

MSME AS ENGINES OF GROWTH: EXPLORING THE FRAMEWORK FOR  
REHABILITATION AND RESOLUTION

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## MSME AS ENGINES OF GROWTH: EXPLORING THE FRAMEWORK FOR REHABILITATION AND RESOLUTION

DR. SURBHI KAPUR\* & ANIMESH KHANDELWAL†

### Abstract

*Insolvency regimes are crucial due to market imperfections, such as coordination problems, incomplete contracts and information asymmetry.<sup>1</sup> For this reason, well-designed insolvency/bankruptcy regimes are crucial to facilitate the exit of failing firms in an orderly fashion and realise the potential productivity gains therefrom. Such regimes are required to deal methodically with the financial distress of commercial entities (i.e., corporate insolvency) and entrepreneurs who have either been trading as a sole proprietor or who are part of a closely-held private entity (i.e., personal/individual insolvency).<sup>2</sup>*

*A robust framework for insolvency resolution encourages deeper more resourceful capital markets and higher levels of entrepreneurship. Insolvency law is broadly recognised as an essential tool in well-functioning economies. A balance of mechanisms that allow for timely and effective resolution (and if it fails, liquidation) also provides for a “fresh start” for individual entrepreneurs and the rehabilitation of viable businesses. In this way, it tends to enhance creditor recoveries and lender confidence. Globally, a concern has been expressed that while insolvency systems are evolving, there continue to be barriers to effective restructuring for Micro, Small and Medium Enterprises (MSMEs) and whether the system adequately serves the interests of the MSMEs. Therefore, sufficient availability of credit to business entities, specially the MSMEs, while being a major determinant of entrepreneurial activity, is interlocked with the nature of a country’s legal and socio-economic fabric.*

*MSMEs often face liquidity issues and are generally at a higher default risk. They usually face scarcity of working capital, higher interest rates and larger collateral requirements. More often than not, it is difficult to separate business assets from personal assets. In view of this, MSMEs deserve a differentiated treatment in their insolvency resolution/bankruptcy process. It is necessary that such a specialised regime resolves their insolvency in a time bound manner with the least amount of*

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<sup>1</sup> Müge Adalet McGowan & Dan Andrews, *Insolvency Regimes and Productivity Growth: A Framework for Analysis*, 10 (Org. for Econ. Coop. and Dev. (OECD), Working Paper No. 1309, 2016), <https://www.oecd.org/economy/growth/insolvency-regimes-and-productivity-growth-a-framework-for-analysis.pdf>.

<sup>2</sup> *Id.* at 11.

*disruption and low-cost bearing. Concomitantly, the avoidance of social stigma associated with business failure and personal risk of individuals should be given emphasis. Considering the importance of this business sector globally, their exit policy may also provide for out-of-court restructuring mechanisms and measures for debt counselling.*

*Despite the pivotal role and strategic importance in the context of industrial development and economic growth of a country, the MSME sector experiences several constraints and challenges. Specifically, while in the Indian economic landscape, it is observed that as a catalyst for socio-economic transformation of the country, the MSME sector is extremely crucial in addressing the national objectives of bridging the rural-urban divide, reducing poverty and generating employment to the teeming millions. In this milieu, research is aimed at conducting a preliminary examination of issues relevant to the insolvency resolution/bankruptcy of MSMEs, and in particular, to consider whether the existing legal mechanisms provide sufficient and adequate solutions for MSMEs. It shall also be the endeavor of this research to consider what further potential work might be required to streamline and simplify insolvency/bankruptcy procedures for MSMEs. Additionally, it will be germane to examine whether there exist policies for out of court restructuring, preventive restructuring or pre-packaged insolvency resolution of MSMEs.*

*Further, the research will also scrutinize the MSME insolvency/bankruptcy procedures from the point of view of the nature of business of MSMEs in general, i.e., varied and innovative.*

*The entire analysis shall be conducted in order to understand all the issues from a cross-country perspective, specifically focusing on the juxtaposition of similar issues/solutions adopted within the Indian legal framework vis-à-vis the procedures and practices followed by the other economies, including that of Japan and France. The research will also reflect upon the importance of international soft law instruments including, but not limited to, the UNCITRAL Model Law on Cross-Border Insolvency and the Reports of the UNCITRAL Working Groups.*

*This discourse will be incomplete without considering the ever-evolving jurisprudence in the area of insolvency resolution/bankruptcy of MSMEs which is reaching a state of matured development, however, the ramifications of the same are yet to attain realization.*

## I. INTRODUCTION

The world is changing dynamically, and globally there is an increasing demand for improved and sophisticated systems for resolution of insolvency. So much so, that, 'Resolving Insolvency' is a major determinant in the Ease of

Doing Business (EoDB) rankings released by the World Bank.<sup>3</sup> The international agencies, including but not limited to, the World Bank and United Nations Commission on International Trade Law (UNCITRAL) are working towards harmonizing best practices in insolvency resolution. In fact, almost all the economies around the globe, big or small, are striving to establish frameworks which not only boost entrepreneurship but also maximize value of the assets and effectively conduct a resolution/rehabilitation of persons, both juristic and natural in economic distress. The ultimate goal is to manage the availability of credit which, in turn, would positively affect the economic growth of each nation.

In the simplest manner, a company or an individual becomes insolvent when their assets are insufficient to repay debts and manage their liabilities.<sup>4</sup> In such a situation, a corporate insolvency resolution/rehabilitation process (CIRP) may be initiated against an incorporated company by its creditors or the company itself. Similarly, an insolvency resolution/rehabilitation process may be commenced against individual defaulters by its creditors or by the individual herself/himself. Such a process results either in the resolution/rehabilitation of entity/individual or into a discharge of debts by way of a “fresh” start. If the process fails, it ultimately leads to liquidation/bankruptcy of the entity/individual.

## II. MICRO, SMALL AND MEDIUM ENTERPRISES - A UNIQUE ENTITY

During the deliberations of the UNCITRAL Working Group I (WG I) at their twenty-second session<sup>5</sup> in February 2014, the Countries were concerned with the task of understanding the meaning and definition of the term, Micro, Small and Medium-sized enterprises (MSMEs, also popularly known as SMEs in some economies of the world). Some nations shared their experience with respect to simplified business forms, it was noted that the focus of a country’s legislative reform was not based on the size of the business, but on providing appropriate measures for businesses to formalize with minimal capital requirements. Later in the life cycle of such businesses, when they became more successful, they could transition to full limited liability corporations.

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<sup>3</sup> *Ease of Doing Business Rankings*, THE WORLD BANK, <https://www.doingbusiness.org/en/rankings> (last visited on Mar. 31, 2021).

<sup>4</sup> *Corporate Insolvency: a quick guide*, THOMSON REUTERS, <https://uk.practicallaw.thomsonreuters.com/9-385-9763> (last visited on Mar. 25, 2021).

<sup>5</sup> U.N. Comm’n on Int’l Trade Law, *Report. of Working Group. I (MSMEs) on the Work of Its Twenty-Second Session*, U.N. Doc. A/CN.9/800 (Feb. 28, 2014).

Other examples were given of the creation of certain categories of companies based on size and the types of business undertaken, but they noted that the traditional approach to corporation law had not relied on different sizes of enterprises. In addition, it was observed that some simplified regimes have focused directly on assisting MSMEs, while other systems were applied to smaller enterprises only after the regimes had been developed for other purposes, yet the net result of both approaches had been positive for MSMEs and larger enterprises. In general, it was agreed that although a definition of MSMEs was used in certain contexts, (including providing policy support through mechanisms such as subsidies and taxation relief,) it was not necessary to approach the simplification of business incorporation with specific company size in mind. The main concern in terms of size of enterprises intended for inclusion in a simplified incorporation regime was to ensure that sole proprietors were considered for inclusion in the regime, even those that might be engaged in relatively simple business activities.

It was, therefore, observed that MSMEs are a unique entity which encompass various forms. They may be a limited liability company, a partnership firm with unlimited liability or even sole proprietorships with a single person running the organization and having complete liability. Not only are the MSMEs diverse in the form of the entity, they are also diverse in the businesses undertaken by them. Due to the comparatively smaller size of organizations, the MSMEs manufacture and/or provide services which are extremely varied and cater to the needs of some of the biggest corporations in the world. In a country like India, MSMEs are defined by the amount of investment in their plant and machinery or the money utilized by a service provider on their equipment.<sup>6</sup>

### III. MICRO, SMALL AND MEDIUM-SIZED ENTERPRISE - ISSUES FACED

While the forms and nature of MSMEs are entirely different from big corporations, the problems and predilections faced by MSMEs are similar. Liquidity in a broader context can be described as the degree to which an asset or security can be bought or sold in the market at a price value. In simpler terms, liquidity can be defined as the ease of converting to cash, often

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<sup>6</sup> Micro, Small and Medium Enterprises Development Act, No. 27, Acts of Parliament, 2006 (India).

considered the most liquid asset of all.<sup>7</sup> A major hurdle in conducting business by MSMEs is a lack of liquidity, also known as, liquidity crunch. This is more prominent in MSMEs than other big corporates, primarily, because of the smaller size of the business and the fact that most MSMEs cater to production of goods/provision of services of one particular kind.

Besides a liquidity crunch, one of the major determinants of solvency of an MSME is the stability and reliability of the business of the companies they serve. If the companies to whom they supply goods and/or provide services themselves default on their loans and enter into an insolvent state, that will have a domino effect on all MSMEs which are its vendors, suppliers, distributors etc. This is a recurring difficulty in most developing as well as developed economies. Whenever a large business goes bust, the MSMEs are the worst affected entities.

Adding on to the factor of liquidity crunch and failure of large corporates, the MSMEs also tend to be at a higher default risk. In the eventuality that the MSME fails to meet its debt obligations and the fact that the local laws provide for a lower threshold for initiation of insolvency, a higher number of MSMEs will be admitted into an insolvency proceeding which will lead to an erosion in its value and also create distrust in their already limited customer base.

The rising concern among different jurisdictions is with respect to bifurcation of personal assets of the proprietor with that of the proprietorship. Some economies provide for exclusion of personal assets of the proprietor during an insolvency resolution/rehabilitation proceeding. In such a scenario, it becomes extremely difficult to execute the exclusion of personal assets from the business assets. Further, coupled with this dilemma is the fact that most MSMEs being sole proprietorships or very small companies, the social stigma attached with an insolvency/bankruptcy process is huge. These MSMEs work within the close quarters of their own family members or within a community which is extremely close knit and initiation of such a proceeding direly affects the social, communal, and inter-personal relations between themselves.

It is, therefore, highly imperative that when mechanisms are being devised to govern the insolvency/rehabilitation proceedings of MSMEs, they need to be decidedly cost-effective with a focus on the mitigating and contributing factors. The unique nature of business conducted by the MSMEs

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<sup>7</sup> *Explained: What does liquidity crisis mean?*, INDIA TODAY (Aug. 23, 2019), <https://www.indiatoday.in/business/story/india-liquidity-crisis-nbfc-ilfs-sectoral-slowdown-economic-growth-1590770-2019-08-23>.

which are the backbone of any economy demands a distinctive solution to their indebtedness.

#### IV. ADR AND OUT OF COURT SETTLEMENTS AND DEBT COUNSELLING

Access to Alternative Dispute Resolution (ADR) has been widely known as a relatively inexpensive dispute redressal mechanism that often results in the immediate resolution of the dispute. If a settlement can be reached, the parties will save advisory, litigation, and appeal costs. It is private and non-coercive, and proceeds under the protection of a strict confidentiality order imposed by the Court. It is informal and unstructured with each litigant having an opportunity to discuss his or her case in private with the settlement judge, an independent third party. It allows the litigants to control the outcome of their dispute and encourages creative resolutions which would not be available through a trial. It is more cooperative and less confrontational than a trial, and it eliminates the uncertainties that are inherent in a trial.<sup>8</sup>

The World Bank 'Principles for Effective Insolvency and Creditor/Debtor Regimes' explicitly state that creditors and debtors may find ADR techniques useful to facilitate informal (out of court) workouts:

an informal workout process may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution. While a reliable method for timely resolution of inter-creditor differences is important, the financial supervisor should play a facilitating role consistent with its regulatory duties as opposed to actively participating in the resolution of inter-creditor differences.<sup>9</sup>

In fact, the use of ADR tools, such as mediation, to enhance the possibility of business restructuring in the face of financial distress has been increasing world-wide in the context of formal restructuring procedures,<sup>10</sup> and their potential for pre-insolvency processes has also been utilized. For example,

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<sup>8</sup> Sidney K. Swinson, *Alternative Dispute Resolution in Bankruptcy*, 36 TULSA L. J. 813, 815 (2001).

<sup>9</sup> WORLD BANK, PRINCIPLES FOR EFFECTIVE INSOLVENCY AND CREDITOR/DEBTOR REGIMES 19 (2016), <http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf>.

<sup>10</sup> Nina P. Mocheva & Angana R. Shah, *Mediation in the Context of (Approaching) Insolvency: A Review on the Global Upswing*, TRANSNATIONAL DISPUTE MANAGEMENT (Nov. 2017) [https://insolventmediation.nl/media/uploads/file/18-Mediation-in-the-context-of-\(approaching\)-Insolvency-A-review-of-the-Global-Upswing.pdf](https://insolventmediation.nl/media/uploads/file/18-Mediation-in-the-context-of-(approaching)-Insolvency-A-review-of-the-Global-Upswing.pdf).

the Portuguese pre-insolvency conciliation procedure that is carried out by the Institute to Support Small and Medium Enterprises and Investment<sup>11</sup> is an extrajudicial administrative procedure for the debtor to reach an agreement with some or all creditors to avoid insolvency.

MSMEs face liquidity problems as most disputes are payment related, and it can even be more critical when MSMEs find themselves caught in the middle of supply chain disputes. Therefore, speedy dispute resolution is essential, as well as keeping good business relationships, especially for small businesses as they have fewer clients. Overall, the consequences of unresolved disputes can have major impacts on business climate, profitability, growth and even survival. In anticipation of an upsurge of disputes arising from or relating to COVID-19, the ADR scheme aims to provide speedy and cost-effective means to resolve such disputes, especially for those involving MSMEs that may be adversely affected or hard hit by the pandemic. Similarly, the Department of Justice, of the Hong Kong Special Administrative Region has launched the COVID-19 Online Dispute Resolution (ODR) Scheme for resolution of disputes involving MSMEs.<sup>12</sup>

Persons, both natural and juristic, often turn to credit and debt counsellors when their credit becomes unmanageable and debt problems make it difficult for them to meet their financial obligations. Debt counselling is defined differently by different authors. Kelly-Louw (2008:201) defines debt counselling as a process whereby debt counsellors assist consumers who are experiencing debt-related problems by providing them with budgeting advice, restructuring their debt payments, negotiating on their behalf with credit providers, monitoring their payments, and providing them with after-care service.<sup>13</sup> Debt counselling is also defined as an educational programme that aims to create awareness about credit-related services for consumers who borrow money and make use of credit facilities like credit cards. Uribe and Tait define debt counselling as a debt reduction service and a financial education to debtors. These authors further state that this service is for consumers who are

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<sup>11</sup> *A guide to pre-insolvency and insolvency proceedings across Europe*, DELOITTE (Jan. 2017), <https://www2.deloitte.com/global/en/pages/legal/articles/europe-insolvency-proceedings-guide.html>.

<sup>12</sup> *Stand in solidarity against COVID-19*, DEP'T OF JUSTICE (April 11, 2020), [https://www.doj.gov.hk/en/community\\_engagement/sj\\_blog/20200411\\_blog1.html](https://www.doj.gov.hk/en/community_engagement/sj_blog/20200411_blog1.html)

<sup>13</sup> Michelle Kelly-Louw, *The Prevention and Alleviation of Consumer Over-indebtedness*, 20 S. AFR. MERCANTILE L. J. 200, 223 (2008).



having problems dealing with the management of their personal finances and who need help in paying off their debts so that their credit rating can improve.<sup>14</sup>

In India, several National Missions like Start Up India, MUDRA, Stand Up India, “Make in India”, Clean India and Digital India are aimed at evolving an entrepreneurial India with a focus on MSMEs and their development. MSMEs need a separate dispensation and touch towards their credit access needs for setting up or growth or diversification. However, information asymmetry and the perception of high risk are two major constraints on the flow of credit to the MSMEs sector. Being the principal financial institution for MSMEs with credit plus institutional experience, the Small Industries Development Bank of India (SIDBI) has been advised by the RBI to play the lead role in the initiative of credit and debt counselling to the MSMEs. This is largely addressed by permitting credit intermediaries to act as facilitators and enablers to micro and small entrepreneurs, so that they can access the formal financial system channel with greater ease and flexibility.

## V. THE INTERNATIONAL PERSPECTIVE

The global community realized the necessity of devising a different framework with simplified procedures concerning the MSMEs. The work on formulating this began, as far back as 2014, when the UNCITRAL Working Group V (WG V) deliberated during its forty-fifth session at New York that the resolution/reorganization of MSMEs needs a special approach distinct from what had been provided in the UNCITRAL Legislative Guide.<sup>15</sup>

Further, during its 2017 session, the WG V opined on the question - Whether the provisions of the UNCITRAL documents with regard to insolvency resolution were adequate for MSMEs? The nitty-gritties with respect to identifying and defining MSMEs was left to the wisdom of the national legislators which may demarcate MSMEs in line with the economic and political conditions in their own country. “*There was also agreement on the need to ensure that mechanisms to address the insolvency of MSMEs be fast, flexible, and cost efficient, and that the focus in establishing such mechanisms should be on natural or legal persons engaged in economic activity.*”<sup>16</sup>

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<sup>14</sup> Esteban Uribe & Amanda Tait, *Credit Counselling: A Way Forward*, PUB. INT. ADVOC. CTR. (March 30, 2007) [https://www.piac.ca/wpcontent/uploads/2014/11/credit\\_counselling\\_report\\_final.pdf](https://www.piac.ca/wpcontent/uploads/2014/11/credit_counselling_report_final.pdf).

<sup>15</sup> U.N. Comm’n on Int’l Trade Law, *Report of Working Group V (Insolvency Law) on the Work of Its Forty-Fifth Session*, 1, U.N. Doc. A/CN.9/803 (May 6, 2014).

<sup>16</sup> *Id.*

In the next year, the WG V resolved that the insolvency resolution of MSMEs which were the backbones of most economies was not only essential for the individual countries but also was vital in order to achieve the Sustainable Development Goals (SDGs). A unique perspective of out-of-court proceedings such as mediation, conciliation etc. were identified by the WG V.<sup>17</sup> This international group also decided that the provisions for MSMEs must be speedy, simple and cost effective. They may utilize the hybrid tools of settlement agreements and enforcement of the same by courts. The factors which could lead to a better resolution of MSMEs were carved out in the form of incentivizing early access, achieving balance of interests between debtors and creditors as well as building safeguards against the abuse of the simplified process.<sup>18</sup>

Later that year, the WG V expressed its concern that a definition of MSMEs may be required since the benefits of a simplified regime can only be reaped by them. There was also a deep discussion on the actual provisions relating to liquidation, reorganization, discharge and third-party guarantors in the MSME insolvency resolution process.<sup>19</sup> Besides formulating actual provisions for insolvency resolution of MSMEs, WG V has also acknowledged that the World Bank has also been working on a document regarding insolvency resolution of MSMEs, however the report has been delayed due to the ongoing Covid-19 pandemic and its after-effects.<sup>20</sup>

## VI. THE CROSS-COUNTRY PERSPECTIVE

### A. France

In France, there is a procedure of simplified liquidation specially designed for the purposes of MSMEs.<sup>21</sup> During this process, the liquidator is required to prepare a report on the financials of the debtor MSME, and the Court makes the final decision with regard to initiation of the process. If it appears,

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<sup>17</sup> U.N. Comm'n on Int'l Trade Law, *Report of Working Group V (Insolvency Law) on the Work of its Fifty-Third Session*, U.N. Doc. A/CN.9/937 (May 18, 2018).

<sup>18</sup> *Id.*

<sup>19</sup> U.N. Comm'n on Int'l Trade Law, *Report of Working Group V (Insolvency Law) on the Work of its Fifty-Fourth Session*, U.N. Doc. A/CN.9/966 (Dec. 20, 2018).

<sup>20</sup> U.N. Comm'n on Int'l Trade Law, *Report of Working Group V (Insolvency Law) on the Work of its Fifty-Sixth Session*, U.N. Doc. A/CN.9/1006 (Dec. 16, 2019).

<sup>21</sup> Paul Talbourdet & Joanna Gumpelson *Restructuring and Insolvency in France: Overview*, THOMSON REUTERS, [https://uk.practicallaw.thomsonreuters.com/1-501-6905?transitionType=Default&contextData=\(sc.Default\)](https://uk.practicallaw.thomsonreuters.com/1-501-6905?transitionType=Default&contextData=(sc.Default)) (Last visited on Mar. 31, 2021).

from the liquidator's report, that the debtor is a small business with a limited number of employees and assets, the Court will order an initiation of the simplified liquidation. The rules of the same are similar to that of a standard liquidation, however, the advantage of the simplified procedure is the abridged ascertainment of receivables.<sup>22</sup> Further, claims that are received by the liquidator are pre-checked and are filed with the registry where any person may object to them. Time is of the essence in this process which has to be completed within a time frame of six months to one year. Assets are either sold or auctioned and the presence of litigation pertaining to employment does not prevent the process from being completed.<sup>23</sup>

### *B. Japan*

Japan is among the best jurisdictions in the world for insolvency proceedings and resolution of distressed assets. This is evident from its position in the Ease of Doing Business World Rankings. Japan has four key laws governing rehabilitation, insolvency resolution and liquidation of small businesses, and they are a debtor inclined jurisdiction. The rehabilitation proceedings *viz.* Civil Rehabilitation Proceeding (CRP) and Reorganization Proceedings for Corporates (RC) are both governed by the courts of Japan. The CRP is in the nature of a Debtor-in-Possession proceeding where the debtor itself files for rehabilitation process before the courts, and the process is commenced with the debtor retaining hold on its assets under the supervision (and not intervention) of the court. Consequently, the RC is in the nature of court administered proceeding which can be filed by either the debtor, the creditor or the shareholder of the company, and it commences with the appointment of a reorganization trustee who controls the assets of the company and drives the process forward.<sup>24</sup>

Further, the Japanese regime provides for a detailed guideline for out of court processes. The Out-of-Court Workout for Multi-Financial Institutions (the "Guidelines") were introduced in 2001 and are intended to rehabilitate small

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<sup>22</sup> Isabelle Didier, *The Reform of Insolvency Proceedings in France – A Professional's Point of View*, 15 J. Bankr. L. & Prac. 5, art 4 (2006) <https://www.iiiglobal.org/sites/default/files/isabelledidiernewrigime.pdf>.

<sup>23</sup> JOANNA GUMPelson & PHILIPPE DUBOIS, FRANCE: RESTRUCTURING & INSOLVENCY LAWS & REGULATIONS 2020 (INT'L. COMPAR. LEGAL GUIDE (ICLG), 2020), <https://iclg.com/practice-areas/restructuring-and-insolvency-laws-and-regulations/france>.

<sup>24</sup> *Global Restructuring and Insolvency Guide Japan*, BAKER & MCKENZIE, 7 (2017), <http://restructuring.bakermckenzie.com/wp-content/uploads/sites/23/2017/01/Global-Restructuring-Insolvency-Guide-New-Logo-Japan.pdf> (last visited on Mar. 31, 2021).

businesses by avoiding a formal court proceeding. Along with the Out-of-Court Work Out, the Government of Japan also allows debtors to borrow funds from the Resolution and Collection Corporation (RCC) in order to sail through difficult times. There is also a unique provision for a turnaround ADR (alternate dispute resolution) which has been introduced in Japan. The Turnaround ADR concept was created under the Law on Special Measures for Industrial Revitalization and Innovation. It refers to rehabilitation proceedings for businesses facing operational failure, through mutual consultations among the affected parties rather than through insolvency proceedings in court. The Turnaround ADR proceedings may be carried out only by ADR providers who are certified by the Minister of Justice and who have been approved and authorized by the Ministry of Economics, Trade and Industry ('METI') of Japan, which selects specialists with the requisite knowledge of business revitalization.<sup>25</sup>

### *C. Focus on India*

#### *1. Provisions of Indian Law*

The Indian insolvency regime is governed by the Insolvency and Bankruptcy Code, 2016 (the "**Code**"). The Code calls for introducing an entirely novel culture for payment of dues. The general practice in India had always been to delay payments till the time it was possible. This not only adversely affected the businesses, especially MSMEs, but also reflected badly on the credit culture and availability of credit in India.<sup>26</sup>

The Code provides for insolvency resolution and liquidation of corporate persons under Part II. This part also provides for certain safeguards for MSMEs, specifically. One such safeguard is in the form of section 29A of the Code which exempts the MSMEs from its applicability. Section 29A bars the promoters of the corporate entities undergoing insolvency process from proposing a resolution plan and taking control back. This bar is not applicable for MSMEs where the promoters of the MSME, even after losing control due to

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<sup>25</sup> *Id.* at 6.

<sup>26</sup> M R Umarji, *Challenges in Implementation of Insolvency and Bankruptcy Code*, 46 *Chartered Sec'y. The J. for Corp. Pro.* 46 (Sept. 2016) [https://www.icsi.edu/media/webmodules/linksofweeks/ICSI\\_CS\\_SEP2016.pdf](https://www.icsi.edu/media/webmodules/linksofweeks/ICSI_CS_SEP2016.pdf).

the creditor in control regime of India may regain control by proposing a resolution plan themselves.<sup>27</sup>

This exemption under the Code has been provided under section 240A which empowers the Central Government to notify any provision of the Code as not applicable on MSMEs in the interest of the general public. The intention behind this is that MSMEs are a unique entity which may not always be resolved by the process which is followed for other corporates.<sup>28</sup> MSMEs are heavily dependent on informal arrangements for their credit as well as client base. Further, the size of the business is small which may not encourage many to bid as resolution applicants in case of MSMEs.<sup>29</sup>

Another important feature of the Code which is highly beneficial for MSMEs is the fast-track insolvency resolution process provided under chapter IV, part II of the Code. “*The World Bank in its Report on the Treatment of MSME Insolvency, categorizes the fast track process as a process that shortens timelines to make general insolvency law more suitable for MSMEs.*”<sup>30</sup>

It is interesting to note that in the context of the Code, MSMEs can be on the side of the creditors (operational) or the debtors. Their role as creditors has been discussed previously as well, wherein the MSME may be supplying goods or services to the corporate entity under insolvency resolution, and due to non-payment of the outstanding amounts, the insolvency process would be initiated.<sup>31</sup> As debtors, however, it is important to see that MSMEs in India can be proprietorships, partnerships, or companies. In the case of proprietorships and partnerships, the provisions with regard to corporate insolvency would not be applicable on them. The provisions of individual insolvency which are contained in Part III of the Code would be the applicable law. However, the

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<sup>27</sup> Sanjeev Ahuja, *Resolve and How: All about resolution plans under Insolvency Bankruptcy Code, 2016*, INSTITUTE OF INSOLVENCY PROFESSIONALS (Aug. 2018) <https://icsiip.com/Portals/0/article/Aug%202018%20Issue.pdf>.

<sup>28</sup> Kanika Kitchlu-Connolly, *Section 29A of the Insolvency and Bankruptcy Code, 2016- Is there an opportunity for a rethink?* INSTITUTE OF INSOLVENCY PROFESSIONALS (Jan. 2019) <https://icsiip.com/Portals/0/Jan%202019%20Issue.pdf>.

<sup>29</sup> M S Sahoo, *Insolvency Reforms A Road Under Construction*, <https://ibbi.gov.in/uploads/resources/ab85b78f0ae05938cae4a7c6bae0c225.pdf> (last visited Mar. 31, 2020).

<sup>30</sup> Shreya Prakash, *Re-designing the Fast-Track Insolvency Process*, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, (2019) <https://www.ibbi.gov.in/uploads/publication/2019-10-11-191135-wv5q0-2456194a119394217a926e595b537437.pdf>.

<sup>31</sup> See Bibek Derby & Aparajita Gupta, *Ease of Exit: The IBC Way*, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (2020), <https://www.ibbi.gov.in/uploads/whatsnew/2020-10-01-210733-43cms-9224c9b668aac0d6149a5d866bfb4c79.pdf>.

same have not been notified till date, resulting in MSMEs being governed by archaic legislations like the Provincial Insolvency Act, 1909.<sup>32</sup>

Further, the Indian regime also provides legislative support to MSMEs in the form of the MSME Development Act, 2006 (MSMED Act). This law ensures the promotion, development and enhancement in business of the MSMEs. In accordance with the provisions of the MSMED Act, MSMEs are classified as below:

- (i) a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;
- (ii) a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and
- (iii) a medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees.

The new classification has come into effect from 1<sup>st</sup> July, 2020. The earlier criterion of classification of MSMEs under the MSMED Act, 2006 was based on investment in plant and machinery / equipment. It was different for manufacturing and services units. It was also very low in terms of financial limits. Since then, the economy has undergone significant changes. In the aftermath of COVID-19 pandemic, Hon'ble Prime Minister was quick to recognize the role of MSMEs in building the Nation. A revision in MSME criteria of classification was announced in the *Aatma Nirbhar Bharat* package on 13<sup>th</sup> May, 2020. Under this package, the MSME sector has not only been given substantial allocation but has also been accorded priority in implementation of the measures to revive the economy. This has been done in order to align the Indian economy with the travails unfolded by the COVID-19 pandemic, to establish an objective and composite system of classification, and to provide ease of doing business.<sup>33</sup>

In order to provide a simpler, faster mechanism to address the stress in the accounts of MSMEs and to facilitate the promotion and development of

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<sup>32</sup> See Pihu Mishra & Sushanta Kumar Das, Social Ramifications of Bankruptcy Law, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (2020), <https://www.ibbi.gov.in/uploads/whatsnew/2020-10-01-210733-43cms-9224c9b668aac0d6149a5d866bfb4c79.pdf>.

<sup>33</sup> Ajit Ranade, *Small Business and the Insolvency Law*, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (2020), <https://www.ibbi.gov.in/uploads/whatsnew/2020-10-01-210733-43cms-9224c9b668aac0d6149a5d866bfb4c79.pdf>.

MSMEs, the Ministry of MSMEs, the Government of India, vide its Gazette Notification dated 29<sup>th</sup> May, 2015 notified a 'Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises'. Further, the Reserve Bank of India has also issued guidelines to the Banks on 17<sup>th</sup> March, 2016. Under these guidelines, Banks have created mechanism for finalising corrective action plan for revival and rehabilitation of MSMEs.

The various other tools employed under the law are subsidized rates, easy availability of credit, preferential treatment, and a penalty on entities which utilize the services/goods of the MSME but do not make payment for a period of more than 45 days. Sections 15-24 of the MSMED Act deal with the issues relating to the Delayed Payments to Micro and Small Enterprises (MSEs) by the buyers to the MSE supplier. In the case of delay in payment beyond 45 days, MSEs suppliers may approach the Micro and Small Enterprises Facilitation Council (MSEFC) constituted under the Act in all State/UTs. "*In case of default the MSME could approach the Facilitation Council which can help with payment, or impose a penalty or pass a decree. But in practice this mechanism has met with limited success*".<sup>34</sup> Further, in furtherance of the objectives of the MSMED Act, Ministry of MSMEs had launched a portal (<http://samadhaan.msme.gov.in/>) on 30<sup>th</sup> October, 2017.

## 2. *Jurisprudence- Overview of Case laws through the years*

One of the most landmark judgments of the Supreme Court of India relating to the constitutionality of the provisions of the Code is *Swiss Ribbons Vs. Union of India*,<sup>35</sup> wherein it observed the rationale behind introduction of section 29A of the Code as well as upheld its non-applicability on MSMEs.

In the matter of *Sarvana Global Holdings*,<sup>36</sup> the National Company Law Appellate Tribunal (NCLAT) held that, in exceptional circumstances, if the corporate entity undergoing insolvency is an MSME, it is not necessary for its Promoters to compete with other interested parties to regain the control of the MSME. Further, it held that it is open to the Committee of Creditors (CoC) to defer the process of issuance of Information Memorandum, if the Promoter of the MSME offers a viable and feasible plan maximizing the assets of the MSME and balancing the interests of all stakeholders.

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<sup>34</sup> *Id.*

<sup>35</sup> *Swiss Ribbons Pvt. Ltd. v. Union of India*, Writ Petition (Civil) No. 99 of 2018, decided on January 25, 2019.

<sup>36</sup> *Sarvana Global Holdings Ltd. & Anr. v. Bafna Pharm. Ltd. & Ors.*, (2019) 203 CompCas 10.

Further, in the matter of Sushant Aneja,<sup>37</sup> it was held by the NCLAT that in cases where MSMEs were under insolvency resolution, the bar of section 29A of the Code does not apply, and the promoter may submit its resolution plan for taking control, notwithstanding, that there are pending allegations of fraud against the promoter.

The NCLAT further expanded on the scope of MSMEs under the Code in the matter of Bannari Amman<sup>38</sup> wherein the Appellant had filed an application under Section 9 of Code for initiation of insolvency process against the Respondent. The National Company Law Tribunal (NCLT) had dismissed the application on the ground that the Respondent was an MSME, and that the Code provided some safeguards to run its business. The NCLAT held that the NCLT has no jurisdiction to reject the application under section 9 of the Code only on the ground that the distressed entity is an MSME.

In the matter of Amit Gupta,<sup>39</sup> the NCLT had noted that the appellant had failed to establish that the distressed entity was an MSME. The NCLAT, however, observed that if the prospective resolution applicant claims to get the benefits under the MSME provisions, he must take the pains to obtain Memorandum Certificate for the MSME, even if it is an optional requirement under the MSME Act.

Further, there cannot be a dispute in the process only if the Appellant has approached the Government Authorities complaining against the MSME,<sup>40</sup> and in case of a dispute regarding implementation of the resolution plan which the promoter of the MSME claims to not have agreed to, must be taken up before the NCLT which has approved the plan.<sup>41</sup>

In the matter of Shri Swwapnil Bhingardevay,<sup>42</sup> the NCLAT had observed that in case of irregularity of insolvency process of MSME, the insolvency professional appointed in the matter should be responsible, and in

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<sup>37</sup> Sushant Aneja & Ors. v. Mr. Madhusudan Sharma, R.P. for J.D. Aneja Edibles Pvt. Ltd. & Anr., (2019) 812 CompCas 1.

<sup>38</sup> M/s. Bannari Amman Spinning Mills Ltd. Vs. M/s. My Choice Knit & Apparels Pvt. Ltd., (2019) 513 CompCas 2.

<sup>39</sup> Amit Gupta Promoter of M/s. Varanasi Auto Sales Pvt. Ltd. v. Yogesh Gupta, Resolution Pro. of M/s. Varanasi Auto Sales Pvt. Ltd., (2019) 903 CompCas 7-8.

<sup>40</sup> iValue Advisors Pvt. Ltd. v. Srinagar Banihal Expressway Ltd., (2019) 1142 CompCas 4.

<sup>41</sup> Rahul Aneja v. Sushant Aneja & Anr., Unreported Judgments, Company Appeal (AT)(Insolvency) 699 Of 2019, decided on Jan. 16, 2020 (NCLAT), 2.

<sup>42</sup> Shri Swwapnil Bhingardevay v. M/s Khandoba Prasanna Sakharkar Khana Ltd., Unreported Judgments, Company Appeal (AT) (Insolvency) 943 Of 2019, decided on June 2, 2020 (NCLAT), 13.



the matter of Muhamad Yavar Dhala,<sup>43</sup> the NCLAT held that the Appellant cannot apply to the Authorities for Certificate under MSME, while by-passing the Liquidator, such action must be held as illegal.

In the latest order of NCLT, it has been held that the benefit of provisions in relation to MSMEs can only be taken if the process has been initiated after coming into force of the relevant provisions. The amendments in the MSMED Act cannot be applied retrospectively.<sup>44</sup>

### 3. Measures in the light of the Covid-19 pandemic

With coronavirus being declared a 'pandemic' by the World Health Organisation (WHO), several mitigation policies and regulatory reforms have been initiated by the Government of India in co-ordination with the State Governments. Starting with the enforcement of a nationwide cordon sanitaire (complete lockdown of all offices, businesses and industries), the government has been closely monitoring the differential impact of the virulent pandemic across all sectors. On 12<sup>th</sup> May, 2020, the Hon'ble Prime Minister, Shri Narendra Modi announced a special economic and comprehensive package of INR Twenty Lakhs Crores (20 Trillions) towards building Aatma Nirbhar Bharat Abhiyaan or Self-Reliant India Movement, outlining five pillars: Economy, Infrastructure, System, Vibrant demography and Demand.

The Ministry of Corporate Affairs (MCA), Government of India, increased the threshold for the determination of default in insolvency matters from INR One Lakh (100 Thousand) to INR One Crore (10 Million) through the amendment of section 4 of the Code (Notification dated 24 March, 2020). This step was taken to, inter alia, assist and aid the functioning of MSMEs, who may be operational creditors under the Code, and may face disruptions and consequently, defaults owing to the economic slowdown and unprecedented lockdown. This step has been upheld in the matter of *Pankaj Aggarwal Vs. Union of India*<sup>45</sup> by the High Court of Delhi.

MSMEs are the primary drivers of economic growth across all the sectors of the Indian economy. For this reason, the government has decided to notify a special insolvency resolution framework for the MSMEs. This will be

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<sup>43</sup> Muhamad Yavar Dhala v. Kavita Surana, Unreported Judgments, Company Appeal (AT) (Insolvency) 384 Of 2020 decided on Dec. 8, 2020 (NCLAT), 9.

<sup>44</sup> POSCO India Pune Processing Ctr. Priv.Ltd. v. Dhaval Jitendrakumar Mistry, Unreported Judgment, IA 514/2020 in CP (IB) 268 Of 2018, decided on Jan. 6, 2021 (NCLT), 7.

<sup>45</sup> Pankaj Aggarwal v. Union of India, Unreported Judgment, 3685 of 2020, decided on June 23, 2020 (Delhi HC) 4.

in addition to the earlier announced measures regarding the increase in the threshold for the determination of 'default' under the Code.

## VII. CONCLUSION

MSMEs are a unique entity requiring an entirely special procedure for the purpose of resolution/reorganization. They are the backbone of the economy and the drivers of growth. The problems faced by them are exclusive to such companies. While international efforts have been made by the UNCITRAL Working Group V and the World Bank to devise a framework for insolvency resolution of MSMEs, jurisdictions like France and Japan are already successfully implementing simplified procedures for insolvency resolution of MSMEs. Indian law provides benefits to the MSMEs under the MSME Development Act, 2006 as well as the Insolvency and Bankruptcy Code, 2016. The Government of India is also taking policy efforts in this area through the Reserve Bank of India as well as the Ministry of Corporate Affairs. Specially, in the light of the Covid-19 pandemic, Government of India has launched the Atmanirbhar Bharat mission and the legislature has made requisite amendments to accommodate MSMEs and their insolvency resolution. While out of court procedures are gaining popularity in order to resolve disputes relating to MSMEs and their resolution/reorganization, the contemplated special framework for MSMEs presents a ray of hope for small businesses in these uncertain times.