

Can MSMED Act Be An Alternative To Proceedings Under IBC For Start-Ups?

written by Rajdev Singh | May 20, 2020



Can Proceedings Under IBC Fall in the Ambit of MSMED Act?

One of the most gabbed and appalling legislation in recent times has been the development of the Insolvency & Bankruptcy Code, 2016 ("IBC") as a recovery mechanism. However, the recent announcement by the Finance Minister("FM"), Ms. Nirmala Sitharaman, has brought shock to the businesses in a gambit to give relaxation to the defaulting companies due to the stress of COVID-19. The FM has announced exclusion starting from elimination of COVID-19 debt from the definition of default to non-initiation of proceedings for one year under IBC. There is an amendment to enhance the threshold limit to trigger insolvency from 1 lakh to 1 crore in a drive to save the economy. In the light of such announcements, The Micro, Small and Medium Enterprises Development Act, 2006 ("MSMED Act") aims at facilitating the promotion, development and recovery mechanisms for micro, small and medium enterprises("MSME").

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Classification

The MSMEs are widening their domain across various sectors of the economy, producing a diverse range of products and services to meet the demands of domestic as well as global markets. The classification of the same is as follows:

Delayed Payments to Micro And Small Enterprises

As per the MSMED Act, the buyer needs to make all payments before the agreed time. In absence of such agreement between the parties regarding the agreed time, the MSME is entitled to receive payments, from the date or acceptance of goods or services by the buyer.^[1]

On failure of the payment, the buyer is liable to pay compound interest three times the bank rate as notified by the Reserve Bank of India for any goods and services supplied.^[2] If the same is not complied with and the payment is still not made, a reference can be made to the Micro and Small Enterprise Facilitation Council ("MSEFC") in the prescribed form and it shall be decided within 90 days from the date of referring.^[3]

Micro and Small Enterprise Facilitation Council

The state governments shall establish one or more MSEFC. ^[4] Each MSEFC should consist of members not less than 3 and not more than 5^[5]. The structure of the same should be as follows:

- One Director of industries; and
- One or more office-bearers or representatives of associations of micro or small industry or enterprises in the state; and
- One or more representatives of banks and financial institutions lending to micro or small enterprises; or
- One or more persons having special knowledge in the field of industry, finance, law, trade, or commerce.

Reference to Micro and Small Enterprises Facilitation Council

Upon reference to the MSEFC regarding the amount due under section 17, the council shall either itself conduct conciliation in the matter or seek the assistance of any institution or centre providing ADR services. Upon the failure of conciliation, the council shall either take up the dispute for arbitration by itself or refer it to any other institution or centre. Every reference made shall be decided within 90 days from the date of referring.^[6]

The award can also be made against a foreign buyer, which is binding and enforceable. The execution of the award is under the Arbitration and Conciliation Act, 1996. The option of appeal is not available to the buyer.

MSMED VS Insolvency and Bankruptcy Code ("IBC")

MSME provides speedy recourse through the council to resolve pending issues. IBC is not a mechanism for the recovery of dues but for the resolution of disputes between the parties. There is a disadvantage associated with the IBC whereby the debtor may undergo liquidation and as per the waterfall mechanism the Operational Creditor may receive close to nothing.

In case of no resolution, the IBC may trash the debtor(s) with almost no or minimal chances of further recovery of debts. At the same time, it is very beneficial for the MSME & startup(s) as MSMED gives a speedy resolution in comparison to any other legal framework. The recent proposal for suspension of sections 7, 9 & 10 shows that MSME will adopt alternative methods. The relief from IBC is time-consuming and this may affect the future of the enterprise.^[7]

MSME Samadhaan

An online portal was started named 'MSME SAMADHAAN. on October 30, 2017. Data indicate that out of the 12,037 cases filed for pending settlement of ₹4,035 crores in all MSEFCs across the nation, 4,163 cases were disposed of with the final settlement of ₹1,202 crores and the remaining cases were at various stages of settlement. The total number of applications filed by MSMEs is 39,769 out of which a good number of cases have been brought to a conclusion.^[8]

Conclusion

The above data would indicate that compared to an application filed under IBC, it would be preferable for startups to refer the pending dues with the MSMEFC since the council is obliged to settle the reference made before it within 90 days from the date of making such reference, unlike the prolonged time for recovery under the IBC. The filing of cases before MSEFC has been made easier through an online portal, with basic details of the vendor and supporting documents to substantiate the debt payable to file a case against the defaulter.

Further, the realization of debt without the restriction of liquidation value provided in the resolution plan would be possible through the MSEFC process since the decree passed by the MSEFC covers the amount due with interest accrued during the period. Moreover, a defaulter desirous of filing an appeal

will have to deposit 75 per cent of the award amount before filing an appeal.

- [1] Section 15 of the MSMED Act.
- [2][2] Section 16 and 17 of the MSMED Act.
- [3] Section 10 of the MSMED Act.
- [4] Section 20 of the Act.
- [5] Section 25 of the Act.
- [6] Section 18 of the Act.
- [7]

https://ibclaw.in/debt-recovery-under-msmed-act-an-alternative-to-ibc/#_ftn1
[8]

<https://www.thehindubusinessline.com/opinion/msmes-need-not-use-ibc-to-recover-dues/article29343556.ece>

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