



**UNRAVELLING LEGAL
COMPLEXITIES: AN EXPLORATION
OF THE INTERSECTION OF
MICRO, SMALL AND MEDIUM
ENTERPRISES DEVELOPMENT ACT,
2006 AND ARBITRATION AND
CONCILIATION ACT, 1996**

Introduction:

In the dynamic landscape of commercial transactions, disputes often arise, prompting a need for legal action. Notably, some parties are covered¹ under the ambit of Micro, Small and Medium Enterprises Development Act, 2006² ('**MSMED Act**'), and seek to resolve their dispute under the MSMED's Act framework, even though there may exist a separate arbitration clause in the Agreement between the parties.

Before initiating any legal action or entering into a contractual arrangement, parties often grapple with preliminary inquiries regarding who can initiate proceedings under the MSMED Act, the implications of an arbitration clause in the agreement between the parties when one party qualifies as a Micro, Small and Medium Enterprises ('**MSME**'), and the reliefs available to a party not classified as an MSME.

This article aims to succinctly address these inquiries and provides insights into the intersection of MSMED Act and Arbitration and Conciliation Act, 1996 ('**Arbitration Act**').

Approach to Facilitation Council:

Under the MSMED Act, 'seller' and 'buyer' have been defined for the purpose of the Act.

In terms of the object of the Act, only a 'seller', who is a registered MSME, can initiate claims against a buyer entity and a 'buyer' cannot³. This clarification has further been provided in the decision of *Uniseven Engineering and Infrastructure Pvt. Ltd. v. Micro and Small Enterprises Facilitation (MSEF) Council District (South) and Anr.*⁴ As per the decision of the Hon'ble Delhi High Court, a buyer cannot initiate proceedings under the MSMED Act. This interpretation stems from the clear language of Section 18 of the MSMED Act, emphasizing that the party initiating a claim must be the supplier, and not the buyer. The relevant part of the Delhi High Court's decision has been reproduced below:

"37. The amount due under Section 17 can only be an amount liable to be paid by the Buyer to the Supplier and not the other way round. Thus, it is clarified that the language in Section 18 i.e., "any party to a dispute" cannot be extended to a claim by a Buyer against the supplier as the same is qualified as being only in respect of the amount due under Section 17."

¹ Please refer to clause 2(n) of the Act for the definition of supplier.

²Micro, Small and Medium Enterprises Development Act, 2006, can be accessed at: <https://samadhaan.msme.gov.in/WriteReadData/DocumentFile/MSMED2006act.pdf>

³ The Supreme Court in its decision in *M/s Vaishno Enterprises v. Hamilton Medical AG & Anr.*, 2022 SCC Online SC 355, observed that the jurisdiction of the MSME Council pursuant to Section 18 of the MSMED Act would depend on whether the supplier within the meaning of the Act was a registered MSME at the time of execution of the contract in light of the statutory provisions of Section 2(n) read with Section 8 of the Act which provides that the Act applies only in cases where the supplier has filed a memorandum with the relevant authority.

⁴ *Uniseven Engineering and Infrastructure Pvt. Ltd. v. Micro and Small Enterprises Facilitation (Msef) Council District (South) and Anr.* 2023 SCC Online Del 3889.

Thus, it is clear that a buyer will not be able to initiate proceedings against a supplier under the MSMED Act, and only a registered MSME supplier will be able to proceed for its claims to the Facilitation Council. Accordingly, as detailed in the following paragraphs, the remedies available to a ‘buyer’ in a contract with a ‘seller’ who is an MSME, is to invoke the arbitration clause under the contract.

MSMED Act v. Arbitration Act:

It is well-settled that the provisions of the MSMED Act override the provisions of the Arbitration Act, in relation to matters concerning MSME. This has also been clarified by the Hon’ble Supreme Court in the *Gujarat State Civil Supplies Corporation Ltd. v. Mahakali Foods Pvt. Ltd., arising out of SLP No. 12884/2020*⁵. This judgment states that even though there may exist an independent arbitration clause in the Agreement between the parties, the general law is that the provision of the MSMED Act override the provisions of the Arbitration Act in case there is inconsistency between the two legislations. The relevant paragraph is extracted below:

“34. The upshot of the above is that:

(i) Chapter-V of the MSMED Act, 2006 would override the provisions of the Arbitration Act, 1996.....”

The above mentioned legal precedent emphasizes the legislative intent to prioritize the protection and welfare of MSMEs, even if it means superseding the arbitration clauses in agreements.

It is therefore crucial to explore the recourse available to a buyer in instances where they have claims against a seller (MSME).

Jurisdiction of Section 11 under the Arbitration Act:

The decisions of *Essar Oil and Gas Exploration and Production Limited v. Gargi Travels Private Limited A.P. No.73 of 2023*⁶ and *M/s Porwal Sales v. M/s Flame Control Industries Arbitration Petition No.77 of 2017*⁷ clarify that even though MSMED Act overrides the provisions of the Arbitration Act, filing of an application under section 11 of the Arbitration Act for appointment of arbitrator is possible in circumstances where reference to the Facilitation Council for conciliation is yet to be made by a seller registered as an MSME. Accordingly, in case conciliation proceedings under MSMED Act have not begun, a section 11 application under the Arbitration Act before the court will be squarely maintainable, and

⁵ Gujarat State Civil Supplies Corporation Ltd. v. Mahakali Foods Pvt. Ltd. (2023) 6 SCC 401.

⁶ Essar Oil and Gas Exploration and Production Limited v. Gargi Travels Private Limited 2023 SCC Online Cal 913.

⁷ M/s Porwal Sales v. M/s Flame Control Industries 2019 SCC Online Bom 1628.

accordingly arbitration can commence between the parties under the Arbitration Act. The relevant part of the judgments have been reproduced below:

Essar Oil and Gas Exploration and Production Limited v. Gargi Travels Private Limited
A.P. No.73 of 2023:

“52. In such background, there could not have been any bar for the petitioner to invoke the principles of Section 11 of the 1996 Act in view of the absence of consensus between the parties regarding appointment of arbitrator(s). In the absence of any specific bar, as discussed above, this Court is fully competent to take up and decide the application under Section 11, which is squarely maintainable under the law.”

M/s Porwal Sales v. M/s Flame Control Industries Arbitration Petition No.77 of 2017:

“28If the argument as advanced on behalf of the respondent that Section 18(4) creates a legal bar on a party who has a contract with a Small Scale Enterprise, to take recourse to Section 11 under the Arbitration and Conciliation Act, 1996 for appointment of an arbitrator, then the legislation would have so expressly provided, namely that in case one such party falls under the present Act, the arbitration agreement, as entered between the parties would not be of any effect and the parties would be deemed to be governed under the MSMED Act in that regard. However, subsection (4) of Section 18 of the MSMED Act does not provide for such a blanket consequence in the absence of any reference made by a party to the Facilitation Council.....”

Leveraging the benefit of invoking Section 11 of the Arbitration Act provides the buyer with a first-mover advantage, allowing them to take proactive legal action before the supplier initiates claims against them under the MSMED Act. These advantages include being able to arbitrate the claims in a timely manner before the supplier resorts to conciliation against the buyer and abstaining from bringing contractual claims as counter claims under the MSMED Act. However, if the buyer cannot secure this initial advantage, they must then present their counterclaims during the facilitation process.

Conclusion:

Navigating this intersection of the MSMED Act and the Arbitration Act requires a nuanced understanding of legal precedents and strategic considerations. According to the decisions of the courts, it is apparent that that a buyer can gain the first mover’s advantage by filing application under section 11 of the Arbitration Act, before the seller refers the dispute to the Facilitation Council for conciliation. However, if the seller has approached the Facilitation Council for conciliation before filing and adjudication of the application for section 11 of the Arbitration Act, the court may not impede on the jurisdiction of the Facilitation Council. This is based on the established law that the provisions of the MSMED Act override the provisions

of the Arbitration Act. In this scenario, the buyer, will have the remedy to make a counter-claim before the Facilitation Council and/or the arbitration under the MSMED Act.

Nevertheless, there remains a legal gap, as court decisions have varied depending on the specific facts of each case. The question of whether a first-mover advantage consistently prevails or if the MSMED Act invariably supersedes the Arbitration Act is still subject to interpretation. Observing ongoing developments in this area of law becomes imperative to stay abreast of any emerging trends or clarifications.
