

TREATMENT OF MSME INSOLVENCY UNDER IBC

Prachi Apte and Sushanta Kumar Das

Micro, small and medium enterprises (MSMEs) form the foundation of the economy and are the key drivers of employment, production, economic growth, entrepreneurship, and financial inclusion. MSME sector is the critical source of livelihood for nearly 110 million people in the country and a total of 30% of India's GDP.¹ It has envisioned that the MSME sector would account for 50% of GDP and add 50 million fresh jobs over the next five years.² It is perhaps no surprise that MSMEs are particularly vulnerable to financial shocks. The most important reason for this being first, difficulty in accessing finance in the right quantity, at the right time; second, attracting and retaining qualified workforce, and third, penetrating regional, national and international markets. The emergence of the second wave of COVID-19 was unexpected, for which the sector was ill-prepared, having hardly recovered from the blow of the first wave of pandemic.³ It is trite to mention here that these enterprises are increasingly recognised as being the backbone of many economies but face specific hurdles in using the insolvency system. Moreover, MSMEs in India have relatively suffered the most during the current pandemic times and the problem of delayed payment remains one of the biggest challenges to these MSMEs.

IMPORTANCE OF MSME SECTOR

Changing definition

While India will now be using investment and annual turnover as the criteria to classify MSMEs⁴, global trends in classifying the MSMEs show that it has widely used, the number of employees as a variable to define MSMEs. The earlier definition of MSMEs is defined in the MSME Development

Act, 2006 (MSMED Act) based on investment in plant, machinery or equipment to classify MSMEs. The limit on investment was different for the manufacturing and services sectors. These limits were exceptionally low in terms of financial limits.⁵

Since then, the economy has undergone significant changes. To facilitate ease of doing business, the Government has proposed a turnover-based definition by replacing the current investment-based definition of MSMEs.⁶ Union Ministry of Micro, Small and Medium Enterprises (Ministry of MSMEs) has notified the new definition and criterion which came into effect from July 1, 2020.⁷ The new definition also removed the difference between the manufacturing and service sectors.⁸

Revised classification applicable w.e.f. July 1, 2020			
Composite Criteria: Investment in Plant & Machinery/equipment and Annual Turnover			
Classification	Micro	Small	Medium
Manufacturing Enterprises & Enterprises rendering Services	Investment: Not more than ₹ 1 crore & Turnover; not more than ₹ 5 crore.	Investment: Not more than ₹ 10 crore & Turnover; not more than ₹ 50 crore.	Investment: Not more than ₹ 50 crore & Turnover; not more than ₹ 250 crore.

Growth

This section focuses on the role played by MSMEs in maintaining a healthy economy. It analyses the data on the employment rate generated by MSMEs, MSMEs by socially backwards groups, percentage of different categories of MSMEs etc. The purpose of the analysis is to understand the consequences of the failure of MSME sector on the economy as a whole. India is currently one of the fastest growing economies in the world. MSME sector is likely to continue to play a significant role in the growth of the Indian economy. In the last ten years, the MSME sector has shown impressive growth in terms of parameters like number of units, production, employment, and exports. Given the right set of support systems and enabling framework, this sector can contribute much more, enabling it to actualise its immense potential.⁹

The MSMEs in India are playing a crucial role by providing large employment opportunities at comparatively lower capital costs than large industries as well as through industrialisation of rural and backward areas, *inter alia*, reducing regional imbalances, assuring more equitable distribution of national income and wealth. According to the National Sample Survey (NSS) 73rd round, conducted by National Sample Survey Office, Ministry of Statistics & Program Implementation during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities.¹⁰ Table 1 shows the distribution of MSME activity-wise.

Table 1: Estimated Number of MSMEs (Activity Wise)

Activity Category	Estimated Number of Enterprises (in lakh)			% Share
	Rural	Urban	Total	
Manufacturing	114.14	82.50	196.65	31
Electricity*	0.03	0.01	0.03	-
Trade	108.71	121.64	230.35	36
Other Services	102.00	104.85	206.85	33
All	324.88	309.00	633.88	100

*Non-captive electricity generation and transmission

Table 2: Distribution of Enterprises Category Wise (in lakh)

Sector	Micro	Small	Medium	Total	% Share
Rural	324.09	0.78	0.01	324.88	51
Urban	306.43	2.53	0.04	309.00	49
All	630.53	3.31	0.05	633.88	100

As Table 2 shows, 99.5% of all MSMEs fall in the micro category. While micro enterprises are equally distributed over rural and urban India, small and medium ones are predominantly in urban India. In other words, micro enterprises essentially refer to a single man or a woman working on their own from their home. The medium and small enterprises, that is, the remaining 0.5% of all MSMEs, employ the remaining five crore-odd employees.¹¹

Table 3: Percentage Distribution of Enterprises in rural and urban areas (Male/ Female ownership)

Sector	Male	Female
Rural	77.76	22.24
Urban	81.58	18.42
All	79.63	20.37

Table 2 and 3 shows that out of 633.88 lakh MSMEs, 608.41 lakh (95.98%) MSMEs were proprietary concerns. There was dominance of male in ownership of proprietary MSMEs. Thus, for proprietary MSMEs, male owned 79.63% of enterprises as compared to 20.37% owned by female.

Employment in MSME Sector

As per the NSS 73rd round conducted during the period 2015-16, the MSME sector has been creating 1109.89 lakh jobs across the country. Table 4 shows the distribution of MSME activity wise.

Table 4: Estimated Employment in the MSME Sector (Activity Wise)

Broad Activity Category	Employment (in Lakh)			Share (%)
	Rural	Urban	Total	
Manufacturing	186.56	173.86	360.41	32
Electricity	0.06	0.02	0.07	0
Trade	160.64	226.54	387.18	35
Other Services	150.43	211.69	362.22	33
All	497.78	612.10	1109.89	100

Out of 1109.89 lakh people employed in MSME sector, 844.68 (76%) are male employees and remaining 264.92 lakh (24%) are females. Table 5 shows the sectoral distribution of workers in male and female category.

Table 5: Distribution of workers by gender in rural & urban areas (Numbers in lakh)

Sector	Female	Male	Total	% Share
Rural	137.50	360.15	497.78	45
Urban	127.42	484.54	612.10	55
Total	264.29	844.68	1109.89	100
% Share	24	76	100	

These numbers suggest that, on average, less than two people are employed per MSME. At one level this gives a picture of how small these really are. But a breakup of all MSMEs into micro, small and medium categories is even more revealing.

However, in spite high growth rate and good prospects, the Indian MSMEs have been subject to certain constraints. The most notable barriers are lack of timely credit, procurement of raw materials at a competitive cost, inadequate infrastructure facilities including power, water and road, and lack of skilled manpower for manufacturing, services, marketing, etc. The most important constraints faced till date are technological backwardness.¹²

GOVERNMENT'S STEPS FOR MSME SECTOR

The Government and regulators through various legislations and directives have attempted to create a conducive environment for the development of the MSME sector. One of the major steps in this direction has been the enactment of the Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act).¹³ The Insolvency and Bankruptcy Code, 2016 (Code/ IBC) brought in a robust insolvency regime in India. An effective insolvency regime, if properly implemented, may mitigate many of the challenges facing MSMEs.¹⁴ IBC is the one-stop solution for resolving insolvencies, which previously was a long process that did not offer an economically viable arrangement. The Code aims to protect the interest of the small investor and provides for ease of exit for business in India.¹⁵

MSMED Act, 2006

This law has measures for the promotion, development, and enhancement of competitiveness of MSMEs. The Act also specifies how payment delays and related disputes are to be settled. In case of a 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.¹⁶ Although the Act addresses the issue of delayed payment, the said process has been highly questionable owing to the enforceability of the awards passed by the council.¹⁷

Resolution under IBC

The IBC becomes relevant to MSMEs mostly when they are operational creditors to large debtors. There are cases where MSME can also be a financial creditor.¹⁸ The IBC provides a comprehensive framework for the resolution of insolvency and bankruptcy of corporate persons, LLP, individuals, partnership firms, and sole proprietorship firms in a time-bound manner for maximisation of value of assets. The pre-packaged insolvency resolution process (PPIRP/Pre-Pack) at present applies only to corporate MSMEs. Most MSMEs by virtue of being a partnership or proprietorship firms have to resort to the standard corporate insolvency resolution process (CIRP).¹⁹ The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (Second Amendment) has brought relief to the MSME by relaxing the applicability of the provisions of section 29A of the Code.²⁰

Section 29A of IBC

Section 29A of the Code provides for the persons ineligibility to be a resolution applicant(s) and thus, forms an important criterion of eligibility to submit a resolution plan. The Second Amendment introduced section 240A, which provides certain relaxations to MSMEs with respect to the applicability of restrictive provision of section 29A. The intention behind the enactment of this provision was to grant exemptions to corporate debtors (CDs) which are MSME(s), by permitting a promoter who is not a willful defaulter or covered under any other specific disqualification as provided under section 29A, to bid for the resolution plan of an MSME.²¹ The second amendment also empowers the Central Government to allow further exemptions or modifications with respect to the MSME sector, if required, in the public interest. With the introduction of these mindful exemptions, it is expected that the MSMEs may find bidders, and may not have to undergo liquidation.²²

In recognition of the importance of MSMEs to the Indian economy and the unique challenges faced by them, the Insolvency Law Committee (ILC) recommended the exemption of the application of certain provisions of the Code on MSMEs. Illustratively, since usually only promoters of an MSME are likely to be interested in acquiring it, the applicability of section 29A has been restricted only to disqualify willful defaulters from bidding for MSMEs.²³ The Supreme Court in *Swiss Ribbon's* case²⁴ reiterated that the rationale for excluding such industries from the eligibility criteria laid down in section 29A (c) and (h) is because *qua* such industries, other resolution applicants may not be forthcoming, which then will inevitably not lead to resolution, but liquidation.

INSOLVENCY IN THE MSME SECTOR

In pursuit to create a vibrant MSME sector, the Ministry of MSME, Government of India has taken a multi-pronged strategy. The focus is not merely on the issues related to the commencement and growth of MSMEs but also on ensuring that they sustain their business. However, due to various reasons, MSMEs are prone to sickness.²⁵ There have been a few attempts to address this issue. However, the need to devise a more robust mechanism for dealing with sick MSMEs became necessary so as to make suitable arrangements for detecting symptoms of industrial sickness at an early stage and take corrective actions to prevent sickness.²⁶

In the aftermath of the COVID-19 pandemic, the Hon'ble Prime Minister was quick to recognise the role of MSMEs in building the Nation. Consequently, MSMEs formed a very prominent part of the announcements made under the *Atmanirbhar Bharat Abhiyaan*. Under this scheme, the MSME sector has not only been given substantial allocation but has also been accorded priority in the implementation of the measures to revive the economy. To provide immediate relief to the MSME sector, various announcements have been made under the scheme. The Government's top focus is on energising the MSMEs in the country.²⁷ It is also trite to mention here that under this scheme all businesses (including MSMEs) were provided with collateral-free automatic loans of up to three lakh crore rupees. MSMEs were allowed to borrow up to 20% of their entire outstanding credit as of February 29, 2020, from banks and non-banking financial companies (NBFCs). Borrowers with up to ₹ 25 crore outstanding and ₹ 100 crore turnover were made eligible for such loans to avail the scheme till October 31, 2020. Interest on the loan was capped and a 100% credit guarantee on principal and interest were given to banks and NBFCs.²⁸

It is also noteworthy that the scheme has provided ₹ 20,000 crores subordinate debt for stressed MSMEs. This scheme aims to support stressed MSMEs which have non-performing assets (NPAs). Under the scheme, promoters of MSMEs will be given debt from banks, which will be infused into the MSMEs as equity. The Government will facilitate ₹ 20,000 crore of subordinated debt to MSMEs. For this purpose, it will provide ₹ 4,000 crore to the Credit Guarantee Fund Trust for micro and small enterprises, which will, in turn, provide partial credit guarantee support to banks providing credit under the scheme.²⁹

A Special Liquidity Scheme was announced under which ₹ 30,000 crore of investment will be made by the Government in both primary and secondary market transactions in investment grade debt paper of NBFCs/Housing Finance Companies (HFCs)/Micro Finance Institutions (MFIs). The Central Government will provide a 100% guarantee for these securities. The existing Partial Credit Guarantee Scheme (PCGS) will be extended to partially safeguard NBFCs against borrowings of such entities (such as primary issuance of bonds or commercial papers (liability side of balance sheets)). The initial loss of 20% will be borne by the Central Government. The PCGS scheme will facilitate liquidity worth ₹ 45,000 crores for NBFCs.³⁰ Although these announcements are expected to assist MSMEs in tackling economic stress, they may not prove to be much effective owing to low

demand and longer period to derive economic normalcy. Thus, several steps have also been taken to revive the stressed MSMEs under the aegis of the MSMED Act and IBC.³¹

Reasons for MSME insolvency

It is observed in the World Bank Report³² that, part of the explanation of why MSMEs fail in such large numbers is simply because they constitute the largest proportion of private sector businesses. These challenges arise from factors such as size, lack of available collateral, undiversified nature, and lack of suitable external governance mechanisms, all of which contribute to a high MSME failure rate. As such, it is crucial for insolvency regimes to be responsive to MSMEs particular requirements. In India MSMEs are facing great challenges some of the notable challenges are listed below:

Complex insolvency systems

MSME insolvency faces unique challenges and issues. Complex insolvency systems deter MSMEs from resorting to formal procedures to tackle financial distress. Unsophisticated MSMEs struggle to understand this complexity; thus, discouraging timely use of insolvency by MSMEs.³³

Creditor behaviour

In the absence of any mechanism to deal with insolvent MSMEs, creditors have few incentives to deal with MSME debtors through legal processes. Creditor passivity often arises when creditors weigh the amount they estimate they will receive from participating in the insolvency process against the amount of time and money this effort requires. If the cost outweighs the return, then creditors make the rational decision of not getting involved. Secured creditors typically focus on enforcement of security as the first sign of financial distress, and thus, efficiencies may be lost.³⁴

Lack of information about MSME debtors

Another major weakness that inhibits the growth of this sector is the lack of good records management by the MSMEs.

Post-insolvency financing

Post insolvency financing is hardly available. MSMEs rely on family and friends for help. MSMEs often lack the resources to cover the costs and fees for a formal insolvency procedure.

Insufficient assets to fund a formal insolvency procedure

The insolvency process itself can be challenging for MSMEs. Smaller MSMEs may lack funds to cover the expenses of an insolvency process or fail to generate an expectation for unsecured creditors to receive any returns.³⁵

Personal debts

MSMEs are often financed with a mixture of corporate debt and personal debt taken by the

entrepreneur (including granting of potentially personal guarantees). The failure of the MSME may thus have severe consequences for the entrepreneur and their family including, social stigma.³⁶

In order to understand the structural bottlenecks and factors affecting the performance of the MSMEs, RBI had set up an Expert Committee on MSMEs under the Chairmanship of Shri U.K. Sinha in January 2019. The Committee undertook a comprehensive review of the sector and gave several recommendations for the economic and financial sustainability of the MSME sector. These recommendations are wide-ranging and broadly relate to, legislative changes, infrastructure development, capacity building, technological up-gradation, improving backward and forward linkages, improving financial support from formal sources, newer technological interventions for robust underwriting practices, and credit delivery.³⁷ Due to the above-stated reasons, there needs to be a certain reconsideration of the insolvency process, in order to ensure the timely resolution and protection of the MSMEs. The report suggested that, based on the vulnerability and size, the insolvency code should provide for out-of-court assistance to MSMEs, who are predominantly proprietorships, such as mediation, debt counseling, financial education, etc.³⁸

Action taken by the Government

To reduce corporate stress, the Government suspended the initiation of fresh insolvency proceedings under sections 7, 9 and 10 of IBC for defaults arising on or after March 25, 2020, till March 25, 2021. RBI, too, announced a loan moratorium from March 1, 2020, to August 31, 2020, along with an asset classification dispensation and special resolution framework for COVID-19 related stressed assets. Under the resolution plans that could be invoked under the above window, lenders were permitted to grant an additional moratorium of up to two years. Also, MSME accounts classified as Standard, where the aggregate exposure of banks and NBFCs was ₹ 25 crore or below as of March 1, 2020, were permitted to be restructured without a downgrade in the asset classification, subject to certain conditions.³⁹

Pre-packaged insolvency resolution for MSMEs

The Central Government promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 on April 4, 2021, which aimed at providing an efficient, alternative insolvency resolution framework for corporate persons classified as the MSMEs under the Code, for ensuring quicker, cost-effective and value-maximising outcomes for all the stakeholders in a manner which is least disruptive to the continuity of MSME businesses and preserves jobs.

The Ordinance, in essence, has amended the Code allowing the Central Government to notify the pre-packaged process for defaults of not more than one crore rupees to be initiated by the corporate debtor.⁴⁰ The ordinance introduces PPIRP exclusively for MSMEs as defined under section 7(1) of the MSME Act. The PPIRP is regulated under chapter III-A of part II of IBC; from sections 54A-58 read with Insolvency and Bankruptcy Board of India (Pre-packaged Insolvency Resolution Process) Regulations, 2021 and Insolvency and Bankruptcy (Pre-packaged Insolvency Resolution Process) Rules, 2021.

INSOLVENCY RESOLUTION PROCESS FOR NON-CORPORATE MSMEs

The PPIRP applies only to corporate MSMEs. Although Part III of the Code provides for a resolution and bankruptcy process to address the insolvency of proprietorships and partnership firms, its provisions are yet to be notified. It is found that a vast number of MSMEs in the country fall outside the purview of PPIRP for their turnaround under IBC as these are not registered companies.⁴¹ As noted above, in 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities.⁴² These far outnumber the MSMEs which are registered as companies around 780,000 or 60% of all active companies in the country which will benefit from the PPIRP.⁴³ These companies represent just above 1% of all the unincorporated MSMEs, implying that the informal sector businesses far outnumber the organised sector and will not be covered by the PPIRP. Extending an insolvency resolution scheme under IBC to unincorporated entities and proprietorships, however, is hugely challenging given the large number of such enterprises.⁴⁴

The United Nations Commission on International Trade Law (UNCITRAL) referred to pre-packs as 'expedited reorganisation proceedings'. In attempting to understand the pre-pack and framing the provisions of pre-pack for the Indian scenario, the ILC, in its report⁴⁵ has studied several global jurisdictions, including the United Kingdom (UK), the United States (US), in order to frame relevant law for our country. There is no doubt that the UK and US continue to be the lead flag bearers of pre-pack arrangements, but pre-packs for unincorporated MSMEs is yet to be formally brought under Part III of the Code. Therefore, it is imperative to examine the treatment of non-corporate MSMEs under other jurisdictions so that the pre-pack resolution process for non-corporate MSMEs in India, can be brought into existence that will benefit the un-incorporated MSMEs in India.

International Practices

United Kingdom

The primary legislation governing insolvency is the Insolvency Act, 1986 which was modified by the Enterprises Act, 2002 and has made radical changes to corporate and personal insolvency.⁴⁶ The UK legislation does not specifically use the term MSME. However, a company voluntary arrangement (CVA) is a vehicle for SME to restructure, rather than to liquidate through bankruptcy.⁴⁷ The UK law has made provisions for Individual and Partnership firms.

Individual Voluntary Arrangement (IVA) is a private negotiation between debtors and creditors wherein the debtors avoid the stigma of bankruptcy. While negotiations are outside of the court, they are supported by legal provisions embedded in the law.⁴⁸ If the debtors and creditors can come up with an agreement on the composition of debts, then the court only plays a role in sanctioning the agreement. There is no bankruptcy in the case of an IVA since a plan of repayment is agreed upon before a debtor can be called 'bankrupt'.⁴⁹ An IVA is available to all individuals, sole traders or those in a business partnership who are experiencing financial difficulty.⁵⁰

A Partnership Voluntary Arrangement (PVA) is a formal agreement between a partnership firm and its creditors to repay all or part of its debts over time. Much like the very similar Company Voluntary Arrangement (CVA), a PVA is a legally binding agreement to repay debts owing to creditors through monthly contributions over a typical period of between three and five years. Depending on the circumstances of the business and the amount it can afford to repay each month, this could mean that only a proportion of the total debt is paid. The PVA also provides the partnership with protection from creditor action. Once the PVA has been proposed, no creditor action can be taken. This extends for the length of the agreement if it is approved. That can make a PVA an especially useful restructuring tool.⁵¹

Where an unincorporated/non-LLP partnership is insolvent and where a rescue of that partnership or business is possible, an administration may be appropriate. An Administrator is a licensed insolvency practitioner appointed by the partners of the business out of court, a floating charge holder (for example the holder of an agricultural charge) or by the court on application. An administration protects the partnership and its business from its creditors whilst proposals regarding its future are prepared. It does not protect the individual partners' estates and other assets and the individual will need to deal with any residual claims of creditors following the administration. The Administrators deal with all classes of the creditor. The procedure is similar to that of Company administrations.⁵²

United States

In the US, businesses and individuals seeking relief under the US Bankruptcy Code are allowed to file a petition under the Bankruptcy Code Chapters 7, 9, 11, 12, 13, and 15.⁵³ The US Bankruptcy Code specifies 'small business debtors', it does not refer to MSME or SME.⁵⁴

A Chapter 11 bankruptcy is a legal process that involves the reorganisation of a debtor's debts and assets. It is available to individuals, sole proprietorships, partnerships, and corporations. The main reason to file for Chapter 11 bankruptcy is to be able to prevent a business from permanently closing. Of course, the company needs to be in such a position that the restructuring of its debt makes financial sense.⁵⁵

Chapter 13 provides a reorganisation plan to individuals who do not want to go through a Chapter 7 bankruptcy. Individuals get an opportunity to reorganise their financial affairs while being under the protection of the Bankruptcy Court. Although an individual, who is operating a business as a sole proprietor or conducting a professional practice, can file a Chapter 13 petition as most Chapter 13 debtors are 'consumer debtors'.⁵⁶

The COVID-19 pandemic has made few changes in the bankruptcy laws of the US. The Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law by the president on March 27, 2020, made several changes to bankruptcy laws designed to make the process more available to businesses and individuals, economically disadvantaged by the pandemic.⁵⁷

Canada

In Canada, Division II ‘consumer’ proposal is used as a highly streamlined mechanism for micro business which is provided under the Bankruptcy and Insolvency Act, 1985 (BIA). These provisions are accessible to non-incorporated self-employed individuals and sole proprietors whose debts are less than 250,000 CAD, excluding a mortgage or hypothec on the individual’s principal residence.⁵⁸

The consumer proposal provisions of Division II of Part III of the BIA allow a much more streamlined summary process. The provisions were enacted as a mechanism to deal with smaller estates on a more cost-effective and expedited basis. A Division II proposal must be made to creditors generally but is not binding on secured creditors that have not filed a proof of claim. Division II proposals were designed as consumer proposals; however, they are available to self-employed individuals and sole proprietors that fall within the criteria mentioned above.

For individuals, bankruptcy offers an opportunity for a fresh start financially. Individuals, including business sole proprietors, who are first-time bankrupts have the option of automatic discharge after they make an assignment or are ordered into bankruptcy, which is either in nine months or 21 months, depending on whether the bankrupt has surplus income, unless it is opposed by a creditor, the trustee, or the Superintendent of Bankruptcy.⁵⁹

Australia

Debt agreements were introduced as an alternative to bankruptcy. They were intended to provide debtors with a cost-effective means of making arrangements with their creditors while avoiding bankruptcy and some of its more serious consequences. Debt agreements are binding agreements made between debtors and their creditors in accordance with Part IX of the Bankruptcy Act, 1966. Under these agreements, insolvent debtors propose legally binding repayment arrangements to their creditors. If such a proposal is accepted by the creditors, the debtor is released from the debts owed to these creditors upon completion of the agreed payments.

Debt agreements are subject to the oversight of the Official Receiver, AFSA.⁶⁰ Debtors proposing a debt agreement cannot have been bankrupt, nor have had a debt agreement or a Part X arrangement⁶¹, within the preceding 10 years.⁶²

Republic of Korea

The Debtor Rehabilitation and Bankruptcy Act (DRBA) consolidated the Corporate Reorganisation Act, 1962, the Composition Act, 1962 and the Bankruptcy Act, 1962 to make the procedure for bankruptcy and rehabilitation of insolvent companies more efficient and streamlined.⁶³ The Composition Act and the Bankruptcy Act apply to all types of legal entities including individuals, corporations, and unincorporated foundations or associations, etc.⁶⁴

The DRBA includes (i) a rehabilitation procedure for corporates and individuals; (ii) a streamlined summary rehabilitation procedure (SRP) for SMEs; (iii) a rehabilitation procedure for individuals

with small debts; (iv) a liquidation procedure for individuals and corporates which includes a summary liquidation procedure for SMEs.⁶⁵

The process, timing, and product of the Korean Individual Rehabilitation Proceeding (IRP) is generally similar to the U.S. Chapter 13 process. Owners of unincorporated businesses are eligible to use the procedure for individual rehabilitation, provided they meet the debt thresholds for the procedure.⁶⁶ This simplified procedure enables individuals to restructure all debts (business and personal) in a single proceeding.

The Summary Rehabilitation Proceedings (SRP) under the DRBA is a streamlined procedure that aims to reduce costs, increase efficiency, and boost the chances of successful plan adoption. SMEs with debts of no more than KRW 3 billion may access the process. The SRP modifies the corporate rehabilitation procedure described above by eliminating the need for a custodian and an inspector in most cases. An inspection commissioner, who is an accountant or a court official may be appointed, with simplified duties under Supreme Court Regulations. In addition, a creditors' council is not required in all cases and the voting thresholds for adoption of a plan are relaxed.⁶⁷

CONCLUSION AND SUGGESTIONS

The ongoing pandemic has led the Government of India to restructure, reset and revamp the present insolvency law to boost the Indian economic growth prospect. The COVID-19 crisis has caused distress and failure in the MSME sector. The insolvency law since its enactment in 2016 has been amended several times in order to protect the interest of MSMEs. The authors are of the view that the Code has introduced prepacks for MSMEs in order to safeguard their interest. However, provisions for resolution process for non-corporate MSMEs also need to be deliberated upon.

The Working Group on Individual Insolvency⁶⁸ noted that, in 2009-10, the Indian MSME sector was estimated to include 29.8 million enterprises out of which 28 million are unregistered and only 1.8 million registered. MSMEs vary in size and nature. Most fall into the 'micro' category, which usually includes sole proprietorships and single-employee businesses. Small enterprises may have more than one owner and multiple employees but may have an informal business structure. Firms at the other end labeled as 'medium' enterprises may be starkly different from their micro and small counterparts and have hundreds of employees, yet they may not be corporatised. MSMEs, for a variety of reasons, forgo the formal registration of their enterprise and operate without limited liability. These MSMEs are, therefore, likely to be the biggest consumers, and expected to be the biggest beneficiaries of the law relating to insolvency and bankruptcy of individuals and partnership firms, as and when notified. MSME insolvencies cannot be treated at par with corporate resolution as MSME insolvency faces unique challenges and issues.⁶⁹

The Union Budget 2021-22 has made structural reforms in the MSME sector. It further aims to ensure faster resolution of cases by strengthening the NCLT framework and introducing an alternate method of debt resolution and a unique framework for the MSME sector. As noted above,

in 2015-16, there were about 633.88 lakhs unincorporated MSMEs⁷⁰ in India. Many MSMEs are not incorporated and even if they are, the shareholders/managers usually guarantee the company's debts. Therefore, any effort to enhance the attractiveness of the corporate insolvency regime should be accompanied by a simultaneous reform of the regime of personal insolvency in order to allow an effective discharge of debts for honest but unfortunate debtors.⁷¹ This makes it imperative to address issues faced by unincorporated MSMEs. Going forward, lawmakers will play a crucial role in addressing the challenges associated with insolvency of unincorporated MSMEs. They can examine how pre-packs will evolve and operate for the unincorporated MSMEs in India.

The concept of 'Pre-packaged Insolvency' has not suddenly come into vogue. This concept by different names has found its place in the Insolvency Laws in the UK, US, Singapore, France and Canada. The outbreak of the COVID-19 pandemic and the lockdown imposed thereto forced companies, industries and enterprises all over the world to remain shut for a long period of time thus pushing innumerable business units, specifically, the MSMEs, into financial distress and causing a threat to the very existence of such enterprises.⁷²

It is trite to mention here that IBC is evolving to offer innovative ways of servicing emerging needs of the economy. Taking note of the current practices prevailing in other jurisdictions with respect to non-corporate MSMEs, some suitable tailor-made changes can be adopted in Indian context. The UK's IVA model offers negotiation between the parties, even though the negotiations are outside of the court but are backed by the legal provisions and in the end this process will avoid the stigma of bankruptcy. The PVA model offers debt repayment plan wherein the debtor - creditor enter into formal agreement. The US Code offers 'reorganisation proceedings' under chapter 11, which are out-of-court restructurings wherein it provides reorganisation of debtor's debts and assets and this prevents a business from permanently closing. The chapter 11 proceedings will be beneficial to non-corporate MSMEs in India, as large number of MSMEs fall in the non-corporate category and are often financed with a mixture of corporate and personal debt. The Canadian 'consumer' proposal of BIA provides for a streamlined summary process and DRBA also includes the streamlined summary rehabilitation procedures for SMEs, which can be adopted in case of individuals and partnerships firms with minimum debts. At this juncture, the authors opine that combination of 'consumer' proposal and chapter 11 of US Bankruptcy can be adopted in Indian scenario, which in the end will be able to rescue the MSMEs with minimum debt and prevent permanent closure of business.

Currently, the application of PPIRP framework under the Code is restricted to corporate MSMEs. Considering the need of the hour, the Government has played a highly visible role in the insolvency regime. However, we hope to see some rescue mechanism under IBC for the treatment of insolvency of non-corporate MSMEs. The practices in other jurisdiction with respect to non-corporate MSMEs, over all depicts that, the insolvency and bankruptcy laws of US, UK, Canada, Australia and Republic of Korea's focus is more towards, rehabilitation, negotiation, summary proceedings, debt restructuring and ultimately rescue the MSMEs from permanent closing and revive it to the normal mode of functioning. We are aware of the fact that in India, the second wave of COVID-19 is putting

a majority of small businesses in a precarious financial situation, pre-pack has emerged as a ray of hope for the MSMEs. Unfortunately, since large number of MSMEs which fall under the category of non-corporate entities are not benefited of pre-pack. Therefore, the authors are of the opinion that there is need for policy discourse on providing for a framework if possible, within the IBC, or otherwise to rescue non-corporate MSMEs.

NOTES

* *Author's would like to thank Dr. Anuradha Guru & Ms. Pihu Mishra for their inputs.*

¹ Annual Report, 2020-21, Ministry of Micro, Small and Medium Enterprises, Government of India.

² Mr. Nitin Gadakari, Hon'ble Minister of Road & Transport, speaking at the inaugural session of Three-day TiE Global Summit on December 12, 2020.

³ Subrahmanya M. H. B. (2021), "Breaking down COVID'S Impact on MSMEs: Demand, Supply shocks that are determining issues for small firms", *Financial Express*, 16 May.

⁴ Vaishnav A. and Surya S. (2020), "Definition of MSMEs", PRS Blog.

⁵ Sharma D. (2020), "MSMEs-New Definition and criterion notified; will come into effect from 1 July 2020", The SCC Online Blog, 3 June.

⁶ Report of the Expert Committee on Micro, Small and Medium Enterprises, June 25, 2019, Reserve Bank of India.

⁷ Supra Note 5

⁸ Supra Note 1

⁹ Supra Note 6

¹⁰ Annual Report, 2019-20, Ministry of Micro, Small and Medium Enterprises, Government of India.

¹¹ Misra U. (2020) "Explained: Why are Medium, Small, Micro Enterprises Worst hit by COVID-19 lockdown?", *The Indian Express*, 7 May.

¹² Mukherjee S. (2018), "Challenges to Indian micro, small scale and medium enterprises in the era of globalization", *Journal of Global Entrepreneurship Research*, Vol 8.

¹³ Supra Note 6

¹⁴ Batra S. (2017), "IBC & MSME Insolvency", *Legal Era*.

¹⁵ Gupta A. (2019), "Financial Stress & Insolvency Issues for MSMEs", *Virtual Law*.

¹⁶ Ranade A. (2020), "Small Business and the Insolvency Law", *Insolvency and Bankruptcy Regime in India- A Narrative*, pp. 257-263.

¹⁷ MSEFC isn't a judicial body and hence the awards passed during arbitration between the parties under Arbitration and Conciliation act will have to be enforced by a court of law.

¹⁸ Supra Note 16

¹⁹ Bhawsar A. (2020), "Decoding the Position of MSMEs under the IBC Regime", *The SignalX Blog*, 14 December.

²⁰ Banerjee V and Mehra G. (2018), "India: MSMEs & Insolvency and Bankruptcy Code", *Lex Witness*, Vol 10 (3), pp. 20-22.

²¹ Supra Note 19

²² D'Coasta V. and Ojha A. (2019), "Amendment in IBC qua MSMEs: East, Endrose and Ensure", *Mondaq*.

²³ Report by the Insolvency Law Committee, March, 2018.

- ²⁴ *Swiss Ribbons Pvt. Ltd. and Anr. v. Union of India and Ors*, (2019) 4 SCC 17.
- ²⁵ Tabassum S. and Fasi M. (2017), “Suitable Mechanism for Revival of Sick MSMEs”, *Journal of Rural and Industrial Development*, Vol 5 (1).
- ²⁶ *Ibid.*
- ²⁷ Supra Note 1
- ²⁸ Summary of announcements: Aatma Nirbhar Bharat Abhiyaan, PRS Legislative Research.
- ²⁹ Presentation made by Union Finance and Corporate Affairs Minister Smt. Nirmala Sitharaman under Aatmanirbhar Bharat Abhiyaan to support Indian economy in fight against COVID-19, Ministry of Finance, May 13, 2020.
- ³⁰ Supra Note 28
- ³¹ Anand N. (2020), “The IBC 2016 & MSMEs: What the future holds?”, *IBC Laws*.
- ³² Report on the Treatment of MSME Insolvency, (2017), World Bank Group.
- ³³ *Ibid.*
- ³⁴ Supra Note 14
- ³⁵ *Ibid.*
- ³⁶ Supra Note 32
- ³⁷ Supra Note 6
- ³⁸ Supra Note 15
- ³⁹ Ministry of Finance, Government of India, *Economic Survey 2020-21*, Vol II, pp. 37-38.
- ⁴⁰ Priya M. (2021), “Insolvency Amendment-Pre-Pack for MSMEs”, *Livelaw*, 09 April.
- ⁴¹ Prakash G. C. (2021), “Most MSMEs fall outside bankruptcy Code Ambit”, *Livemint*, 09 April.
- ⁴² Supra Note 1
- ⁴³ Supra Note 41
- ⁴⁴ *Ibid.*
- ⁴⁵ Report of the Sub-Committee of the Insolvency Law Commission on Pre-packaged Insolvency Resolution Process, October, 2020.
- ⁴⁶ “Insolvency in brief- A guide to insolvency terminology and procedure”, Price Waterhouse Coopers LLP.
- ⁴⁷ Sarra J. P. (2016), “Micro, Small and Medium Enterprises (MSME) insolvency in Canada”, *Allard Research Commons*.
- ⁴⁸ Sane R. (2015), “Personal Insolvency: Lessons from UK and Australia”, *The Leap Blog*, 28 December.
- ⁴⁹ Ramann S. et al. (2015), “Reforming personal insolvency law in India”, *Indira Gandhi Institute of Development Research*.
- ⁵⁰ Conway L. (2019), “Individual Voluntary Arrangements”, *House of Commons Library-Briefing Paper*.
- ⁵¹ Simon A., “Partnership Voluntary Arrangements”, *Company Debt*.
- ⁵² Smith R. J., “Company Administration (including Partnership Administration)”, *Richard J Smith and Company*.
- ⁵³ US Bankruptcy Code-Title 11 of the United States Code, *Corporate Finance Institute*.
- ⁵⁴ Supra Note 47
- ⁵⁵ Maverick J. B. (2020), “Chapter 11 vs. Chapter 13 Bankruptcy: What’s the difference?”, *Investopedia*.
- ⁵⁶ Epstein D. G. and Fuller C. (1985), “Chapters 11 and 13 of the Bankruptcy Code - Observations on Using Case Authority from One of the Chapters in Proceedings under the Other”, *Vanderbilt Law Review*, Vol 38, p. 902.
- ⁵⁷ Supra Note 55
- ⁵⁸ Part III Divisions II, *Bankruptcy and Insolvency Act, 1985*.
- ⁵⁹ Supra Note 47
- ⁶⁰ Australian Financial Security Authority.
- ⁶¹ *Bankruptcy Act 1966*, section 185C(4)(a).
- ⁶² Chen V. et al. (2018), “An evaluation of Debt Agreement in Australia”, *Monash University Law Review*, Vol 44 (1). pp. 152-153.

⁶³ Allen & Overy (2021), “Restructuring Across Borders”, England and Wales: Corporate restructuring and insolvency procedures.

⁶⁴ Park Y. (2003), “Unified Insolvency Law of Korea”, *Journal of Korean Law*, Vol.3 (2), pp.161-192.

⁶⁵ Rosha A. (2020), “Republic of Korea: Financial Sector Assessment Program-Technical Note-Insolvency and Creditor Rights”, International Monetary Fund.

⁶⁶ Secured debts may not exceed KRW 1 billion, and unsecured debt may not exceed KRW 500 million.

⁶⁷ A rehabilitation plan under the SRP may be adopted by unsecured creditors with the consent of either (i) creditors holding at least 2/3 of the value of unsecured claims; or (ii) creditors holding at least 1/2 of the value of unsecured claims and a majority of the persons with voting rights.

⁶⁸ Report of IBBI’s Working Group on Individual Insolvency (Regarding strategy and approach for implementation of the provisions of the Insolvency and Bankruptcy Code, 2016 to deal with the insolvency of Guarantors to Corporate Debtors and Individuals having business), 2017.

⁶⁹ *Ibid.*

⁷⁰ National Sample Survey (NSS) 73rd round, 2015-16, National Sample Survey Office, Ministry of Statistics & Programme Implementation.

⁷¹ Gurrea-Martinez A. (2020), “Implementing an Insolvency Framework for Micro and Small Firms”, Singapore Management University School of Law.

⁷² Bindra J. (2021), “The Jigsaw of Pre-Packaged Insolvency for MSMEs”, Taxguru.