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THE TREATMENT OF TIME BARRED DEBTS AND RECOVERY OF INTEREST ON UNPAID DEBTS UNDER MSMED ACT, 2006: A LEGISLATIVE OVERLOOK?

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ABSTRACT

The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, serves as a critical piece of social welfare legislation designed to protect MSMEs by ensuring timely payments and addressing credit constraints. However, ambiguities in the statutory framework have led to confusion regarding the recovery of time-barred debts and the accrual of interest. This paper critically examines the intersection of the MSMED Act with the Limitation Act and the Indian Contract Act to address these legislative overlooks.

This paper analyzes the implications of the non-obstante clause in Section 18 of the MSMED Act. Drawing on judicial precedents such as *Silpi Industries v. Kerala State Road Transport Corporation* and *Shanti Conductors (P) Ltd. v. Assam State Electricity Board*, the paper argues that the MSMED Act does not create an independent right to recover stale or time-barred debts. Consequently, the standard limitation periods apply to references made to the MSME Facilitation Council.

Furthermore, the paper highlights the predicament faced by buyers under Section 22, which mandates maintaining debts and penal interest on books of accounts, potentially damaging credit ratings, even when an MSME refuses to accept payment. By invoking Section 38 of the Indian Contract Act, the author contends that a “valid tender of payment” by a buyer should discharge the obligation to pay the statutory interest if the supplier refuses

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acceptance. The paper concludes by advocating for legislative clarity and guidelines that allow buyers to write off interest liabilities following a valid tender, thereby striking a balance that protects MSMEs without imposing onerous pecuniary burdens on compliant buyers.

Keywords: MSME Act 2006, Time Barred Debts, Limitation Period, Tender of Payment, Interest on Delayed Payments.

INTRODUCTION

The MSME Act was intended to be a social welfare legislation aimed at fostering conducive environment for growth and protection of MSME industry. The aim was to foster policy support for the MSME industry, provide for growth of MSME by empowering Government to formulate policies and address the issue of credit crunch by enabling timely payments of the services or goods rendered by the MSMEs. While the earlier Act of 1993¹ was only related to the payments of the amounts owed to the MSMEs, the Act of 2006² was a comprehensive legislation that provided for establishment of a National Board for MSMEs to examine and review the policies for MSMEs, aimed at facilitating and enhancing the competitiveness of the MSMEs by providing them the necessary support and advise the Central Government on issues related to MSMEs. Additionally, the affirmative provisions that relate to extension of progressive credit facilities to MSMEs, promotion policies, classification among various types of MSMEs on basis of investment made, provisions related to information memorandum for facilitating establishment of MSMEs and establishment of funds for facilitating payments to MSMEs were made in the Act of 2006.

Chapter V of the Act essentially retains the provisions of Interest on delayed payments to small scale and ancillary Industrial Undertakings Act, 1993 with revised timelines for the purposes of ensuring timely payment of credit due to MSMEs. The provisions provide that the maximum agreed period for payment for goods or services rendered by MSMEs cannot be extended for more than 45 days from the day of acceptance or deemed date of acceptance by means of an

¹Interest on delayed payments to small scale and ancillary Industrial Undertakings Act, 1993 (32 of 1993).

²The Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006).

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agreement between the parties. The maximum period with respect to the date of acceptance is also provided in the Act. Any objection with respect to the supply made by the MSME must be made within 15 days and the date of acceptance would be the date when such objection is removed by the supplier. In case of absence of any communication by the buyer, on the expiry of 15 days from the date of delivery, the day of Actual delivery would be the date of delivery. The significance of such deeming provision is important as the calculation of date of interest is to be from the 'appointed day' which is the day immediately following the expiry of 15 days from the date of deemed acceptance or date of acceptance. The calculation of rate of interest essentially depends on this day of deemed acceptance, which would be the date of original delivery of the goods. Considering the amount of interest to be the three times the bank rate, the deemed date of original delivery of goods could add substantial pecuniary burden on buyer.

For instance, if a supplier supplies the goods on 1st December and no date of payment is agreed upon. If the buyer does not raise any objection by 16th December, 1st December would be the deemed date of acceptance and thereby the appointed day would be 17th December. This implies the interest would be calculated from 17th December itself at three times the bank rate. In this example, the parties cannot extend the agreed period for delivery beyond 14th January as the mandate under proviso to section 15 provides. Further, the period agreed on by the parties can be valid beyond such period as the date of acceptance can vary if there is an objection with regard to the supply made. The underlying point is that the period of payment under the contract is subject to the timelines provided for under the Act.

Section 18 of the MSME Act³ contains a non obstante clause that generates legitimate confusion with respect to the recovery of time barred debts by the MSME pursuant to an application made to MSME facilitation council. Another pertinent issue arises due to the applicability of section 22 that mandates maintaining the debts and interest requisite payable to the MSMEs on the books of accounts of the MSMEs.⁴ This provision has the potential to negatively affect the credit rating of the buyers dealing with the MSMEs in light of the fact that there could be legitimate situations where a MSME refuses to accept debt or cannot be located pursuant to which the buyer cannot

³The Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) s 18.

⁴The Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) s 22.

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discharge his obligations with the effect that the interest payable on such debts is put at three times the bank rate notified by RBI. Therefore, the paper aims to address the potential treatment of time barred and legally irrecoverable debts under MSME Act and the need for legislative clarity in cases where subsequent to a valid tender of payment has been refused by the MSME and its potential implications in light of section 22. The paper also argues that a balanced approach is required that fosters the ease of doing business while protecting the rights of the MSMEs.

APPLICABILITY OF LIMITATION PERIOD FOR REFERENCE TO MSME FACILITATION COUNCIL

The very root of the issue on applicable law on the MSMEs is the non obstante clause of section 18 of the MSME Act.⁵ The section provides that any party can make reference to the MSME council for amount due under section 17,⁶ notwithstanding any law in force. The interpretation of the non-obstante clause is determinative of the rights that other party may have against the MSME under Limitation Act or general law, particularly in cases where exercise of such right by the buyertreads over the right of MSME to approach facilitation council under section 18 of the MSME Act. The Supreme Court in *Silpi Industries v. Kerala State Road Transport Corporation*,⁷ clearly held that section 43 of the A & C Act, which mandates application of limitation Act to the arbitration under A&C Act, would apply to arbitrations under section 18(3) of the MSME Act. This has to be read in light of the fact that the council would refer the dispute to arbitration after conciliation as required under the Act. This implies that in light of the timely dispute resolution envisaged by the Act, it would not be the case that the arbitration after the conciliation would be delayed to the extent of the fact that limitation should be computed from the day when conciliation was over, that interpretation would lead to absurd consequences. The practical implication of ruling in *Silpi Industries* is that the limitation would have to be seen with respect to the date on which the right to sue accrued to the MSME in pursuance of payment schedule envisaged under the Act after excluding the legitimate time spent in conciliation proceedings.

⁵The Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) s 18.

⁶The Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) s 17.

⁷*Silpi Industries v. Kerala State Road Transport Corporation* 2021 SCC OnLine SC 439.

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The interpretation of the phrase right to sue under the MSME Act can be taken from INTEREST ON DELAYED PAYMENTS TO SMALL SCALE AND ANCILLARY INDUSTRIAL UNDERTAKINGS ACT, 1993. This is due to the fact that there is no express right over and above the existing laws that is created in favour of MSMEs. Apart from the enabling provisions that provide for taking steps in favour of MSMEs through establishing board to that effect for advising government and other ancillary provisions, the statute nowhere creates a separate right to recover the dues in favour of MSMEs. The Act of 2006 only provides a recovery mechanism whereby the timelines under 1993 Act are revised and no tangible conclusion can be drawn with respect to overriding of limitation Act to that effect in favour of MSMEs. This being the current legal position, the interpretation offered to the applicability of limitation by SC under 1993 Act can be said to be applicable and apposite to the issues arising under MSME Act.

The SC in *Shanti Conductors (P) Ltd. v. Assam State Electricity Board*,⁸ clearly held that article 113 of the limitation Act would apply to the debts owed to MSMEs under the 1993 Act and in absence of any express period for payment agreed on by the parties, the limitation period would begin to run from the expiry of 30 days of day of acceptance or deemed acceptance under the 1993 Act. The MSME Act just revises this period to 15 days and therefore it can be said that where there is express period agreed upon for the payment, the limitation period would begin to run from the expiry of 15 days from the day of acceptance or deemed acceptance.

In a recent judgment, the three judge bench of Bombay HC⁹ held that maintaining the debt owed to MSMEs on the Books of accounts under section 22 of the MSME Act would not mean that the cause of action for suing with respect to the debt owed by MSME would be renewed on each day the entry is kept on the books of accounts by the company. The statutory obligation to maintain the debt on the books cannot be interpreted in an absurd manner so as to accord MSMEs a right to recover stale and time barred debts when the whole scheme of the Act aims to resolve the payment in a time bound manner by fixing deadlines for payment. The limitation period has been interpreted by SC in *Shanti conductors case* and can be said to be applicable on

⁸*Shanti Conductors (P) Ltd. v Assam State Electricity Board*(2019) 19 SCC 529.

⁹*Sonali Power Equipment v Chairman, Maharashtra State Electricity Board and Others* 2023 SCC OnLine Bom 2397.

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the MSMED Act as well. The right to sue accrues on payment not being made within the period agreed upon or on the expiry of 15 days from the day of acceptance or deemed date of acceptance.

THE POSITION ON INTEREST PAYABLE ON VALID TENDER OF PAYMENT

Another issue that crops up is that there could be a scenario where a buyer has tried all in its capacity to tender payment to the buyer and buyer refuses to accept the payment. This is essentially a perilous circumstance because the supplier might delay taking of payment even when the buyer has tendered the payment making him liable to pay interest at three times the interest rate, imposing a burdensome pecuniary burden on the buyer.

Section 38 of the Indian Contract Act,¹⁰ clearly provides that where a valid tender of performance is made to the other party to the contract and that party refuses to accept the payment, the buyer can be discharged of its obligation to pay. As between debtor and creditor it is a recognized rule in equity that if the creditor refused to accept the tender of the debt, the debtor is not liable to suffer any consequence for non-performance of his part. The said principle in equity has been woven into the statutory law as could be seen from Section 38 of the Contract Act.¹¹

The essentials of the valid tender of performance are,

- (1) It must be unconditional;
- (2) It must be made at proper time and place, and under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing there and then to do the whole of what he is bound by his promise to do;
- (3) If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.

¹⁰The Indian Contract Act, 1872 (9 of 1872) s 38.

¹¹*Pradeep Chandran v Nimmi Velappan and another* (1994) 1 KLT 144.

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What is “tender” in English Law, is “an offer to perform” under section 38 of the Indian Contract Act. Where the performance due consists in the payment of sum of money, a tender by the debtor, though refused by the creditor, does not release him from his obligation to pay the debt.¹²The debtor is bound in the first instance ‘to find out the creditor and pay him the debt when due’, if the creditor will not take payment when tendered, the debtor must nevertheless continue always ready and willing to pay the debt. Then, when he is sued upon it, he can plead that he tendered it, but he must pay the money into Court. If he proves his plea, the creditor gets nothing but the money originally tendered to him, i.e. no interest or damages, while the debtor gets judgment for the costs of the action, and so is placed in as good a position as he held at the time of the tender.¹³In *Salik Ram Upadhia v. B. Jai Gopal Singh*,¹⁴ it was held that if the amount due is validly tendered to the creditor by the debtor or by his agent, on the debt becoming payable, the creditor is bound to accept the money and if he does not accept it, he is not entitled to claim interest after the date of the tender.

THE IMPLICATIONS OF A VALID TENDER ON INTEREST UNDER MSMED ACT

The legal implication of the Bombay High Court judgment, wherein the scheme behind Chapter V of the MSME Act was studied, is relevant in the aforementioned scenario. The Bombay HC has opined that the scheme behind the MSMED Act was to facilitate timely repayment of debts by putting a robust recovery mechanism in place. The Act nowhere create a distinct right to recover debts in favour of MSMEs over and above any existing law in place. This inference can also be drawn from the reasoning of the SC in *Silpi Industries* case also where the SC clearly opined that MSMED Act overturned the existing laws to the extent they were contrary to the scheme of the Act based on which it can be said that the limitation period as provided under section 43 of the arbitration Act would apply to the arbitration under section 18(3) of the Act.

Therefore, the analysis of the legal position under section 38 of ICA would highlight that pursuant to a valid tender of the payment by the buyer pursuant to the requisite contractual obligations would mean that refusal by the supplier to accept payment would imply a discharge of the obligation of the buyer to tender interest on the amount due to him. In case of non-

¹²*Guna Krishna Gauns v Antonio Joao Braganza* 2008 SCC OnLine Bom 1201.

¹³*Dixon v Clark* (1847) 136 ER 919.

¹⁴*Salik Ram Upadhia v. B. Jai Gopal Singh* AIR 1955 ALL. 350.

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acceptance of payment by the seller, the buyer should do a proper documented tender of the offer to the supplier with all the necessary proofs of postal receipt, fax or mail records or other requisite documents that a valid tender of offer is made to the supplier. The reasoning of the SC in Shanti Conductors case clearly points out that the non obstante clause in current section 18 of the MSMED Act only overrules those laws that are contrary to the scheme and purpose of the Act. The Bombay HC has also reaffirmed this point by highlighting the underlying objects and reasons of the MSMED Act, 2006. The Act facilitates recovery of debts and does not create a separate independent right to recover the debts under the Act. As no provision in the Act runs contrary to the section 38 of ICA, the non-acceptance of a valid tender of payment would make the interest on the debt irrecoverable by the MSME as provided for under section 16 of the Act.

If the reasoning of the SC and Bombay HC as specified before is read with section 38 of the ICA, a valid tender of payment renders the interest on the debt irrecoverable under the contract Act as well as MSMED Act. Pursuant to such valid tender it should be made permissible for the buyers to write off the interest due on the debt from their books of accounts as the credit rating of the buying entity is negatively affected for a period of three years till the limitation period expires. The legislature or the ministry can draft certain guidelines on the requirements of a valid tender of payment by the buyers, subsequent to such valid tender a waiting period can be prescribed on the expiry of which it should be made permissible for the suppliers to write off the interest on their debts.

CONCLUSION

The interpretation of non obstante clause has created good amount of confusion and apprehension on the part of suppliers that deal with the MSMEs. Requisite clarifications or amendments need to be introduced to instill confidence in the buyers that deal with the MSMEs. The issue has to be approached with an aim to promote ease of doing business so as to offer greater market opportunities to MSMEs that deal with a whole range of buyers today due to integration of the economy at various levels of the supply chain. In absence of legislative clarity regarding the highlighted issues the buyers might be apprehensive of dealing with MSMEs due to apprehension regarding high interest rates and obligations of maintaining the debt and interest

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on the books of accounts under section 22 of the Act. The provisions regarding limitation period and writing off the interest on the debt by buyers pursuant to a valid tender of payment need urgent legislative clarity. The need is to strike a balance that secures and facilitates recovery of debts owed to MSMEs but at the same time the obligations should not be made onerous for the buyers who are willing to tender payments to MSMEs.



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