

Deciphering the Position of MSME(s) under the Scheme of IBC

Introduction:

The Micro, Small and Medium Enterprises (**MSME(s)**) have unequivocally been an integral part of the Indian Economy for decades now. As per the data available with the Ministry of Statistics & Programme Implementation, the contribution of the MSME sector accounted for 28.90% of the country's Gross Domestic Product for the Financial Year, 2016-17.[\[1\]](#) National Sample Survey conducted by the Ministry of Statistics & Programme Implementation also highlighted the fact that MSME(s) were the largest provider of employment after agriculture in the nation. This is an extremely important indicator of the integral position that MSME(s) hold in the Indian Economy. Thus, it is no surprise that the Government has been making robust changes in the framework pertaining to MSME, to further boost the economy and GDP.

This article tries to address two concerns with reference to MSME(s). The first part of the piece talks about the recent changes brought about in the fundamental definitions and the new criteria of delineation of MSME(s). The second part addresses the interplay between the scheme of Insolvency and Bankruptcy Code, 2016 (**Code**) and exemptions granted to MSME(s) under the scheme, especially, noting that exemptions can only be availed by the entities to which, they are granted in the first place.

Change in the Definition of Micro, Medium and Small Enterprises:

MSME(s) are governed and regulated by The Micro, Small and Medium Enterprises Development Act, 2006 (**hereinafter referred to as "MSMED Act"**). The said act has been enacted to provide for the facilitation, promotion, development and enhancement of the competitiveness of MSME(s). The MSMED Act categorized MSME(s) into two classes[\[2\]](#):

1. **Manufacturing Enterprises:** These MSME(s) are engaged in the production or manufacturing of goods in any industry.
2. **Service Enterprises:** These MSME(s) are engaged in providing services.

The definition and criteria of MSME(s) is provided under the MSMED Act. Earlier the criteria for classification of MSME was provided as under:

However, now the Central Government through the Union Ministry of Micro, Small and Medium Enterprise has issued a Gazette notification no S.O 2119(E) dated June 26th 2020[\[3\]](#) for implementation of the upward revision in the definition and criteria of MSME(s). As per the said gazette notification, the new definition and criterion for MSME(s) have come into effect w.e.f. July 1st, 2020.

Now the criteria is not divided between the two categories viz. manufacturing and service industry but a composite criterion is provided without any difference. Under the said Gazette Notification, it is also specified that the procedure for filing the memorandum for MSME will

now be known as “Udyam Registration” The notification also provides for registration of MSME(s), grievance redressal of enterprises etc.

Position of MSME(s) under the Scheme of Insolvency and Bankruptcy Code, 2016:

The aims and objectives of the Code explicitly specify that the Code is enacted with the purpose of, *inter alia*, consolidation of laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms, and individuals in a time bound manner for *maximization of value of assets of such persons*. For this purpose, a Resolution plan under Section 5(26) of the Code is designated to be the ‘way-out’ for insolvent entities coming under the Code.

Keeping in mind the objectives enshrined under the Code and the position of nascent judicial jurisprudence, the Ministry of Corporate Affairs (**MCA**) constituted the Insolvency Law Committee under the chairmanship of Sh. Injeti Srinivas, with the mandate of making recommendations for the better functioning of the Code.

The Report on the Insolvency Law Committee was presented to the Ministry of Corporate Affairs on 26 March 2018^[4] wherein numerous recommendations were proposed to safeguard the interests of MSME(s). The committee recognised the need to protect MSME(s) as they are the bedrock of Indian economy, and the intent is not to push them into liquidation and affect the livelihood of employees of these enterprises.

Section 29A^[5] of the Code provides for the persons who are ineligible to be Resolution Applicant(s) and thus, forms an important criterion of eligibility to submit a Resolution Plan. The committee thought it fit to grant exemptions to corporate debtors which are MSME(s), by permitting a promoter who is not a wilful defaulter or covered under any other specific disqualification as provided under Section 29A, to bid for the Resolution Plan of an MSME. The recommendation relating to the exemption of MSME under Section 29-A enumerated that, a new section namely Section 240A in the Code be inserted, which specifically exempted resolution applicants from the ambit of Section 29-A, and paved the way for them to submit Resolution Plans for MSME(s) that are undergoing Corporate Insolvency Resolution Process (**CIRP**).

Thus, the Ministry of Law and Justice through [the Insolvency and Bankruptcy Code \(Second Amendment\) Act, 2018](#)^[6], inserted Section 240A in the Code. Section 240A specifies that clauses (c) and (h) of Section 29A shall not apply to the resolution applicant in respect of CIRP of any MSME.

As per the aforementioned amendment, only the following classes of person are exempted under Section 29A and hence, they are eligible to submit a resolution plan in case of MSME(s)-

1. A person who at the time of submission of the resolution plan has an account or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter which is classified as non-performing asset in by the RBI and at least a period of 1 year has lapsed from the date of such classification till the date of commencement of CIRP of Corporate Debtor. [Clause (c)]

2. A person who has executed a guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under the Code and such guarantee has been invoked by the creditor and remains unpaid in full or part. [Clause (h)]

The rationale for this relaxation was that a business of an MSME attracts primarily, the interest from a promoter of MSME and may not be of interest to other resolution applicants since usually only the promoters of MSME(s) are likely to be interested in acquiring it.

Persons prohibited from submitting a Resolution Plan under the Scheme of the Code:

It is important to note the fact here that Promoters of MSME(s) may try to take undue advantage of the aforementioned changes brought in by the insertion of Section 240A in the Code by seeking a blanket protection against all the prohibitions, mentioned in Section 29-A despite the fact that Section 240A only exempts persons specified under clause (c) and clause (h) of Section 29A.

Section 29A contains several other classes of person who are ineligible to submit a resolution plan irrespective of the fact whether the corporate entity is a MSME or not. The NCLAT and the Supreme Court, have held that Section 29-A reflects a very important object of the Code, which is to see that undesirable persons are rendered ineligible to submit resolution plans so that such persons may not come into the management of stressed corporate debtors.

Therefore, according to Section 29A, the following persons are prohibited and ineligible to be a Resolution Applicant for any Corporate Debtor, including, MSME(s):

- As per clause (a), any person, who is declared an insolvent.
- According to clause (b), any person who is a wilful defaulter in terms of the RBI Guidelines issued under the Banking Regulation Act, 1949^[7].
- According to clause (d), any person who has been convicted for any offence punishable with imprisonment for two years or more under specified Acts; or for seven years or more under any law for time being in force.
- According to clause (e), any person who is disqualified to act as a director under the Companies Act, 2013
- Similarly, according to clause (f) any person who is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities market.
- According to clause (g), If a person has been in the management, control or promoter of a Corporate Debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority under the Code.
- According to clause (j), if any person comes within the purview of connected person.

Connected Person means, as has been defined in the clause itself, means to include:

- Any person who is the promoter or in the management or control of the resolution applicant; or
- Any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or
- The holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii)

Therefore, a person in order to be eligible to submit a resolution plan –

- shall fulfil the criteria laid down by the resolution professional with the approval of the committee of creditors; and
- shall not suffer from any disqualification mentioned under section 29A, unless exemptions have been stated explicitly by law.

The Code is a beneficial legislation which puts the corporate debtor back on its feet, not being a mere recovery legislation for creditors. The interests of the corporate debtor have, therefore, been bifurcated and separated from that of its promoters or those who are in management. Thus, the aforementioned prohibitions continue to operate for persons, including promoters, notwithstanding the exemption(s) granted under Section 240A.

Conclusion:

The legislative intent behind the insertion of Section 29A in the Code was to prevent defaulting persons, including the promoters, from buying-back the corporate debtor, which could occur potentially at steep discounts to the grave prejudice of other stakeholders. Hence, this is the exact reason why only limited exemptions have been granted under Section 240A in a purely contextual purpose of the Code, and the importance of MSME(s) in the Indian economic paradigm. In the case of *Chitra Sharma & Ors. Vs Union of India & Ors*^[8] the Hon'ble Apex Court has described the insertion of Section 29A in the code as a 'plugging loophole' and has ruled that strict adherence to Section 29A is mandatory and that wilful defaulters shall not be permitted to participate in the CIRP.

In the case of *Swiss Ribbons v. Union of India*^[9], it has been held that the Code is one of the most important legislations consisting of dynamic and contemporary changes. These changes are extremely necessary to make sure that the legislation is in line to rectify the anomalies that hinder its effectuation in its true essence. In this background, an appreciable step has been taken by the legislature by the insertion of Section 240A, which gives these exempted persons a legitimate opportunity to be a Resolution Applicant while making sure that the other prohibitions under Section 29A would continue to apply to all the corporate entities, thereby protecting the sanctity & intent behind the insertion of the Section, and the Code as an extension.

[1] <https://msme.gov.in/sites/default/files/Annualrprt.pdf>

[2] Section 7 of Micro, Small and Medium Enterprises Development Act 2006.

[3] http://www.dcmsme.gov.in/IndianGazzate_0.pdf

[4] http://www.mca.gov.in/Ministry/pdf/ReportInsolvencyLawCommittee_12042019.pdf

[5] Ins. by Act 8 of 2018, sec. 5 (w.r.e.f. 23-11-2017).

[6]

[https://www.ibbi.gov.in/webadmin/pdf/whatsnew/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20\(Second%20Amendment\)%20Act,%202018_2018-08-18%2018:42:09.pdf](https://www.ibbi.gov.in/webadmin/pdf/whatsnew/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20(Second%20Amendment)%20Act,%202018_2018-08-18%2018:42:09.pdf)

[7] https://m.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9907

[8] Chitra Sharma & Ors Vs UOI & Ors, Writ Petition (Civil) No. 744 of 2017.

[9] Swiss Ribbons Pvt. Ltd. & Anr. Vs UOI, Writ Petition (Civil) No. 99 of 2018.