

MSMED Act-An Alternative For Debt Recovery Over IBC

written by Avani Sinha | May 20, 2020



Ministry of MSME, Govt. of India

Debt Recovery under MSMED Act, More convenient than IBC?

The Micro, Small and Medium Enterprises (MSME) sector has emerged vividly as a progressive segment in recent times. This sector has become the backbone of the Indian economy and plays a key role in supporting the manufacturing sector. It contributes substantially as an ancillary unit in the comprehensive development of large industries and the socio-economic development of the country.

EFFECT OF OUTBREAK OF PANDEMIC ON MSMEs

The outbreak of the COVID 19 pandemic in the country, has largely affected the businesses of various small and large scale industries thereby impelling the government to amend various laws to forestall the collapse of the economy of the country.

Thus, owing to the pandemic, the Ministry of Finance, Government of India on March 24, 2020 and further on May 13, 2020, released press statements^[1] that stipulated various benefits safeguarding the interests of the MSMEs on priority.

Vide these press statements, the minimum threshold of pecuniary limit for initiating an insolvency process has been increased from Rupees 1 lakh to 1 crore and also the possibility of suspension of Sec 7, 9 and 10 of IBC has been formulated. In such a scenario, the MSMEs would have to consider an alternative to recover their dues. Consequently, the rescission of the sections 7, 9 and 10 would generate a pre IBC era for the MSMEs.

LEGAL REGIME PROMULGATED TO CONSIDER THE INTEREST OF MSME- MSMED ACT

The small scale industries and services are contributing remarkably to the economy and in order to sustain this sector, the government has formulated exclusive legislation for MSMEs known as the Micro, Small and Medium Enterprises Development Act (MSMED), 2006. This Act promotes the advancement and strengthens the competitiveness of MSMEs.

To provide relief to the ailing economy, the Government of India has announced an Economic Relief Package^[2] wherein the priority is given to the MSMEs in order to safeguard their interests. Definition of MSME in accordance with the provision of the MSMED Act, 2006, and the revised definition of MSME as announced by the Government of India vide Economic Relief Package on May 13, 2020 is detailed below-

ALTERNATIVE FOR MSME-

In order to protect the MSMEs and to ensure optimum benefit in a short time, the MSMED Act was enacted in 2006. It is a comprehensive act for the promotion and regulation of small enterprises.

After the introduction of the Insolvency and Bankruptcy Code, 2016, the MSMEs were treated at par with the other Operational Creditors. In IBC, the mechanism of the Insolvency Resolution Plan is adopted to permit recourse to creditors to plan a resolution process. Since, MSMEs are considered as Operational Creditors under IBC, during the insolvency process, MSMEs file

their claims with the Insolvency Resolution Professional (IRP) or the Resolution Professional (RP). Thereafter, IRP or RP either accepts, rejects or modifies the liability.

Under IBC, Section 29A outlines how only certain people are eligible to be resolution applicants. The Section 240A (1) of IBC grants exceptional power to MSME. As per this section, certain provisions of section 29A shall not apply to the resolution applicant in respect of the corporate insolvency resolution process of any micro, small and medium enterprises. Under this section, The government has also been empowered to not to include MSME in IBC.

Subsequent to the recent amendment in IBC, the large scale industries having an enormous capital might manage to survive by resorting to provisions such as recovery suits, summary suits, etc., in order to recover their dues. However, since the MSMEs do not hold enough capital, liquid assets and resources to sustain during the delayed recovery, therefore this sector can go into distress and may collapse. Thus, with the suspension of the sections that trigger the insolvency process and also the increase in the threshold for initiation of the insolvency process, the MSMEs having no option under the IBC will have to utilize MSME Act.

Under this Act, the MSME is entitled to receive payments within 45 days from the date of acceptance of goods or services by the buyer. In the event of the buyer failing to make payment of the amount to the supplier, the buyer shall be liable to pay compound interest on that amount from the day of acceptance or day of deemed acceptance of goods or services, as the case may be, from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank.

On failure of such payment, a reference can be made to the Micro and Small Enterprise Facilitation Council (MSEFC) and the dispute shall be decided within 90 days from the date of making the reference.

Important sections[4] for recovery under MSME Act are produced below-

Section 15- It describes the liability of the buyer to make payment. The buyer shall make payment to the MSME within 45 days from the day of acceptance or the day of deemed acceptance as agreed between MSME and buyer.

Section 16- In the event when the buyer fails to make payment of the amount to the supplier, the buyer shall be liable to pay compound interest on the said amount to the supplier.

Section 18- It sets out that any party to the dispute shall make reference to the MSEFC. Thereafter, the conciliation proceedings are conducted as per the sections 65 to 81 of the Arbitration and Conciliation Act, 1996. Every reference made under this section shall be decided within a period of ninety days from date of making such reference.

Thus, the advantage of being treated as exceptional under IBC has been lost by the MSME in cases of value being less than Rupees 1 crore. The suspension of sections 7, 9, 10 would further affect the filing of cases as an Operational Creditor by the MSMEs.

CONSEQUENCES OF RECENT AMENDMENTS

During the process of resolution under IBC, delayed payments have adverse effect on the working capital of the MSME leading to financial distress. At times, in a resolution plan the liquidation value can be nil. Consequently, the MSME may have to take a massive restructuring, largely affecting the capital value held by MSME which eventually impacts the working of MSMEs.

Therefore, post modifications of the provisions under IBC the MSMEs can look into a simpler and focused method through the MSMED Act. Under this Act, the time frame for payment and disposal of the case is concise in order to safeguard MSMEs. Furthermore, there is a provision of the guaranteed principal amount plus interest to the MSMEs.

The amendment in the threshold of the pecuniary value has prevented the MSMEs from being dragged into resolution under IBC. Hence, this would further protect the overall economy of the country from being subjected to the downfall.

The MSMED act ensures timely recovery of the dues and compound interest to be payable to the MSME by the buyer thereby preventing the loss of the operations and reduced capital during the pendency of an application moved by the MSME. The timeline of disposing off the case in 90 days which further ensures speedy redressal of the case. Recently, the MSMED has introduced an online portal for the filing of the applications by the micro and small enterprises that further relieves them from the litigation costs.

This alternate remedy no doubt is an easy way of getting the dues and the amendment in minimum threshold of initiating insolvency prevents the MSMEs when they are Corporate Debtors. However, this also takes away the exceptional rights of the MSMEs as Operational Creditors. The alternate remedy will lead to the MSME having a single window for its dispute resolution.

As we are still waiting for ordinance to be passed for suspension of Sec 7, 9 and 10. Apparently, there is a likelihood that these sections might not be suspended in a blanket perspective. The whole objective is to save MSMEs from the current difficult situation and sustain the economy.

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- [1] Press release of Finance Ministry
<https://pib.gov.in/PressReleasePage.aspx?PRID=1607942>
 - [2] Press release of Finance Ministry
<https://pib.gov.in/PressReleasePage.aspx?PRID=1623601>
 - [3] S. 7(1) (a) and 7(1) (b) of the Micro, Small and Medium Enterprises Development Act, 2006
 - [4] S. 15, 16 and 18 of the Micro, Small and Medium Enterprises Development Act, 2006

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