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WITNESS

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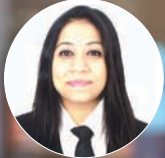
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Senior Partner,
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Associate Partner,
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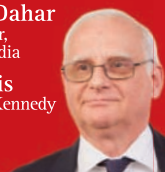
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MSMEs and Insolvency & Bankruptcy Code

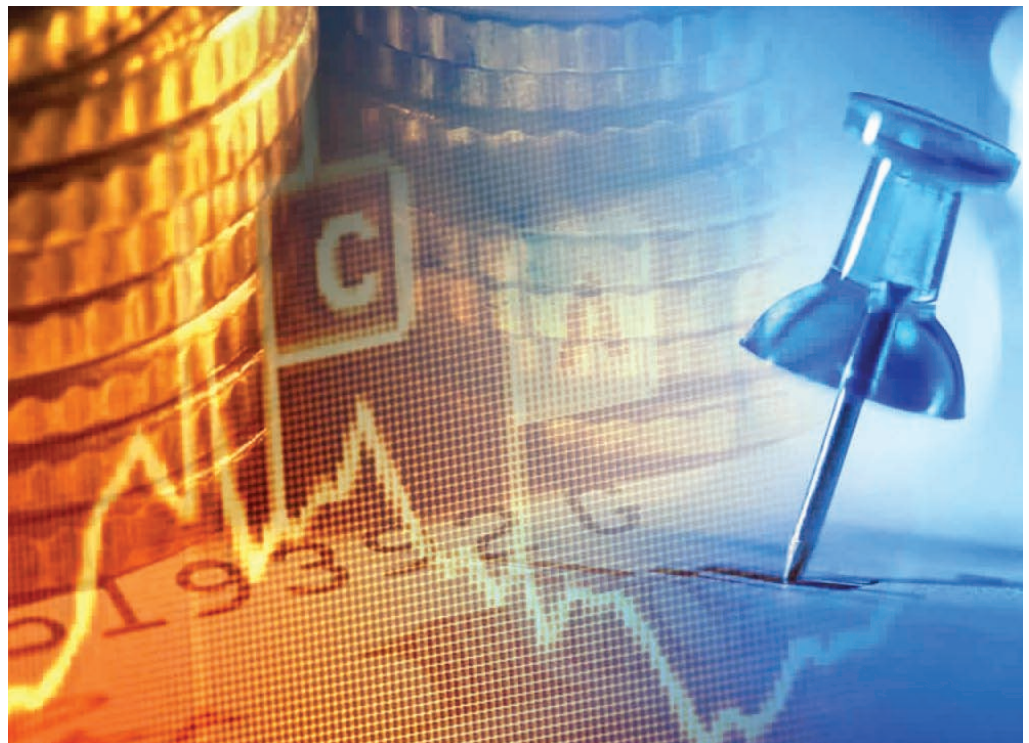
■ Varsha Banerjee & Garima Mehra



The Insolvency and Bankruptcy Code (Second Amendment) Ordinance, 2018 has brought relief to the Micro Small and Medium Enterprises (MSME) by relaxing the applicability of the provisions of Section 29A as regards submission of a resolution plan in case of such entities their favour. It is one of the most significant amendments under the Insolvency and Bankruptcy Code and has a wide impact on the whole insolvency resolution regime. Section 29 A of IBC was introduced through an Ordinance and thereafter it brought into force, with the intention to restrain

untrustworthy promoters from buying back assets at a subsidized price. While the amendment was introduced with the intention to enforce fiscal discipline among corporate citizenry rather than making it a tool to incentivize defaults (by first defaulting and then using the Code to come back and take over the company at reduced debt levels), it has resulted in a vacuum of Resolution Applicant especially in the MSME section. The MSME sector is a major employment generator in the country's economy and thus a very politically sensitive matter.

Micro, Small and Medium Enterprises (MSME's) are basically small sized business units defined in terms of their investment.



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The Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 classifies MSME's into two classes, namely, service and manufacturing. For manufacturing units, those units having investment of not more than Rs. 25 lakhs will be termed as Micro, units having investment ranging between Rs. 25 lakhs but not more than Rs. 5 crores will be termed as Small and for those enterprises having investment between Rs. 5 crores to Rs. 10 crores will be termed as Medium enterprises. Similarly, for Service units, enterprises with investment not exceeding Rs. 10 lakhs will be termed as Micro, enterprises with investment more than Rs. 10 lakhs but not exceeding Rs. 2 crores will be termed as Small and for enterprises with investment ranging between Rs. 2 crores to Rs. 5 crores will be termed as Medium.

Realising that the earlier amendment might have been too harsh for the sector, where it becomes difficult for the innocent Resolution Applicants to file a resolution plan, the Government has now introduced certain exemptions from the applicability of the provisions of Section 29A as regards MSME. The amendment has introduced section 240A which specifically dispenses the applicability of Section 29A clause (c) to (h) in case the Corporate Debtor is a Micro, Small or Medium Enterprise. Further it also envisages power of Central Government to make specific directions as regards applicability and /or modification in case of MSMEs. It is expected that with the introduction of these exemptions, the relatively smaller companies may find takers and they won't have to face liquidation.

Additionally, the disqualifications for Resolution Applicants have been tempered down especially with respect to

convictions faced by way of amending clauses (d) & (e) of Section 29A. Firstly, the disqualification for conviction is limited only for the offences mentioned in the newly inserted twelfth schedule of the Code, that too if the punishment exceeds more than 2 years (7 years in case of any other law). Secondly, the persons who have served imprisonment of two years will not be considered to be exempted as resolution applicants after the expiry of two years from the date of release and thirdly, convictions will not disqualify an applicant if the conviction is in respect of a connected person. These amendments, reducing the ambit of disqualifications makes sure that a genuine resolution applicant is not withheld from exercising his rights as what is being sought against Tata Steel in the Bhushan Power matter. The NCLT in the matter of RBL Bank Ltd. V. MBL Infrastructures Ltd. stated that the object of Section 29A was not to announce all promoters ineligible to be resolution applicants. The Code's objective is to promote an efficient and speedy insolvency procedure, however, the introduction of Section 29A proved to be contrary to the set objectives.

THE POSITION OF MSMEs UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016 - PRE SECTION 29A

The Insolvency and Bankruptcy Code, 2016 was enacted in the year 2016 to provide a comprehensive consolidating legislation with regard to insolvency and bankruptcy in India. Vide the 2018 amendment to the Code Section 29A was inserted which basically laid down provisions with regard to individuals who are not eligible to submit a resolution plan. However, this newly inserted provision came under much scrutiny and criticism on the grounds that Section 29A

has excessively enlarged the scope of disqualification to the extent of drastically reducing the prospective resolution applicants on the basis of what could be labelled as generalized criteria for disqualification wherein it does not differentiate between a genuine applicant and one with antecedents¹. The insertion of this section also caused various difficulties for MSME's since these enterprises were more labour intensive small business units which could not attract much interest from bidders thereby leading to liquidation. The importance of the MSME's in the Indian economy was also discussed in the Insolvency Law Committee Report, 2018.

THE INSOLVENCY LAW COMMITTEE REPORT

The Ministry of Corporate Affairs, formed a committee under the chairmanship of Shri Injeti Srinivas to make recommendations to the Government on issues arising from the implementation of the Insolvency and Bankruptcy Code, 2016. In the report, the Committee recognised the importance of the MSME's in the Indian economy, stating that MSMEs form the foundation of the Indian economy, and are key drivers of employment, production, economic growth, entrepreneurship and financial inclusion. According to the Annual Report of the Ministry of MSME's there are 512 lakh MSMEs in India which contributes to around 37.33 percent of the country's GDP, further highlighting their importance in the economy in terms of job creation and economic growth².

The committee in its report made observations with regard to MSMEs. Their first observation was that the Central Government should be enabled to exempt certain provision of the Code for certain classes of companies (including MSMEs)

¹<https://indiacorplaw.in/2018/06/section-29a-insolvency-bankruptcy-code-pandoras-box.html>

²Insolvency Law Committee Report, 2018

³Insolvency Law Committee Report, 2018

on lines of similar power that it enjoys under Section 462 of the Companies Act. It observed that similar provisions are also present within the ambit of other legislations including Competition Act, 2002, Banking Regulation Act, 1949, Customs Act, 1962, Urban Land (Ceiling and Regulation) Act, 1976. The report concluded that introduction of such a section will be beneficial for relaxing the procedure under the Code for certain classes of companies, including MSMEs, under the aegis of public interest while preserving the scheme and objective of the Code³.

The second recommendation of the Committee was with regard to the treatment of MSMEs by the provisions of the Code. The report identified two central problems that was faced by the MSMEs following the implementation of the Code.

The report highlighted that due to large businesses enterprises undergoing insolvency in accordance with the Code, MSMEs which are usually operational creditors to such large businesses are suffering in two ways:

(1) The large businesses which are undergoing the CIRP process have led to a temporary credit disruption for the MSMEs, which might potentially lead to their liquidation.

(2) Second, in a CIRP where MSMEs are operational creditors, the liquidation value guaranteed to them is negligible.


With regard to the first issue, the report concluded that MSMEs are the bedrock of the Indian economy, and the intent is not to push them into liquidation and affect the livelihood of employees and workers of MSMEs. It suggested that MSME as a Corporate Debtor should be granted exemptions, by permitting a promoter, who is not a willful defaulter, to bid for the MSME in insolvency. The rationale for such relaxation is that an MSME attracts interest primarily from a promoter and may not be

of much interest to other resolution applicants.

Regarding the second issue, the report stated that the key operational creditor which normally includes the important MSMEs usually gets paid over the liquidation value, owing to their role in the operations of the corporate debtor undergoing CIRP.

THE INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ORDINANCE, 2018

MSMEs occupy a very significant and important position in the Indian economy and therefore, due preservation and creation of more MSMEs are to be encouraged. Incentives should be granted to these business units as they are the bedrock of our economy. In consideration of all views the best approach to encourage MSMEs and provide them relief is to exempt or relax applicability of certain provisions under the regular insolvency process. The recent proceedings in NCLT, Mumbai, regarding the case of Wig Associates is creating a scene of confusion as to the applicability of Section 29A to the ongoing proceedings.

The Insolvency and Bankruptcy Code may be at its initial stages of operation and there has already been a lot of confusion in its implementation due to the continuous changes. The due protection and preservation of rights in case of MSMEs will encourage entrepreneurs to enter and continue with their business by eliminating their fear of being targeted by fraudulent people, thereby benefiting the economy. The introduction of Section 29A has not only brought a change in the corporate insolvency resolution process but, it also brought within its wake various aspects having economic effect. In the present economic scenario the limited relief granted to the MSME under IBC regime is in line with our economic policy of protecting, preserving and promoting entrepreneurship in India. 



Varsha Banerjee is an Associate Partner and has been in practice for the last 7 years and represents corporate entities, institutional creditors, shareholders etc. She focuses her litigation practice on corporate restructuring and insolvency matters with expertise in the rehabilitation of distressed entities, issues pertaining to recovery of debt, securitization-related matters and commercial disputes arising out of other contractual matters, civil suits and arbitration law arising in cases of distressed entities.



Garima Mehra is currently working as Associate at Dhir & Dhir Associates.