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DECODING THE ACT SERIES



**The Micro, Small and Medium Enterprises Development
(MSMED) Act, 2006**

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WHY SHOULD WE STUDY THE ACT?



P. Arun Sugavaneshvar
Founder

The Ministry of MSME, Government of India, FY 24- 25 Annual report states that there are a total of 6.33 crore MSMEs in India. **In India, over 99 per cent of total MSMEs qualify as micro-enterprises that make up 6.27 crore enterprises.** There are a total of 3.3 lakh businesses that qualify as small businesses and just 0.05 lakh qualify as medium businesses that sum of 0.01 per cent of all MSMEs.

The Ministry of MSME's revised Classification dated 21st March 2025 applicable w.e.f 1st April 2025, as part of the Aatma Nirbhar Bharat package states **that a micro enterprise is one where the investment in plant and machinery or equipment does not exceed Rs. 2.5 crore and annual turnover not more than Rs. 10 crore. A small enterprise, where the investment in plant and machinery or equipment does not exceed Rs. 25 crore and annual turnover not more than Rs. 100 crore and a medium enterprise, where the investment in plant and machinery or equipment is not more than Rs. 125 crore and annual turnover not more than Rs. 500 crore.**

The MSME Act, officially known as the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, replaced the Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993 (IDP Act). The Micro and Small Enterprises Facilitation Council (MSEFC) has been established under the MSMED Act. **Section 18 of the MSMED Act provides for the mechanism of dispute resolution first through conciliation and then through arbitration** with an intent to reduce litigation and also improve the efficacy whereby MSME's can claim money due through a more streamlined and speedy process. **The MSME Samadhaan delayed payment monitoring platform lists that a total of 2,46,000 odd applications have been received** out of which 23000 odd applications have been settled and 49000 odd applications have been disposed of by the MSEFC.

The Supreme Court in *Silpi Industries vs Kerala SRTC (2021) 18 SCC 790* held that the **Limitation Act, 1963 is applicable to the arbitration proceedings under Section 18(3) of the 2006 Act.** Further the Supreme Court in *M/s Sonali Power Equipments Pvt Ltd vs. Chairman, Maharashtra State Electricity Board, Mumbai & Ors* judgement dated July 17th 2025, held that the **Limitation Act is not applicable to conciliation proceedings under the MSMED Act, 2006.**

It is important as advocates and legal consultants to recognise the growing startup culture in India and the need for learning settlement and arbitration process through MSMED Act apart from other corporate laws and money recovery laws as most of the companies now register under MSME to claim benefits and subsidy. If the above brief resonates with you, please read our newsletter.





HOW THE ACT EMPOWERS?

Chapter 2:

Establishment of Board: (Section 3)

National Board for Micro, Small and Medium Enterprises: The Central Government by notification establish the National Board for Micro, Small and Medium Enterprises, with its head office at Delhi. The board consists of **47** members in total with **18 ex-officio members and 29 members** with two-year terms. The Board is required to meet at least once in every **3** months in a year.

Functions of Board: (Section 5)

The Board shall examine the matters concerning the **promotion and development of micro, small and medium enterprises, review the policies and programmes** of the Central Government, and **advise** on any matters including that use of funds or Funds constituted.

Chapter 3:

Classification of Enterprises: (Section 7)

The Act provides a detailed framework for **classifying enterprises** into micro, small, and medium categories. This classification is based on investment criteria:

- **Section 7(a)** :For enterprises engaged in the **manufacture or production of goods** pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 :
- **Section 7 (a)(i)- Micro enterprise**: Investment in plant and machinery does not exceed **twenty-five lakh rupees**.
- **Section 7 (a)(ii) - Small enterprise**: Investment in plant and machinery is more than **twenty-five lakh rupees** but does not **exceed five crore rupees**.
- **Section 7 (a)(iii) - Medium enterprise**: Investment in plant and machinery is **more than five crore rupees** but does **not exceed ten crore rupees**.
- **Section 7 (b) - For enterprises engaged in providing or rendering of services**:
- **Section 7 (b) (i) - Micro enterprise**: Investment in equipment does not **exceed ten lakh rupees**.
- **Section 7 (b) (ii) - Small enterprise**: Investment in equipment is **more than ten lakh rupees** but does **not exceed two crore rupees**.
- **Section 7 (b) (iii) - Medium enterprise**: Investment in equipment is **more than two crore rupees** but does **not exceed five crore rupees**.

Advisory Committee (Section 7(2)):

The Central Government is to constitute an Advisory Committee, which plays a crucial role in examining matters related to the classification of enterprises and provides recommendations based on factors such as **investment, employment, technological needs, entrepreneurship promotion, and international standards**..The Member-Secretary of the National Board is also the **ex officio Member-Secretary** of this Committee.

Memorandum of micro, small and medium enterprises: (Section 8)

Any person intending to establish a micro, small, or medium enterprise (file the memorandum within **180 (one hundred and eighty days)** from the commencement of the Act) is **required to file a memorandum** with a specified authority. The **form and procedure for filing this memorandum** are notified by the Central Government, based on Advisory Committee recommendations.

Chapter 4:

Measures for Promotion and Development: (Section 9)

The Central Government may specify **programs, guidelines, or instructions** for facilitating promotion and development, including **skill development, technological upgradation, marketing assistance, infrastructure facilities, and cluster development**.

Credit Facilities (Section 10):

Policies and practices for credit to these enterprises are **progressive** and specified by the Reserve Bank of India to ensure **timely and smooth credit flow, minimize sickness, and enhance competitiveness**.

Procurement Preference Policy (Section 11):

Central or State Governments may notify **preference policies** for the procurement of goods and services produced or provided by micro and small enterprises by their ministries, departments, aided institutions, and public sector enterprises.

Funds and Grants (Sections 12,13 and 14):

The Act allows for the constitution of **one or more Funds**, credited with **grants made by the Central Government**(after appropriation made by the Parliament by law. These Funds are to be utilized exclusively for the promotion and development measures outlined in the Act. The Central Government shall have the power to administer the Fund or Funds and shall be responsible for their coordination, ensuring timely utilisation and release of sums in such manner and in accordance with such criteria as may be prescribed.

Chapter 5:

Provisions for Delayed Payments:

This chapter specifically focuses on protecting micro and small enterprises from delayed payments.

Buyer's Liability (Section 15):

Buyers are liable to make payments on or before the agreed date (not exceeding **45 days** from acceptance) or, if no agreement, before the "appointed day". The "appointed day" as defined in **section 2(b)** as 15 days from delivery/service, or the day an objection is removed, or the day of deemed acceptance if no objection is made.

Interest on Delayed Payments (Section 16):

If a buyer fails to pay, they are liable to pay **compound interest with monthly rests** at three times the bank rate notified by the Reserve Bank, from the appointed day or agreed date. This interest applies "notwithstanding anything contained in any agreement between the buyer and the supplier or in any law for the time being in force".

Reference to Micro and Small Enterprises by Facilitation Council for Dispute Resolution (Section 18):

Any party to a dispute regarding amounts due under Section 17 may make a reference to the **Micro and Small Enterprises Facilitation Council**. The Council shall conduct **conciliation** in accordance with the provisions of the Arbitration and Conciliation Act, 1996, or refer the matter to any institution providing **alternative dispute resolution services**. If the conciliation initiated by the Council fails, it shall either itself take up the dispute for arbitration or refer it to any institution or centre providing such services. The Council or the centre to which the dispute is referred shall have jurisdiction to act, **even if the supplier or the buyer is located in different parts of India**. Every reference made under this section shall be decided within **90** (ninety days) from the date of such reference.

Establishment of Micro and Small Enterprises Facilitation Council (Section 20):

State Governments are mandated to establish **one or more** Micro and Small Enterprises Facilitation Councils at specified places, with defined jurisdiction. These Councils are designed to facilitate the resolution of disputes related to delayed payments to micro and small enterprises.





PENALTY UNDER THE ACT

1. Penalty by Way of Interest (Sections 15, 16 & 17)

The buyer shall make the **payment** to the supplier on or before the **date** agreed upon him and the supplier if it is in writing or when it is not explicitly written, then on or before the appointed date (**U/s 15**). However, under no circumstances shall the period agreed upon in writing between the supplier and the buyer exceed **forty-five days** from the date of acceptance or the date deemed as acceptance.

If the buyer **fails** to make payment to the supplier, then he will be **liable** for a penalty (**U/s 16**).

Penalty/Consequence:

- The buyer is liable to pay **compound interest** with monthly rests from the appointment date, to the supplier and the interest shall be paid at **three times** the RBI's notified bank rate on the outstanding amount from the date payment became due.

For any goods or services provided by the supplier, the buyer shall be liable to pay the principal amount along with the **interest** (**U/s 17**).

2. Penalty for contravention of Section 8 or Section 22 or Section 26 (Section 27)

If a person intentionally fails to comply with filing the **memorandum** (**U/s 8(1)**) or refuses to provide information when asked by an **authorised officer** (**u/s 26(2)**), or abets someone else do so, they can be fined. However, the filing of a memorandum is discretionary in the case of micro and small enterprises but mandatory for the medium enterprises who are engaged in manufacturing.

Penalty/Consequence:

- **Section 27 (a)** - For First Conviction, a fine can be imposed up to **Rs. 1,000**.
- **Section 27 (b)** - For Second or Subsequent Conviction fine shall not be less than **Rs. 1,000** and it shall not exceed **Rs. 10,000**.
- **Section 27 (2)** - If a buyer of goods and services did not furnish the **unpaid amount** (principal and interest) owed to the MSMEs (as required **U/s 22**), the penalty should not be less than **Rs. 10,000**.





HOW THE COURTS HAVE INTERPRETED & ADJUDICATED?

1. Case insight: MSEFC failed its duty to refer the dispute to arbitration

Case title: *Bafna Udyog v. Micro & Small Enterprises and Another* [2024 SCC OnLine Bom 110]

Relevant provisions: Sections 11(6), 2(4), 7, 76(d), 65 to 81 of the Arbitration & Conciliation Act, 1996 and Sections 18(3), 18(5), 24, 17 of the **Micro, Small & Medium Enterprises Development Act, 2006** (“The MSMED Act”)

Legal question: Can the High Court appoint an arbitrator under Section 11(6) of the Arbitration & Conciliation Act, 1996, when the Micro & Small Enterprises Facilitation Council (MSEFC) fails to refer a dispute to arbitration as per the MSMED Act, particularly in the **absence of a prior arbitration agreement** between the parties?

Context:

Bafna Udyog, a registered small entity and supplier, sought to recover Rs. 92,41,072/- with interest from Respondent No. 2 (a buyer). Despite acknowledging the debt, Respondent No. 2 failed to pay. Bafna Udyog filed a statement of claim and a declaration of termination of conciliation under Section 76(d) of the Act with the MSEFC (Respondent No. 1). The **MSEFC failed to act** in accordance with Section 18(3) of the MSMED Act by not referring the dispute to arbitration within the mandatory ninety-day period under Section 18(5). This inaction led Bafna Udyog to file the Arbitration Petition, seeking the appointment of a retired District Judge as an arbitrator under Section 11(6) of the Act.

Final verdict:

The petition was **dismissed as not maintainable**. The Court ruled that Section 11(6) of the Act, which allows for court appointment of an arbitrator, applies only where there is an **"appointment procedure agreed upon by the parties"** as contemplated by an arbitration agreement under Section 7 of the Act. In this case, no such arbitration agreement, either express or implied, existed. The Court clarified that while Section 18(3) of the MSMED Act provides for statutory arbitration, it only deems the provisions of the Arbitration Act applicable after the Council or its designate commences the arbitration. Inaction by the MSEFC **does not entitle a party to invoke Section 11(6) of the Act** to seek an arbitrator without an existing arbitration agreement. Furthermore, the Petitioner's claim that acknowledgment of debt implies termination of conciliation without MSEFC reference was rejected, deeming the petition **premature** as conciliation must be conducted by the Council first. The Petitioner was, however, granted liberty to pursue other available legal remedies.

2.Case insight: MSME Loan Restructuring: Banks Must Follow Statutory Directives

Case Title: *M/s. Pro Knits v. The Board Of Directors Of Canara Bank & Ors.*(2024 INSC 565)

Relevant Provisions: Section 9 of the **Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act)**, Sections 13(2), 35 of the **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)** and Sections 21, 35A of the **Banking Regulation Act, 1949**

Legal Question: Whether the Notification dated 29th May 2015 (Instructions for Framework for Revival and Rehabilitation of MSMEs), issued under Section 9 of the MSMED Act, concerning the "Framework for Revival and Rehabilitation of MSMEs," is **mandatory or merely directory** for Banks/Non-Banking Financial Companies (NBFCs), particularly regarding the classification of MSME loan accounts as Non-Performing Assets (NPAs)?

Context:

Appellants, who are Micro, Small, and Medium Enterprises (MSMEs), challenged a Bombay High Court order which ruled that Banks/NBFCs were **not obliged to adopt the restructuring process** outlined in the 29th May 2015 Notification on their own initiative. The MSMEs contended that their loan accounts should not have been classified as NPAs under the SARFAESI Act without first following the rehabilitation framework. The Banks/NBFCs argued the Notification was not mandatory and that the SARFAESI Act provisions override other laws.

Final Verdict:

The Supreme Court found the High Court's decision, stating that banks are not obliged to adopt the restructuring process on their own or that the framework is not mandatory, to be **erroneous and indefensible**. The Court held that the Instructions/Directions issued by the Central Government under Section 9 of the MSMED Act, and by the RBI under Sections 21 and 35A of the Banking Regulation Act, **possess statutory force and are binding on all Scheduled Commercial Banks**.

This "Framework for Revival and Rehabilitation of MSMEs" **must be followed prior to the classification of an MSME's loan account as an NPA**. However, the Court also clarified that it is equally **incumbent on the concerned MSMEs to be vigilant** and provide authenticated documents to the banks substantiating their MSME status before their account is classified as NPA. If an MSME fails to do so and allows the SARFAESI Act proceedings to conclude, they cannot subsequently raise this plea. The High Court's impugned order was **set aside**, and the appeals were allowed to this extent, with appellants retaining the option to pursue other legal remedies for unresolved factual issues.

3.Case insight: Legal framework and judicial interpretations concerning delayed payments

Case Title: *Goodyear India Ltd., rep. by its Zonal Manager, A. Baburaj v. Nortan Intec Rubber (P) Ltd. and another [O.P. No.888 of 2010]*

Relevant Provisions: Arbitration and Conciliation Act, 1996: Section 34(3) of the **Arbitration and Conciliation Act, 1996**, and Section 19 of the **Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act)** .

Legal Question: Whether a petition challenging an Arbitral Award was maintainable if the **mandatory pre-deposit of 75% of the entire award amount** (principal and interest) was not made within the statutory limitation period prescribed by Section 34(3) of the Arbitration and Conciliation Act, read in conjunction with Section 19 of the MSMED Act?

Context:

A dispute arose between Goodyear India Ltd. (the Petitioner) and Nortan Intec Rubber (P) Ltd. (the First Respondent) concerning agreements for the supply of raw materials and finished products. The First Respondent referred the dispute to the Micro and Small Enterprises Facilitation Council under the MSMED Act, 2006. The Council passed an award directing the Petitioner to pay ₹80,11,495/- as principal, along with prescribed interest. The Petitioner filed an Original Petition to challenge this award on 29.03.2010, which was within the initial three-month limitation period, but **without making the mandatory pre-deposit of 75% of the award amount**. The First Respondent argued that the petition was not maintainable due to this non-compliance.

Final Verdict:

The High Court **dismissed the Original Petition**, ruling that it was **hopelessly barred by limitation and thus not maintainable**. The court determined that the **mandatory 75% pre-deposit of the entire award amount (including both principal and interest)**, as required by Section 19 of the MSMED Act, was not fulfilled within the statutory limitation period of 90 days or the further 30-day grace period (a total of 120 days) from the date of receiving the award.

Although the petition was filed within the initial time frame, the complete **75% deposit** was only made on 04.06.2012, long after the statutory deadline of 13.05.2010. The court emphasised that "entertain" means "**admitting to consideration**", and an appeal without the required payment cannot be considered. Crucially, the Arbitration and Conciliation Act, 1996, does not provide for condonation of delay **beyond the 30-day** grace period under Section 34(3). Consequently, the petition was deemed to be properly filed only on 04.06.2012, by which time it was **definitively time-barred**.

4.Case insight: MSEFC: Payment Dispute and Penalty

Case Title: M/s. Maa Alloys (P) Ltd. Deogaon, v. M/s. Shree Metalic Ltd. (MSEFC Case No. 10/2011)

Relevant Provision: Sections 15 & 16 of the MSMED Act, 2006. Compound interest with monthly rests at 3 times the Bank rate as notified by the Reserve Bank of India.

Legal Question: Was M/s. Shree Metalic Ltd. liable to pay the outstanding principal and interest to M/s. Maa Alloys (P) Ltd. for supplied goods under the MSMED Act, 2006?

Context:

M/s. Maa Alloys Pvt. Ltd., a Micro Enterprise, supplied goods to M/s. Shree Metalic Limited but received only part payment, leaving an outstanding balance. The claimant filed an application with the MSEFC. The Opposite Party did not respond to multiple notices, which were returned as "plant is closed," or "refused," and did not attend Council sittings.

Final Verdict:

The Council **decided to pass an award ex parte**. M/s. Sree Metaliks Limited was **directed to pay the principal amount of Rs.12,58,047** and an **interest claim of Rs.22,57,786.00**, calculated up to 05.09.2011, as per Sections 15 & 16 of the MSMED Act, 2006. It was further stipulated that **compound interest with monthly rests at 3 times the Bank rate** as notified by RBI shall be payable until the dues are realised.

5. Case insight: MSMED Act Prevails Over General Arbitration Law

Case Title: *M/s. Silpi Industries etc. v. Kerala State Road Transport Corporation & Anr. etc.* [Civil Appeal Nos. 1570-1578 of 2021] with *M/s. Khyaati Engineering v. Prodigy Hydro Power Pvt. Ltd.* [Civil Appeal Nos. 1620-1622 of 2021]

Relevant Provisions: Sections 11(6), 23(2A), and 43 of the Arbitration and Conciliation Act, 1996, Sections 15, 16, 17, 18(3), and 24 of the Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act) and Limitation Act, 1963.

Legal Questions: Whether the Limitation Act, 1963 applies to arbitration proceedings under the MSMED Act, 2006 and whether counter-claims are maintainable in arbitration proceedings held pursuant to the provisions of the MSMED Act, 2006?

Context:

M/s. Silpi Industries (supplier) vs. Kerala State Road Transport Corporation (buyer): The supplier claimed unpaid dues for goods supplied. After conciliation failed, arbitration awards were passed in favour of Silpi Industries. KSRTC challenged these awards, leading the High Court to set them aside and remand the matter. Silpi Industries appealed this decision, raising questions about the applicability of the Limitation Act and the maintainability of counter-claims. M/s. Khyaati Engineering (appellant) vs. Prodigy Hydro Power Pvt. Ltd. (respondent): Khyaati Engineering sought payment for hydro-mechanical equipment from the respondent via the Micro and Small Enterprises Facilitation Council under the MSMED Act. The respondent, however, moved the High Court to appoint a second arbitrator under the 1996 Act, arguing that counter-claims were not entertainable by the Facilitation Council. The High Court allowed this application, appointing an arbitrator and negating the maintainability of counter-claims before the Council. Khyaati Engineering appealed this order.

Final Verdict:

The Supreme Court dismissed all **Civil Appeals**. The Court held that the Limitation Act, 1963 is applicable to **arbitration proceedings** initiated under the MSMED Act, 2006, referencing **Section 43** of the 1996 Act. Crucially, the Court clarified that **counter-claims and set-offs** are maintainable before the Micro and Small Enterprises Facilitation Council and other statutory authorities under the MSMED Act. It emphasized that the MSMED Act is a **special, beneficial legislation** with an overriding effect over the general Arbitration and Conciliation Act, 1996. The Court reasoned that disallowing counter-claims would **defeat the Act's objectives** and could lead to **inefficient parallel proceedings and conflicting findings**.

While the appeals were dismissed, implying the High Court's orders stood (e.g., the remand for Silpi Industries and the appointment of an arbitrator for Khyaati Engineering), the Supreme Court's judgment significantly clarified the legal principles. For Khyaati Engineering, even though the High Court's order appointing an arbitrator was upheld, its *reasoning* that counter-claims are not maintainable before the Facilitation Council was effectively overturned by the Supreme Court's clear pronouncement on the issue. This means that in principle, both **buyer and seller** can raise claims and counter-claims before the MSMED Facilitation Council.



CASE TITLE	LEGAL QUESTION	FINAL VERDICT	RELEVANT PROVISIONS
Bafna Udyog v. Micro & Small Enterprises and Another [2024 SCC OnLine Bom 110]	Can the High Court appoint an arbitrator under Section 11(6) of the Arbitration Act when MSEFC fails to refer a dispute to arbitration under the MSMED Act, without a prior arbitration agreement?	Petition dismissed. Court held that in the absence of an arbitration agreement, Section 11(6) cannot be invoked. MSEFC’s inaction doesn’t entitle parties to approach High Court for arbitrator appointment.	Arbitration & Conciliation Act, 1996: Sections 11(6), 2(4), 7, 76(d), 65–81 MSMED Act, 2006: Sections 18(3), 18(5), 24, 17
M/s. Pro Knits v. The Board Of Directors Of Canara Bank & Ors. [2024 INSC 565]	Is the 29th May 2015 Notification (Framework for Revival and Rehabilitation of MSMEs) under Section 9 of the MSMED Act mandatory for Banks/NBFCs before classifying an MSME loan account as NPA?	Supreme Court ruled the Notification is mandatory. Directions issued under Section 9 of MSMED Act and RBI guidelines have statutory force. Banks must follow the framework before declaring MSME loans as NPAs.	MSMED Act: Section 9 SARFAESI Act: Sections 13(2), 35 Banking Regulation Act: Sections 21, 35A
Goodyear India Ltd. v. Nortan Intec Rubber (P) Ltd. [O.P. No.888 of 2010]	Is a petition to set aside an arbitral award maintainable if the mandatory 75% pre-deposit is not made within the limitation period under Section 34(3) of the Arbitration Act?	Petition dismissed as time-barred. Without depositing 75% within 120 days, the petition was held non-maintainable. Filing date reckoned only upon full deposit.	Arbitration Act: Section 34(3) MSMED Act: Section 19
M/s. Maa Alloys (P) Ltd. v. M/s. Shree Metalic Ltd. [MSEFC Case No. 10/2011]	Was the buyer liable to pay the outstanding principal and interest under the MSMED Act for goods supplied to a registered Micro Enterprise?	MSEFC passed ex parte award. Directed buyer to pay ₹12.58 lakhs as principal and ₹22.57 lakhs interest. Also liable for compound interest at 3× RBI bank rate until payment.	MSMED Act: Sections 15 & 16
M/s. Silpi Industries v. Kerala State Road Transport Corporation & M/s. Khyaati Engineering v. Prodigy Hydro Power Pvt. Ltd. [Civil Appeal Nos. 1570–1578 & 1620–1622 of 2021]	Does the Limitation Act apply to MSMED arbitration? Are counter-claims maintainable before MSEFC?	Supreme Court held Limitation Act applies. Also upheld that counter-claims are maintainable before MSEFC. MSMED Act overrides general arbitration law.	Arbitration Act: Sections 11(6), 23(2A), 43 MSMED Act: Sections 15–18, 24 Limitation Act, 1963

LAWBY WRITES

Have Suggestions or Questions?

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