AN EXAMINATION OF THE INAPPLICABILITY OF LIMITATION TO CLAIMS UNDER THE MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006*

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The Micro, Small and Medium Enterprises Development Act, 2006 (‘MSMED Act’) aims to protect and promote interests of micro, small and medium enterprises (‘MSMEs’) by shortening their working capital cycle. The MSMED Act, inter alia, seeks to incentivise timely payments to MSMEs by mandating a relatively high interest, at three times the bank rate notified by the Reserve Bank of India (‘RBI’), to be paid by a buyer for the period of delay, over the maximum prescribed time period for the payment. The interest mandated by the MSMED Act is compounded until the date of actual payment. The framework around this single provision of the MSMED Act creates a moral hazard of unduly delayed claims by the vendors, immense financial hardship for buyers due to mounting interest and an entirely unintended consequence of disincentivising buyers from dealing with MSMEs. In order to remedy this, the note examines whether, like all commercial claims, a claim under the MSMED Act must also, by the passage of time, be barred by limitation.

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I. INTRODUCTION

One of the foremost requirements for the MSME sector is the availability of credit and shorter working capital cycles. The working capital cycle of an industry is the time taken to convert receivables into cash. The Interest on Delayed Payments to Small and Ancillary Industrial Undertakings Act, 1993 (‘IDP Act’) recognized the importance of access to capital and shorter

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working capital cycles for MSMEs. It mandated the payment of interest to MSME vendors on delayed settlements of their dues. The IDP Act was replaced by the MSMED Act in 2006.

In this note, we investigate the question of whether claims by MSME vendors for amount owed to them under the MSMED Act can become barred by limitation. The changes introduced by the MSMED Act and the subsequent jurisprudence on the applicability of the Limitation Act, 1963 (‘Limitation Act’) to claims under the MSMED Act provide the context to our discussion. In order to further our analysis, we propose to evaluate the question in context of the following fact pattern, which is not uncommon in the functioning of commercial establishments.

Imagine a situation where a corporate buyer purchases certain taxi services from a vendor (a ‘supplier’, as defined under the MSMED Act) at various periods. It is agreed that the buyer shall pay the supplier for the services as and when invoices are raised by the supplier and sent to the buyer.

Under the MSMED Act, each time the buyer avails a taxi from a supplier, he has ‘accepted’ a service and a consequent liability to pay for that accepted service has arisen. Payment against a service which is accepted by a buyer must be made within fifteen days, or as agreed by the parties, subject to a maximum permissible period of forty-five days. Any payment not furnished within such period, would constitute a delayed payment under chapter V of the MSMED Act. The buyer must pay interest on a delayed payment, compounded at three times the bank rate notified by the RBI, for the period of ‘delay until the payment is finally made’. Now, imagine our situation where the buyer has availed taxis on multiple occasions in a period of a month between January 1, 2020 and January 31, 2020. The supplier furnished the invoice to the buyer by February 28, 2020 and the buyer made payments forthwith. The buyer, believing his payment to be in compliance with the forty-five-day period provided under the MSMED Act, makes full and final settlement of the dues owed to the supplier without accounting for any interest.

However, some of these ‘accepted’ services are, in fact not invoiced to the buyer in time, i.e., taxi services availed between January 1, 2020 and January 12, 2020 have already exceeded the forty-five-day window for timely payment. These invoices were not raised and brought to the notice of the buyer for payment to be made in time, and the buyer believing these payments were indeed made in time, did not account for interest payable on such amounts. The buyer learns of these unpaid interest amounts owed by it when the taxi-service provider approaches

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1 The Micro, Small and Medium Enterprises Development Act, 2006, §2(n).
2 The Micro, Small and Medium Enterprises Development Act, 2006, §2(b).
3 The Micro, Small and Medium Enterprises Development Act, 2006, §§2(b), 15.
4 The Micro, Small and Medium Enterprises Development Act, 2006, §16.
him on February 28, 2025 and demands payment along with compounded interest at three times
the bank rate provided by RBI for the entire period of five years. Should his claim to unpaid
amounts and the exorbitant interest rates it has accrued be payable, or should it, in the interest of
justice and balancing of interests between parties, be treated as time barred against the buyer?

In Parts II and III of this note, we discuss the legislative changes brought by the
MSMED Act in the dispute resolution mechanism and the interpretation provided by courts on the
applicability of limitation to the claims of MSME vendors. In Parts IV and V, we examine how
arbitrations conducted under the MSMED Act must be viewed to answer the question of whether
limitation should apply to disputes under the MSMED Act. In Part VI, we discuss the norms
regarding disclosures which are required to be made by buyers with respect to amounts owed to
suppliers and the consequent evergreening of such claims, before arriving in Part VI, at what
we submit is a balanced approach for the future.

II. CHANGES IN THE DISPUTE RESOLUTION MECHANISM

Under the IDP Act, the dispute resolution mechanism available to suppliers and
buyers was conciliation or arbitration before ‘facilitation councils’, in addition to recourse to
courts.

§6 (Recovery of Amount Due) of the IDP Act reads:

“(1) The amount due from a buyer, together with the amount of interest calculated
in accordance with the provisions of sections 4 and 5, shall be recoverable by the
supplier from the buyer by way of a suit or other proceeding under any law for the
time being in force.

(2) Notwithstanding anything contained in sub-section (1), any party to a dispute
may make a reference to the Industry Facilitation Council for acting as an
arbitrator or conciliator in respect of the matters referred to in that sub-section
and the provisions of the Arbitration and Conciliation Act, 1996 shall apply to such
disputes as the arbitration or conciliation were pursuant to an arbitration
agreement referred to in sub-section (1) of section 7 of that Act.”

On the other hand, the MSMED Act provided for the establishment of MSME Facilitation Councils (‘MSME-FCs’) as the exclusive avenue for dispute resolution under the
MSMED Act. The MSMED Act consolidated the disputes before a single forum, which provided,
sequentially, for conciliation and if unsuccessful, then arbitration.

§18 of the MSMED Act (Reference to Micro and Small Enterprises Facilitation Council) reads:

“(1) Notwithstanding anything contained in any other law for the time being in
force, any party to a dispute may, with regard to any amount due under section 17
(Recovery of Amount Due), make a reference to the Micro and Small Enterprises
Facilitation Council.

(2) On receipt of a reference under sub-section (1), the Council shall either itself conduct conciliation in the matter or seek the assistance of any institution or centre providing alternate dispute resolution services by making a reference to such an institution or centre, for conducting conciliation and the provisions of sections 65 to 81 of the Arbitration and Conciliation Act, 1996 shall apply to such a dispute as if the conciliation was initiated under Part III of that Act.

(3) Where the conciliation initiated under sub-section (2) is not successful and stands terminated without any settlement between the parties, the Council shall either itself take up the dispute for arbitration or refer to it any institution or centre providing alternate dispute resolution services for such arbitration and 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 sub-section (1) of section 7 of that Act.

[...]

(5) Every reference made under this section shall be decided within a period of ninety days from the date of making such a reference.”

§18 of the MSMED Act, unlike §6 of the IDP Act, omits the reference to suits as a means of recovery of amounts due to the supplier.

Now, disputes initiated before the MSME-FC are meant to be resolved only through conciliation, and if such conciliation fails, an arbitration process is initiated between the parties. The provisions of the Arbitration and Conciliation Act, 1996 (‘Arbitration Act’) apply to these arbitrations “as if the arbitration was in pursuance of an arbitration agreement”. We shall come to the significance of these words subsequently in Part V.

III. LIMITATION UNDER THE MSMED ACT

The MSMED Act is silent on the applicability of limitation to disputes referred to MSME-FCs. As outlined above, the MSMED Act provides for a mandatory arbitral remedy, governed by the Arbitration Act. According to the Arbitration Act, the Limitation Act does not apply to arbitrations under an enactment. Let us set out the framework to evaluate this position:

§43(1) of the Arbitration Act states that the Limitation Act applies “to arbitrations as it does to proceedings in Court”. But, according to §2(4) of the Arbitration Act, §43 does not apply to arbitrations under a statute.

Section 2(4) of the Arbitration Act reads:

“(4) This Part (Part I) except sub-section (1) of section 40, sections 41 and 43 shall apply to every arbitration under any other enactment for the time being in force, as if the arbitration were pursuant to an arbitration agreement and as if that other enactment were an arbitration agreement, except insofar as the provisions of this

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7 Id.
Part are inconsistent with that other enactment or with any rules made thereunder." (emphasis added)

Keeping in mind the above framework, the question of whether the Limitation Act applies to claims made under the MSMED Act for dues owed to suppliers has been disputed in courts.

In the first set of judicial decisions, confusion arose as to whether the MSMED Act provides for two remedies of dispute resolution; one before a civil court and the other before the MSME-FCs. The argument was that if both remedies are available, and if limitation would be applicable before one (i.e., before courts), logically it should follow that the Limitation Act should apply consistently to both dispute resolution mechanisms (i.e., even in case of disputes adjudicated by MSME-FCs).

This question was discussed, in foremost, by a division bench of the Bombay High Court in *Delton Electricals v. Maharashtra State Electricity Board* (‘Delton’). The argument of inapplicability of Limitation Act to statutory arbitrations by virtue of the exclusion in §2(4) of the Arbitration Act, and thereby under the MSMED Act, (‘Limitation Question’) was brought up here.

The Bombay High Court held the Limitation Act to be applicable to MSME disputes. It presumed that the MSMED Act provided disputing parties the ability to approach a civil court as well as refer their disputes to arbitration. In its opinion, rendering one remedial mechanism before courts subject to limitation while rejecting its application before MSME-FCs would create an incongruous situation. Acting on this ground of this imagined inconsistency it held that the Limitation Act and the principle of laches should be applicable to proceedings before MSME-FCs.

Based on our above discussion of the comparison of §18 of the MSMED Act and §6 of the IDP Act, we know that the only remedy available to suppliers for amounts owed to them is to approach MSME-FCs.

The Limitation Question was again heard by the Bombay High Court, in *Sonali Power Equipment v. Chairman, Maharashtra State Electricity Board* (‘Sonali Power’). According to the division bench in Sonali Power, under the MSMED Act there was no availability of recourse to courts to resolve disputes. Based on this discord with Delton on an understanding of law, it referred the Limitation Question to a larger bench of the Bombay High Court.

While evaluating the divergent views of the two division benches of the Bombay High Court, it is important to note that the Parliamentary Standing Committee of Industry in its 176th Report on the Small and Medium Enterprises Development Bill, 2005 (‘MSME Bill’) had suggested the removal of Clause 19 of the MSME Bill, which provided recourse to civil courts for recovery of amounts:

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9 Id.
11 Id, ¶71.
12 Id, ¶70-71.
13 Sonali Power Equipment v. Chairman, Maharashtra State Electricity Board, 2018 SCC Online Bom 2253.
“(Recovery of Amount Due

19. *The amount due from a buyer, together with the amount of interest calculated in accordance with the provisions of Section 18, shall be recoverable by the supplier from the buyer by way of a suit or other proceeding under any law for the time being in force.*”\(^{15}\) (emphasis added)

This was based on the reason that civil disputes were detrimental to the interest of suppliers as they were time-consuming and involved “other procedural complexities”. The fact that the Parliament chose to omit Clause 19 of the MSME Bill, clearly demonstrates its intention to make a departure from the scheme of the IDP Act where both remedial mechanisms were available. This background lends greater credence to the argument that the incongruity identified by the Court in Delton was truly imagined.

In the absence of recourse to courts under the MSMED Act, the question remains whether limitation applies to arbitrations mandated under the MSMED Act.

The Limitation Question was briefly brought forth before the Supreme Court in 2019 in *Shanti Conductors v. Assam State Electricity Board* (‘Shanti Conductors’).\(^{16}\)

The IDP Act contained the following overriding provision:

> “10. *The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.*”\(^{17}\)

It was argued before the Court in Shanti Conductors that due to the presence of the overriding provision in the IDP Act, the provisions of the IDP Act would prevail over other enactments, including the Limitation Act, and therefore, the Limitation Act would not be applicable. In addressing the argument, the Court reasoned that the overriding provision was inoperative in this circumstance as there were no explicit provisions concerning limitation in the IDP Act which could override the Limitation Act; only a provision expressly dealing with a subject in an enactment, and inconsistent with the treatment of the same subject under another enactment, could override such inconsistent provision of the other enactment through an overriding clause. Therefore, the Court held the Limitation Act to be applicable *vis-à-vis* disputes under the IDP Act. Here again, the Court did not discuss the Limitation Question or examine whether the Limitation Act was *per se* applicable.

Most recently, in 2019, the Limitation Question has been considered by the Bombay High Court in *Shah & Parikh, Engineers and Contractors v. Urmi Trenchless Technology Pvt. Ltd.* (‘Shah and Parikh’).\(^{18}\) The single bench decision also did not address the Limitation Question in any detail, however by remanding the matter to the MSME-FCs to determine whether the impugned claims were time-barred, it impliedly held the Limitation Act to be applicable to disputes before MSME-FCs.

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\(^{15}\) The Small and Medium Enterprises Development Bill, 74 of 2005, Cl. 19.

\(^{16}\) Shanti Conductors v. Assam State Electricity Board, 2019 SCC Online SC 68.

\(^{17}\) The Interest on Delayed Payments to Small and Ancillary Industrial Undertakings Act, 1993, §10.

By virtue of these decisions, the Limitation Question has remained unresolved and is yet to be heard by a larger bench.

IV. SHOULD THE LIMITATION ACT BE APPLICABLE?

The MSMED Act is aimed at the expeditious resolution of purely commercial disputes where the terms of engagement are decided by private parties. Legislative intervention is intended to secure an efficacious remedy for timely payment. Consequently, the MSMED Act should be interpreted to provide an impetus to timely payment of amounts owed to suppliers, and not in a manner that provides fresh rights which have not specifically been granted by the statute (to allow claims that would ordinarily have become barred by limitation) or remedies which have either been specifically excluded (for instance, recourse to courts).

The above approach was outlined by the Supreme Court in the decision of A.P. Power Coordination Committee v. Lanco Kondapalli Power Limited (‘A.P. Power’), in a similar dispute in respect of claims under the Electricity Act, 2003 (‘Electricity Act’) which also provides for statutory arbitration before the Electricity Commission. The Court had to examine whether the bar of limitation had to be respected by the Electricity Commission on the ground that there was no provision in the Electricity Act conferring additional rights upon a party so as to claim even such reliefs which stood barred by limitation before the civil court or in arbitral proceedings.

It held that since a new right which permits claims barred by limitation or takes away the defence of limitation was not being created by the enactment, claims which would not be recoverable by way of an ordinary suit on account of being time barred, would not be admitted. In justifying this conclusion, it stated that it had adopted the following view: “not only because it appears to be more just but also because unlike Labour laws and Industrial Disputes Act, the

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19 The Interest on Delayed Payments to Small and Ancillary Industrial Undertakings Act, 1993, Statement of Objects and Reasons.

(A “A policy statement on small scale industries was made by the Government in Parliament. It was stated at that time that suitable legislation would be brought to ensure prompt payment of money by buyers to the small industrial units […] It was, therefore, felt that prompt payments of money by buyers should be statutorily ensured and mandatory provisions for payment of interest on the outstanding money, in case of default, should be made. The buyers, if required under law to pay interest, would refrain from withholding payments to small scale and ancillary industrial undertakings.”)


(In view of the above-mentioned circumstances, the Bill aims at facilitating the promotion and development and enhancing the competitiveness of small and medium enterprises and seeks to: […] (k) Make further improvements in the Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993 and making that enactment a part of the proposed legislation and to repeal that enactment.”)


21 The Electricity Act, 2003, §158.

(“Where any matter is, by or under this Act, directed to be determined by arbitration, the matter shall, unless it is otherwise expressly provided in the licence of a licensee, be determined by such person or persons as the Appropriate Commission may nominate in that behalf on the application of either party, but in all other respects the arbitration shall be subject to the provisions of the Arbitration and Conciliation Act, 1996 (26 of 1996).”)
Electricity Act has no peculiar philosophy or inherent underlying reasons requiring adherence to a contrary view”.22

The Supreme Court in A.P. Power therefore, favoured an understanding which adopted different approaches in answering the question of applicability of limitation depending upon the nature of the statute, its philosophy or policy objective and the rights that it intends to confer on litigants.

V. STATUTORY ARBITRATIONS ‘UNDER AN ARBITRATION AGREEMENT’

An argument could be made for an examination of the nature of arbitrations under the MSMED Act, to lie outside the purview of statutory arbitrations to which the Limitation Act does not apply.

The MSMED Act contains a special provision where it deems the arbitration to be conducted under the Arbitration Act “as if the arbitration was in pursuance of an arbitration agreement referred to in sub-section (1) of section 7 of that Act” (‘Deeming Provision’) in §18(3). By virtue of §18(3), the MSMED Act creates a legal fiction of the existence of an agreement to arbitrate between a supplier and its customer even when such agreement may not have specifically existed in their contract. Such an arbitration agreement also meets the test of an agreement to arbitrate between parties under sub-section (1) of §7 of the Arbitration Act.23 As per §7(1) of the Arbitration Act, an arbitration agreement means an agreement by parties to submit all or specified disputes to arbitration which arise out of a contractual legal relationship, or a non-contractual legal relationship (such as infringement of trademark claims or unfair competitive practices) between them. The essential requirement of an arbitration agreement under §7(1) is that parties must have agreed to submit existing or future disputes to arbitration. In an arbitration conducted under §7(1) of the Arbitration Act, all provisions of the Arbitration Act (i.e., entire Part I for arbitrations seated in India), including §4324 on limitation, apply.

The language of the Deeming Provision in the MSMED Act may be reflected upon to argue that MSME disputes, which relate to private commercial agreements with rights and

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22 A.P. Power, supra note 20, ¶29.
(“1) In this Part, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.
(2) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.
(3) An arbitration agreement shall be in writing.
(4) An arbitration agreement is in writing if it is contained in:
(a) a document signed by the parties;
(b) an exchange of letters, telex, telegrams or other means of telecommunication including communication through electronic means which provide a record of the agreement; or
(c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other.
(5) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract”);

See generally, JUSTICE R. BACHAWAT, LAW OF ARBITRATION AND CONCILIATION (6TH ED.) (SEPTEMBER 2017).
obligations determined solely by parties, should be resolved as commercial disputes under a private agreement to arbitrate, and not as arbitrations conducted under a statute.

However, it must be added that the above distinction based on the language of the Deeming Provision is being drawn on first principles. No existing literature, discussions in case law or in the history of the MSME Bill have examined the Deeming Provision basis this understanding.

Conversely, we may argue this by stating that the provisions of the MSMED Act being a special legislation with respect to adjudication of disputes concerning MSMEs, would prevail over other enactments in matters which have been expressly dealt by the MSMED Act.25 Specifically, §18(3) of the MSMED 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 sub-section (1) of section 7 of that Act”.

The implication of reading §18(3) is that those provisions of the Arbitration Act should apply to disputes under this section, which would apply in case of an arbitration pursuant to an arbitration agreement referred to in §7(1). On the other hand, §2(4) of the Arbitration Act makes only Part I of the Arbitration Act other than §40(1), §41 and §43 applicable to these arbitrations.

Thus, §18(3) of the MSMED Act and §2(4) Arbitration Act provide a different and inconsistent set of provisions which must apply to arbitrations under the MSMED Act. §18(3) of the MSMED Act provides that those provisions of the Arbitration Act should apply to arbitrations before MSME-FCs which would apply to arbitrations conducted under an arbitration agreement in §7(1) of the Arbitration Act, i.e., all of Part I where arbitrations are seated in India, including Section 43. §2(4) of the Arbitration Act on the other hand, provides that §43 is not applicable to arbitrations before MSME-FCs.

In order to resolve the above mentioned inconsistency, we must bear in mind that the MSMED Act is a special legislation governing the dispute resolution process for MSMEs.26 Further, §24 of the MSMED Act incorporates a 'non-obstante' clause providing that in case of an inconsistency between §15 to §23 of the MSMED Act and any other legislation, the terms of the MSMED Act shall prevail. Consequently, the provisions of §18(3) of the MSMED Act must prevail over those of §2(4) of the Arbitration Act with respect to the statement of provisions of the Arbitration Act applicable to disputes before MSME-FCs.

For the above reasons, we argue that:

(i) the arbitration of disputes under the MSMED Act is essentially an arbitration pursuant to an arbitration agreement; and

(ii) therefore, the Limitation Act should be considered applicable to all claims being arbitrated before MSME-FCs, as it would to arbitrations under an arbitration agreement.

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(“The provisions of §15 to §23 shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.”)

VI. DISCLOSURE OF DEBTS OWED TO MSMES

Another significant change brought by the MSMED Act was mandatory disclosures by buyers of amounts due to suppliers in their audited financial statements. §22 of the MSMED Act reads:

“22. Where any buyer is required to get his annual accounts audited under any law for the time being in force, such buyer shall furnish the following additional information in his annual statement of accounts, namely:

(i) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of each accounting year […]”;

and provides for disclosures of unpaid amounts to suppliers in the financial statements of the buyer. A contravention of §22 was an offence that attracted a minimum mandatory of Rs. 10,000 under §27(2) of the MSMED Act.28

In January 2019, the Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Order, 2019 (‘MSME Order’) was notified under Section 405 of the Companies Act, 2013 (‘Companies Act’).29 Rule 3 of the MSME Order required every specified company to file a bi-annual MSME Form 1 return pertaining to amounts owed to suppliers.30

Under Section 405 of the Companies Act, various additional penalties were prescribed for any violation of the MSME Order. The MSME Order thus, ensured that any incorrectness or incompletion in the disclosures made by a company would attract fines under the Companies Act for officers of up to Rs. 3 lakh or even imprisonment.31 In effect, the MSME Order converted an offence punishable with a fine (as was the position under section 22 of the MSMED Act), into one that could potentially attract a prison term.

In addition to the above, the effect of disclosure of a debt in the financial statements from the perspective of the consequence it has under the Limitation Act must be considered. Disclosure of an amount due to a creditor in the financial statements has been reaffirmed to be an ‘acknowledgment of debt’, most recently by the Mumbai bench of the National Company Law Tribunal in TJSB Sahakari Bank Ltd. v. M/s. Unimetal Castings Ltd.32

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29 The Companies Act, 2013, §405.
30 Ministry of Corporate Affairs, The Specified Companies (Furnishing of Information about Payment to Micro and Small enterprise Suppliers) Order, 2019, Rule 3.
31 Ministry of Corporate Affairs, The Specified Companies (Furnishing of Information about Payment to Micro and Small enterprise Suppliers) Order, 2019 which requires bi-annual disclosures of outstanding dues in Form MSME-1, has been issued under The Companies Act, 2013, §405. As per §405(4):

“If any company fails to comply with an order made under sub-section (1) or subsection (3), or knowingly furnishes any information or statistics which is incorrect or incomplete in any material respect, the company shall be punishable with fine which may extend to twenty-five thousand rupees and every officer of the company who is in default, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to three lakh rupees, or with both.”

the financial statements of the buyer implies that by each act of disclosure the buyer ’acknowledges the debt’ owed to a supplier and thus gives rise to a fresh cause of action to the supplier by virtue of each specific acknowledgment, thereby extending the period of limitation. The act of disclosure would thus have the effect of estopping a corporate buyer from arguing that a debt owed to a supplier had become barred by limitation.

This leads to a situation where a failure to disclose could attract a possible prison term for the buyer, while the act of disclosing the debt would keep on evergreening the claims which may otherwise have become time barred.

VII. CONCLUSION: THE WAY FORWARD

The result of the mandatory financial disclosures and a lack of resolution on the applicability of limitation before claims arbitrated by MSME-FCs gives rise to significant commercial difficulties. Amounts which are not disclosed by the buyer (because they are not known to exist, as set out in our initial example where interest payments were not accounted for), would result in the buyer incurring monetary penalties and potentially imprisonment under the provisions of the Companies Act. Moreover, there are often situations where supplier agreements are no longer existing, and suppliers cannot be traced or are deliberately holding-out to earn higher interest amounts. In those cases, the buyer has no choice but to continue to accrue escalating interest in its books of accounts each year to ensure compliance under the MSMED Act and Companies Act and the MSME Order. The amount continuing to accrue greater interest on the balance sheet would erode the distributable profits of a corporate buyer.

The MSMED Act, as a legislation to shorten the working capital cycle of MSMEs by promoting timely payments, must balance the interest of suppliers and its customers, as no supplier can exist in the absence of its customer. To that extent, the applicability of Limitation Act will ensure that the moral hazard of suppliers waiting out and making claims after a larger amount of interest has accrued to them is avoided.

A regulatory framework of the nature described in this note, besides having led to the inefficient use of judicial time to adjudicate the applicability of limitation, results in substantial distress for corporate bodies in an environment where the urgency for measures to improve ease of doing business and attract investment is already widely felt.

A review of the mechanism to pursue claims owed to suppliers under the IDP Act, the MSMED Act, the legislative history and purpose of the MSMED Act, and the series of judicial decisions on the subject indicate that the confusion with respect to available avenues for parties to resolve disputes has been conclusively addressed. Parties must mandatorily pursue conciliation and then arbitration, sequentially, before MSME-FCs constituted under the MSMED Act to resolve disputes relating to payments owed to suppliers under the MSMED Act.

However, judicial decisions have failed to conclusively address the Limitation Question, i.e. whether the Limitation Act applies to disputes under the MSMED Act, being an

arbitration under a statute. In order to lay the matter to rest, it is suggested that the Central Government should exercise its rule-making powers under §29 of the MSMED Act. It must have the effect of clarifying that claims under the MSMED Act are mere commercial claims which like all other commercial claims must be barred by limitation in the ordinary course. This would balance the interest of corporate buyers, the MSME sector and ensure that judicial time is spent focusing on matters which can be resolved only by judicial intervention and not issues that can be clarified by executive action.