



## Future Trajectory: Leveling the Playing Field for MSMEs in Arbitration



### Introduction

The power of an arbitral tribunal to award interest is a crucial aspect of dispute resolution, ensuring that successful parties are adequately compensated for time value of money and any delays in receiving their due. In a significant pronouncement on this subject in **Shristi Infrastructure Development Versus Scorpio Engineering Private Limited And Anr<sup>1</sup>**, Delhi High Court, under judicious eye of Justice Jasmeet Singh, addressed specific question of whether an ad-hoc arbitrator appointed under **Arbitration Act<sup>2</sup>** possesses authority to grant elevated interest rate stipulated under Section 16 of **MSMED Act<sup>3</sup>**, even when dispute was not initially referred to MSME Facilitation Council.

Core question before Delhi High Court stemmed from Shristi Infrastructure Development's challenge to an arbitral award obtained by Scorpio Engineering Pvt. Ltd., specifically concerning imposition of interest under MSMED Act. This article will delve into a detailed analysis of rationale underpinning this judgment and explore its potential implications for the landscape of arbitration involving MSMEs.

### Jurisdiction of an Arbitrator and the Facilitation Council



Having navigated initial procedural challenges, Court turned its attention to core jurisdictional argument raised by petitioner. Shristi Infrastructure vehemently contended that impugned Arbitral Award was fundamentally flawed and liable to be set aside. Why, according to petitioner, did learned Arbitrator lack very authority to hear and decide claims in this case? Their argument rested on assertion that claims fell squarely under purview of MSMED Act. Furthermore, petitioner highlighted that disputes arising under said Act must be exclusively referred to and resolved through Facilitation Council, which alone is empowered to either act as arbitrator itself or to refer dispute to another adjudicating authority.

Logical extension of this argument was that any pre-existing contractual arbitration clause could not override this purportedly mandatory statutory mechanism. Does MSMED Act truly create such an exclusive jurisdictional domain for Facilitation Council, thereby rendering private arbitration agreements ineffective?

To address this pivotal question, Court meticulously examined crucially provision concerning reference to MSE Facilitation Council. It observed that this provision outlines a specific pathway for dispute resolution involving Micro and Small Enterprises, particularly concerning amounts due. However, it noted a critical aspect: in present case, respondent, Scorpio Engineering Pvt. Ltd., consciously chose not to approach MSE Facilitation Council. Consequently, entire mechanism envisioned under this provision was never set in motion. Court reasoned that this mechanism is triggered only if a party, irrespective of existence of an arbitration clause, actively chooses to approach Facilitation Council. What is significance of this conscious choice by respondent?

Key to unlocking this jurisdictional puzzle, Court pointed out, lies in precise language of relevant sub-section concerning initiation of proceedings before Facilitation Council. Legislature employs word “may” when stating that “any party to a dispute may... make a reference to Facilitation Council.” What is legal import of word “may” in statutory interpretation? Courts have consistently interpreted “may” as indicative of a discretionary, rather than a mandatory, provision. This implies that while Facilitation Council offers a specialized avenue for MSMEs to resolve disputes, it is not an exclusive avenue.

Parties retain freedom to pursue other available legal remedies, including those stipulated in a contractual arbitration clause or under general law, without being compelled to first seek recourse through Council. Does this interpretation undermine purpose of MSMED Act in protecting interests of MSMEs?

In support of this interpretation, Court cited a pertinent judgment from Hon’ble Bombay



High Court in **Porwal Sales v. Flame Control Industries**<sup>4</sup>. In that case, Bombay High Court specifically held that provision concerning Facilitation Council cannot be construed as an absolute bar to initiating proceedings outside its purview for appointment of an arbitral tribunal, especially in absence of any reference being made to Council.

Bombay High Court further reasoned that if intention of legislature was to make Facilitation Council sole and exclusive forum in cases involving MSMEs, MSMED Act would have explicitly stated that existing arbitration agreements would be rendered ineffective. However, relevant provision does not prescribe such a blanket consequence when no reference is made to Council. Moreover, interpreting this provision as mandatory could lead to incongruous situation of imposing a specific remedy on a party (not being an MSME supplier) even when law does not explicitly prescribe it, potentially rendering existing arbitration agreements meaningless.

Drawing from this well-reasoned judicial precedent and plain language of relevant provision of MSMED Act, Court concluded that act of Scorpio Engineering Pvt. Ltd. in choosing to file a petition under Section 11 of Arbitration Act for appointment of an arbitrator, instead of approaching Facilitation Council, could not be deemed legally incorrect or impermissible. Why? Because legislative scheme of MSMED Act does not establish a mechanism involving Facilitation Council as mandatory or exclusive.

Rather, it offers an additional and beneficial forum for registered micro or small enterprises to resolve their disputes through Facilitation Council, should they choose to avail themselves of it. Consequently, the Court firmly held that the appointed arbitrator did indeed possess inherent jurisdiction to adjudicate disputes between parties.

### **The Interest Component Under MSMED Act**

Next crucial aspect that engaged Court's attention was significant interest component awarded by learned Arbitrator. Petitioner, Shristi Infrastructure, mounted a strong challenge against imposition of interest at substantial rate of 38.85% per annum, as prescribed under Section 16 of MSMED Act.

What was crux of their argument against this seemingly high interest rate? Petitioner contended that application of this specific interest rate was legally unsustainable because arbitration proceedings in this case were ad hoc in nature and were not conducted under aegis of Section 18 of MSMED Act. In essence, they argued that benefit of elevated interest rate under Section 16 of MSMED Act, was contingent upon dispute resolution mechanism under Section 18 being invoked. Did Court find merit in this argument?





Court, however, found itself unable to concur with petitioner's submission. To properly address this contention, it turned to relevant provision itself, Section 16 of MSMED Act, which stipulates:

Section 16 of MSMED Act mandates that if a buyer fails to make timely payments to a supplier as stipulated under Section 15, buyer is liable to pay compound interest with monthly rests on outstanding amount. This liability exists irrespective of any agreement between buyer and supplier or any other prevailing law. Interest rate is set at three times bank rate notified by Reserve Bank of India, calculated from 'appointed day' or day immediately following agreed-upon payment date.

In analyzing this section, Court drew support from a coordinate bench of Delhi High Court, which had already deliberated on a similar issue in case of **Indian Highways Management Company Limited vs SOWiL Limited**<sup>5</sup>. What was key takeaway from this precedent? Division bench had clearly articulated that Sections 15 and 16 of MSMED Act confer substantive rights and impose corresponding obligations upon buyers, and critically, these rights and obligations are not dependent on supplier resorting to any specific dispute resolution mechanism. Obligation of buyer to make timely payments under Section 15 and to pay prescribed interest under Section 16 stands independently. It was observed that a supplier might not even need to initiate any proceedings for recovery of rightfully due amounts if buyer adheres to their obligations under these sections.

Coordinate bench in **SOWiL Limited** specifically addressed argument that buyer's obligations under Sections 15 and 16 were contingent upon supplier invoking conciliation or adjudicatory process under Section 18 of MSMED Act. Court unequivocally rejected this proposition, emphasizing that plain language of Sections 15, 16, and 17 of MSMED Act did not support such a restrictive interpretation.

Furthermore, coordinate bench tackled contention that interest under Section 16 could only be awarded in proceedings under Section 18 and not by an Arbitral Tribunal appointed under Arbitration Act. Why did Court find this argument untenable? It was because this argument overlooked express provisions of Section 18(3) of MSMED Act, which explicitly states that provisions of Arbitration Act are applicable to arbitrations conducted under Section 18, just as they would be in cases of arbitration pursuant to a private arbitration agreement. Importantly, it also clarified that in event of any conflict between provisions of Arbitration Act and MSMED Act, provisions of MSMED Act would prevail. This begs question: in context of interest, does MSMED Act establish a different standard than general provisions of Arbitration Act?







To further solidify this point, coordinate bench in SOWIL Limited referred to Supreme Court's decision in **Snehadeep Structures (P) Ltd. v. Maharashtra Small-Scale Industries Development Corpn. Ltd<sup>6</sup>**. Although this case pertained to Interest on Delayed Payments to Small Scale and Ancillary Undertakings Act, 1993 (precursor to relevant provisions in MSMED Act), its underlying principle was highly relevant.

Supreme Court had held that Interest Act was a special legislation concerning interest on delayed payments to small-scale industries and related matters, and as such, it would prevail over any other legislation, including Arbitration Act. Consequently, argument that matter of interest payment would be governed by general interest provisions of Arbitration Act was deemed erroneous.

Supreme Court emphasized that Interest Act had a specific objective of regulating interest on delayed payments to small-scale industries, and Section 4 of that Act explicitly stated buyer's liability to pay interest to supplier "notwithstanding anything contained in any agreement between buyer and supplier or in any law for time being in force." This underscored special and overriding nature of legislation concerning interest in such cases. What does this imply for applicability of Section 16 of **MSMED Act** in ad hoc arbitrations?

Drawing from this persuasive line of reasoning, Court concluded that Sections 15 and 16 of **MSMED Act** indeed confer substantive rights that exist independently of dispute resolution mechanism outlined in Section 18. Therefore, it was not a prerequisite for dispute redressal mechanism under Section 18 to be initiated for interest as contemplated under Section 16 to be granted, even in an ad hoc arbitration. Why would legislature prescribe such a seemingly high rate of interest for delayed payments to MSMEs? Court elucidated that very purpose of Section 16 is to encourage timely payments to medium and small-scale industries, as their financial well-being and success are heavily reliant on prompt receipt of dues. Thus, elevated rate of interest acts as a significant deterrent, discouraging buyers from delaying payments to these enterprises.

In support of this rationale, Court referred to statement of objects and reasons of MSMED Act, specifically highlighting aims to "(f) make provisions for ensuring timely and smooth flow of credit to small and medium enterprises to minimise incidence of sickness among and enhancing competitiveness of such enterprises..." and "(k) make further improvements in Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993 and making that enactment a part of proposed legislation and to repeal that enactment." This clearly demonstrated legislative intent behind provisions concerning timely payments and enhanced interest for delays. Consequently, Court found challenge to





interest component to be without merit and accordingly rejected it. Ultimately, finding no infirmity in impugned Arbitral Award, Court upheld it and dismissed petition.

### **Conclusion: Reinforcing Financial Lifeline of MSMEs Through Arbitration**

Delhi High Court's pronouncement in **the recent case** stands as a significant affirmation of the protective framework enshrined within **MSMED Act**. By unequivocally holding that an ad-hoc arbitrator possesses authority to grant elevated interest rate mandated under Section 16 of MSMED Act, even in absence of a prior referral to MSME Facilitation Council, Court has reinforced substantive rights conferred upon MSME suppliers.

Court's reliance on legislative intent behind MSMED Act, emphasizing crucial need for timely payments to ensure financial health and competitiveness of MSMEs, underscores paramount importance of safeguarding their economic interests. Application of higher interest rate acts as a powerful mechanism to discourage payment delays, thereby providing a much-needed financial lifeline to these enterprises.

Looking ahead, this judgment carries significant implications for landscape of arbitration involving MSMEs. It levels playing field by ensuring that MSME suppliers are not disadvantaged in ad-hoc arbitrations compared to those where Facilitation Council's intervention occurs. Arbitrators must now be cognizant of their power to apply Section 16 interest, irrespective of route to arbitration, thereby strengthening MSMED Act's intended impact.

### **Citations**

1. *Shristi Infrastructure Development Versus Scorpio Engineering Private Limited And Anr.* O.M.P.(COMM.) 246/2022
2. *Arbitration and Conciliation Act, 1996*
3. *Micro, Small, and Medium Enterprises Development Act of 2006*
4. *Porwal Sales v. Flame Control Industries*, 2019 SCC OnLine Bom 1628
5. *Indian Highways Management Company Limited vs SOWIL Limited* 2021 SCC OnLine Del 5523
6. *Snehadeep Structures (P) Ltd. v. Maharashtra Small-Scale Industries Development Corpn. Ltd.* (2010) 3 SCC 34

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