciliation Act was brought into effect at a time when there were a large number of cases pending in the Courts of India. Thus, to ease the burden on the courts of law and to give a cost-effective method to resolve the dispute the Arbitration Act came into being.

Both the Arbitration Act and the MSME Act have provisions related to the arbitral proceedings. Thus, these proceedings were bound to clash. There has always been the question of which can prevail when both of them clash looming in the minds of the parties. The parties in dispute have always questioned the validity of the Acts under which the proceeding has been brought upon by the other party. It had become very necessary for the courts to define the overriding effect of each of the Acts. However, one Act cannot override the other in every case. It would create a. unbalance in the system. There must be certain circumstances under which each of the Acts will prevail.
