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CASE STUDY OF AVR ENTERPRISES V. UNION OF INDIA

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1. INTRODUCTION

1.1 The Micro, Small and Medium Enterprises (hereinafter referred to as 'MSMEs') form an important sector that is critical to the Indian economy due to its contribution in generating employment in both rural and urban areas and in generating revenue through its exports. In order to protect MSMEs from their creditors and to facilitate their development, the Parliament of India has enacted the Micro, Small and Medium Enterprises Development Act, 2006 (hereinafter referred to as 'MSMED Act') with effect from October 2, 2006.¹

1.2 Section 15 of the MSMED Act provides that when a registered MSME supplies goods or provides services to any buyer then the buyer has to pay the agreed amount to the supplier (i.e registered MSME) within the agreed period and when there is no agreed period within fifteen days of delivery of goods or services or deemed acceptance of any such goods or services by the buyer. Proviso to Section 15 provides that in no case the supplier shall agree to receive payment from its buyer after forty-five days of acceptance or day of deemed acceptance of goods/ services by the buyer. In case of non-payment of agreed price by the buyer within the agreed period or within fifteen days of acceptance of goods/ services or deemed day of acceptance of goods or services, then the MSME (i.e. the supplier) shall be entitled to receive compound interest with monthly rests from the day following the agreed date or the sixteenth day till the date of receipt of payment at a rate which would be three times the bank rate as notified by Reserve Bank of India.²

2. REFERENCE OF DISPUTES TO ARBITRATION BY MSMEs

2.1 The MSMED Act also empowers various State governments in India to establish one or more Micro and Small Enterprises Facilitation Council(s) (hereinafter referred to as the 'Facilitation Council') in their territory to resolve the disputes of MSMEs.³

2.2 Section 18 of the MSMED Act provides a two-tier mechanism to resolve the disputes of MSMEs. If any party to a dispute makes a reference to the Facilitation Council

having jurisdiction in its area, then the Facilitation Council first refers the parties to conciliation conducted by it or any other institution or centre providing such services.⁴ If the parties fail to arrive at a settlement in conciliation then the Facilitation Council may itself take-up the dispute for arbitration or refer the dispute to any institution or centre providing arbitration services.⁵ The provisions of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as the 'Arbitration Act') would apply to the dispute between the parties.⁶

2.3 The MSMED Act provides for a quick resolution of disputes by providing a ninety days' time period from the date of reference for the arbitrator to decide such a dispute.⁷

2.4 The Arbitration Act provides for two types of arbitration. Ad-hoc arbitration is when the parties enter into an arbitration agreement before or after the disputes have arisen and agree to refer the disputes to arbitration and decide the place of arbitration, applicable law and manner of selection/ nomination of an arbitrator.⁸ In an institutionalised arbitration, parties agree to refer their disputes to a specialized institution which administers the arbitral process according to its own rules and regulations. Examples of arbitral institutions are London Court of International Arbitration (LCIA), New Delhi International Arbitration Centre (NDIAC), Mumbai Centre for International Arbitration (MCIA), etc.

2.5 Therefore, MSMEs have an option to either refer the disputes that arise with their creditors/ debtors, etc, to ad-hoc arbitration under the Arbitration Act or an institutional arbitration to the Facilitation Council under Section 18 of the MSMED Act.

2.6 Due to this dual option available to MSMEs to go for arbitration under the Arbitration Act or under the MSMED Act, there have been many cases where the issue of over-lap between the MSMED Act and Arbitration Act have come

¹ The Micro, Small and Medium Enterprises Development Act, 2006, Preamble.

² The Micro, Small and Medium Enterprises Development Act, 2006, Section 16.

³ The Micro, Small and Medium Enterprises Development Act, 2006, Section 20.

⁴The Micro, Small and Medium Enterprises Development Act, 2006, Section 18(2).

⁵ The Micro, Small and Medium Enterprises Development Act, 2006, Section 18(3).

⁶ Ibid.

⁷ The Micro, Small and Medium Enterprises Development Act, 2006, Section 18(5)

⁸Venancio D'Costa and Astha Ojha, 'India: Institutional vis-a- vis Ad-hoc Arbitrations In India' (*Mondaq*, June 242020)

<<https://www.mondaq.com/india/arbitration-dispute-resolution/957706/institutional-vis-a-vis-ad-hoc-arbitrations-in-india>> accessed November 29 2020

up before various High Courts India.⁹ Recently, the Hon'ble Delhi High Court in *AVR Enterprises v. Union of India*¹⁰ (hereinafter referred to as the 'instant case') was faced with an issue of deciding whether the provisions relating to arbitration under the MSMED Act would apply to a registered MSME that has invoked ad-hoc arbitration under the Arbitration Act?

2.7 The Hon'ble Delhi High Court in the instant case held that the provisions relating to arbitration of disputes under the MSMED Act would apply only when a reference to institutional arbitration as provided under Section 18 of the MSMED Act is made and not when parties including an MSME, have appointed an arbitrator privately under the Arbitration Act.

3. AVR ENTERPRISES V. UNION OF INDIA¹¹

3.1 Brief Facts:

3.1.1 The Respondent i.e. Union of India issued a tender for procuring Cover water proof 9.1 M x 9.1 M.

3.1.2 The Petitioner i.e. AVR Enterprises is a company registered under the MSMED Act. The Petitioner's bid for the supply of the same was accepted and a contract for supply of Cover water proof was executed between the Petitioner and the Respondent on April 5, 2005.

3.1.3 Disputes arose between the Petitioner and the Respondent with respect to the supplies made by the Petitioner. Hence, Respondent imposed liquidated damages on the Petitioner and adjusted the balance payments due to the Petitioner.

3.1.4 Aggrieved by the actions of the Respondent, the Petitioner invoked arbitration under the contract vide its letter dated July 23, 2010. The Respondent appointed a sole arbitrator in terms of the arbitration clause under the contract to adjudicate the disputes between the parties.

3.1.5 The arbitrator passed an award dated July 14, 2016 wherein he reduced the amount of liquidated damages and directed that the Respondent should pay the balance amount due to the Petitioner with compound interest.

3.1.6 The Respondent challenged the award passed by the arbitrator by filing a petition under Section 34 of the Arbitration Act before the Learned Trial Court.

3.1.7 The Petitioner raised a preliminary objection to the maintainability of the petition filed by the Respondent under Section 34 of the Arbitration Act as the latter had not deposited 75% of the arbitral award amount as stipulated under the provision of Section 19 of the MSMED Act.

3.1.8 The Learned Trial court vide its order dated April 18, 2018 (hereinafter referred to as the 'impugned order') rejected the preliminary objection raised by the Petitioner and held that the provisions of the MSMED Act including Section 19 thereof would not be applicable to the present case as the arbitral proceedings were held under the Arbitration Act and not the MSMED Act.

3.1.9 Aggrieved by the order of the Trial court, the Petitioner filed an appeal before the Hon'ble Delhi High Court.

3.2 ISSUE

3.2.1 Whether Section 18 and 19 of the MSMED Act are applicable when an MSME registered under the MSMED Act has initiated arbitration proceedings under the Arbitration Act?

3.3 DECISION

3.3.1 The Hon'ble Delhi High Court analysed Section 19 of the MSMED Act and observed that the said provision is applicable only in cases when an application to set aside any decree, award or order made by the Facilitation Council or any institution or centre referred by the Facilitation Council is filed before a court of law.

3.3.2 The Learned Delhi High Court relied on the judgment passed by a coordinate bench of the same High Court in the case of *Bharat Heavy Electrical Limited v. The Micro and Small Enterprises Facilitation Centre and Anr*¹² where it was held that the benefit of Section 19 of the MSMED Act is not available when parties have submitted to arbitration by an agreement entered between them and not by a statutory reference under Section 18 (3) of the MSMED Act.¹³

3.3.3 The High Court held that the decision of Gauhati High Court in *Union of India v. Hindustan Metal Refining Works Private Limited*¹⁴ (hereinafter referred to as the '*Hindustan Metal case*') cited by the Petitioner herein was not applicable in the present case as in the *Hindustan Metal case*¹⁵, the issue as to whether Section 19 of the MSMED Act was not applicable to an arbitration that has not been referred under Section 18 of the MSMED Act was not specifically raised. Further in the *Hindustan Metal case* the Gauhati High Court had dismissed the appeal of the appellant therein as it did not find any merit in the grounds taken by the appellant to challenge the arbitral award under Section 34 of the Arbitration Act.

3.3.4 The Hon'ble Delhi High Court in the instant case disagreed with the decision given by the Hon'ble Gujarat High Court in *Saryu Plastics Private Limited and Others v. Gujarat Water Supply and Sewerage Board*¹⁶ (hereinafter referred to as '*Saryu Plastics case*'), wherein it was held by the division bench that Section 19 of the MSMED Act would apply even in cases where the parties have not referred their disputes for arbitration to the Facilitation Council or any institution/ centre designated by it under Section 18 (3) of the MSMED Act. The Gujarat High Court in the *Saryu Plastics case* further held that if Section 19 of the MSMED Act was to be applicable only to awards or orders passed by the Facilitation Council or any institution/ centre designated by it then the word "decree" in Section 19 of the MSMED Act would be rendered otiose as neither the Facilitation Council nor any institution or centre to which a

⁹ Sanjeev Kumar and Anshul Sehgal, 'Arbitration under MSME Act: What's the status?' (*The SCC Online Blog*, June 19 2020) <<https://www.sconline.com/blog/post/2020/06/19/arbitration-under-msme-act-whats-the-status/>> accessed November 29 2020

¹⁰ *AVR Enterprises v. Union of India* 2020 SCC Online Del 624

¹¹ *Supra* (n 10)

¹² *Bharat Heavy Electrical Limited v. The Micro and Small Enterprises Facilitation Centre and Anr* W.P. (C) 10866/2016 and W.P. (C) 10901/2016 decided on September 18, 2017 [Delhi High Court]

¹³ *Ibid*, para 22 and 28.

¹⁴ *Union of India v. Hindustan Metal Refining Works Private Limited* (2014) 5 Gauhati Law Reports 532

¹⁵ *Ibid*

¹⁶ *Saryu Plastics Private Limited and Others v. Gujarat Water Supply and Sewerage Board* AIR 2018 Guj 57

reference for arbitration has been made could ever pass a decree.

- 3.3.5 The Delhi High Court in the instant case held that a harmonious interpretation was to be given to all the provisions of the MSMED Act in such a manner that no word or part of any provision should be rendered redundant or nugatory. Accordingly, the Hon'ble Delhi High Court observed that that if the view of the Gujarat High Court expressed in *Saryu Plastics* case is adopted then the words "*made either by Council or by any institution or centre providing alternate dispute resolution services to which reference has been made by the Council*" would become otiose and surplusage.
- 3.3.6 The Delhi High Court in the instant case also discussed the decision of the Hon'ble Supreme Court of India in *Snehadeep Structures Private Limited v. Maharashtra Small Scale Industries Development Corporation Limited*¹⁷ (hereinafter referred to as '*Snehadeep Structures case*'), wherein it was held that the word "appeal" in Section 7 of the Interest on Delayed Payments to Small Scale and Ancillary Undertakings Act, 1993 (hereinafter referred to as the '**Interest Act**') would include an application under Section 34 of the Arbitration Act and hence every buyer or any other appellant other than a supplier who challenges an arbitration award passed in favour of a small scale industrial undertaking registered under the Interest Act would have to mandatorily deposit 75% of the amount awarded under the arbitration award in the Court or with any such authority with whom the appellant has filed the appeal, before filing such an appeal.
- 3.3.7 The Delhi High Court in the instant case held that the ratio of the *Snehadeep Structures*' judgment of the Hon'ble Supreme Court would not apply to this case as Section 6 of the Interest Act unlike Section 18 of the MSMED Act provides that the supplier under the Interest Act may file a suit or any other proceedings including arbitration proceedings with the Industry Facilitation Council established under the Interest Act to recover the outstanding amount from its buyer. Section 7 of the Interest Act specifically provides that no appeal against any decree, award or any other order shall be entertained by any Court or authority unless the appellant has deposited with it 75% of the amount awarded under the decree, award or the order, as the case may be. The language of Section 7 of the Interest Act unlike Section 19 of the MSMED Act is not qualified by the words "*any decree, award or other order made either by the Council or by any institution or centre providing alternate dispute resolution services to which reference has been made by the Council*" and hence Section 7 of the Interest Act is substantially different from Section 19 of the MSMED Act.
- 3.3.8 Hence, the Delhi High Court held that the mandatory deposit of 75 percent of the award amount provided under Section 19 of the MSMED Act would apply only to proceedings initiated under Section 18 of the MSMED Act and not to an award passed by an arbitrator appointed by the parties solely under the Arbitration Act as Section 19 of the MSMED Act specifically qualifies the words "*decree, award or other order*" with the expression "*made either by the Council or by any institution or centre providing alternate dispute resolution services to which reference has been made by the Council*". The Petition

¹⁷*Snehadeep Structures Private Limited Maharashtra Small Scale Industries Development Corporation Limited* 2010 (3) SCC 34

filed by the Petitioner was dismissed by the Delhi High Court and the impugned order was upheld.

4. CONCLUSION

- 4.1 It can be concluded that there are conflicting decisions of various High Courts on the issue of applicability of Section 19 of the MSMED Act to arbitration proceedings and award passed by the arbitrator(s) appointed by the parties under the provisions of the Arbitration Act and not under Section 18 of the MSMED Act. The Gujarat High Court in the *Saryu Plastics* case seems to have erred in its judgment as it has ignored that the language of Section 19 of the MSMED Act specifically provides that the appellant would have to deposit 75% of the amount under the award or order in the court in which an application for setting aside any decree, award or other order made only by either the Facilitation Council or any institution or centre to which the Facilitation Council has referred the dispute for arbitration.
- 4.2 The word "decree" in Section 19 of the MSMED Act has led to a lot of confusion. I think it was unnecessary for the Parliament to add the word "decree" in Section 19 of the MSMED Act as a Facilitation Council or an institute or centre providing alternate dispute resolution services to which a reference was made by the Facilitation Council cannot ever pass a decree.
- 4.3 Hon'ble Punjab High Court in its judgment in the case of *State of Punjab v. M/s Oasis Contractors and Consultants Private Limited and Anr*¹⁸ also took the same view as the Hon'ble Delhi High Court in the instant case and held that Section 19 of the MSMED Act would apply only in cases where reference for arbitration has been made by the parties to the Facilitation Council or any institution/ centre designated by it under Section 18 of the MSMED Act.
- 4.4 The Hon'ble Delhi High Court judgment in the instant case has rightly interpreted the provisions of the MSMED Act and its applicability to arbitrations conducted under the Arbitration Act.

¹⁸*State of Punjab v. M/s Oasis Contractors and Consultants Private Limited and Anr*, CR – 6867 of 2019 decided on November 22, 2019 [Punjab and Haryana High Court]