LEGAL REFORMS IN THE MSME ECOSYSTEM

INSIGHTS AND WAY FORWARD

- Jointly Organised by -

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Government of India
Ministry of Micro, Small and Medium Enterprises

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MINISTRY OF LAW & JUSTICE
सत्यमेव जयते

Conference on

Legal Reforms in the MSME Ecosystem

Dr. Ambedkar International Centre

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Contents

Executive Summary

Micro, small and medium enterprises (MSME) act as the bedrock of economic development by generating employment, driving businesses and supply chains, creating wealth, fostering innovation, and promoting entrepreneurial spirit. These enterprises are not only economic entities but are also the agents of positive transformation, resilience, and advancement. Their role transcends financial metrics, significantly impacting communities and societies at large. The path to a USD 5 trillion economy goes through the MSME ecosystem indispensably and intricately.

The Micro, Small and Medium Enterprises Development Act, 2006 (hereinafter referred to as the "MSMED Act") was landmark legislation that laid the foundation for enabling the state to create frameworks, policies, regulations, and systems for small businesses in India, cutting across sectors and land boundaries. The MSMED Act was brought on the statute books "to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto."

The MSMED Act, enacted in 2006, was the first-ever legal framework for defining 'enterprise' and to categorize these entities into micro, small, and medium enterprises in both the manufacturing and service sectors. The Act provided for the creation of the National Board- an institutional mechanism for wide-ranging consultations with stakeholders-along with the constitution of funds for promotion, development, and enhancing the competitiveness of enterprises. The legislature envisioned a dedicated dispute resolution framework for resolution of delayed payments through an alternative dispute resolution mechanism.

Following an amendment to the Government of India (Allocation of Business) Rules, 1961, in 2007, the erstwhile Ministry of Small-Scale Industries and the Ministry of Agro and Rural Industries were merged to establish the Ministry of Micro, Small and Medium Enterprises (M/o MSME). The Ministry of MSME is instrumental in complementing and supporting the efforts of the state governments through policy design, scheme implementation, programmes, etc.

The Ministry of MSME has implemented a variety of schemes and initiatives focused on ensuring: i) adequate flow of credit from financial institutions and banks; ii) support for technological advancement and modernization; iii) integrated infrastructural facilities; iv) advanced testing facilities and quality certification; v) access to the latest management practices; vi) entrepreneurship development and skill enhancement through suitable training facilities; vii) support for product development, design intervention, and packaging; viii) the welfare of artisans and workers; ix) aid in improving access to domestic and export markets; and x) cluster-specific measures to foster capacity-building and empowerment of units and their collectives.

The Central Government has initiated significant reforms, notably the overhaul of the registration system through the introduction of Udyam, a no-cost online service designed for MSMEs. In addition, the classification of MSMEs has been made more thorough and inclusive by eliminating the distinction between manufacturing and service sectors and by creating a composite framework that utilizes both turnover and investment as key metrics. Furthermore, it has been mandated that the Ministries and Departments of the Central Government, along with the Central Public Sector Enterprises, must allocate 25% of their annual procurement budget to micro and small enterprises, with a specific requirement that 3% of this allocation is reserved for enterprises owned by women and 4% for those owned by members from Scheduled Castes and Scheduled Tribes.

Since the enactment of the MSMED Act in 2006, numerous pivotal developments have impacted the MSME ecosystem, resulting in a profound change in the operational practices of these enterprises. The establishment of the Goods and Services Tax (GST) system allows MSMEs to explore new and advanced solutions, including improved risk assessment for credit and the obligatory uploading of invoices onto electronic discounting platforms, such as the Trade Receivables Discounting System (TReDS).

Various legislative frameworks have been enacted to improve ease of business, such as the Limited Liability Partnership Act of 2008, the Companies Act of 2013, the Commercial Courts Act of 2015, the Insolvency and Bankruptcy Code of 2016, and the Mediation Act of 2023, all of which directly interface with MSMEs. In contrast, the MSMED Act of 2006 has remained unchanged and requires amendments to ensure its relevance in today's evolving business landscape.

The advent of advanced technologies such as artificial intelligence, machine learning, and blockchain can be utilized by the government to formulate new strategies addressing existing and forthcoming problems, for example, through smart manufacturing, energy-efficient production processes, and prototype development.

The COVID-19 pandemic has resulted in several significant and lasting impacts, particularly marked by a drastic reduction in demand and exports. The MSME ecosystem has been notably affected by these changes. Consequently, it is imperative to develop a robust legal, regulatory, and operational framework for MSMEs that can adequately respond to future pandemic-like disruptions and manage the persistent effects of the COVID-19 pandemic.

The business environment for Micro, Small, and Medium Enterprises (MSME) in India has witnessed a remarkable evolution. Nevertheless, the MSMED Act has remained unchanged for the past eighteen years. To better align the Act with the prevailing and emerging economic realities and to further enable the Central Government to develop effective solutions for the challenges faced by the ecosystem, it is imperative to bring reforms into the MSMED Act.

The thrust of the reforms in the MSMED Act will be focused on:

a. facilitating the promotion and development and enhancing the competitiveness of Micro, Small and Medium Enterprises;

b. enabling, aiding, encouraging, facilitating, handholding, promoting, developing, and protecting MSMEs for the purpose of fair, inclusive growth and instilling free entrepreneurial spirit;

c. enabling, facilitating, and strengthening the policies, programs, and guidelines to encourage innovation, enhance competitiveness, and embed sustainability of the MSMEs;

d. enabling the creation of institutional structures and framework to mitigate concurrent, future, and long-term challenges faced by MSMEs;

e. facilitating the government in enhancing the ease of starting, doing, growing, and closing business through vertical and horizontal integration of systems of state governments, municipal bodies, central government agencies, civil society, and the private sector;

f. making provisions for enabling an online dispute resolution mechanism to minimise the incidences of delayed payments and enhance the ease of doing business; and

g. decriminalising regulatory non-compliances to enhance the ease of doing business.

Accordingly, the reforms in the MSMED Act, 2006 will be driven with the objective of making the legislation more inclusive, comprehensive, and holistic in its scope and outlook.

This report emerges from the dialogues held during ***Udyami Bharat: Legal Reforms in the MSME Ecosystem,*** organized by the Ministry of Micro, Small and Medium Enterprises in collaboration with the Ministry of Law and Justice and National Law University Delhi. The focus of these discussions was on legal reforms and the reduction of litigation expenses for MSMEs. The report is a compilation of deliberations held, insights gained, and the way forward.

KEY ISSUES

The deliberations were held on the issues encapsulated hereinafter:

I. **Delayed Payments:** Delayed payments to micro and small enterprises adversely affect their working capital, hinder business growth, and threaten their operational continuity. The existing power disparity between these smaller enterprises and larger firms poses a notable challenge, as many are reluctant to engage in legal proceedings. Additionally, the prolonged resolution of disputes, coupled with the associated legal expenses, further hinders the prompt recovery of payments for small businesses.

II. **Exponential Litigation Cost:** The enforcement of contracts and the recovery of outstanding payments by micro and small enterprises incur significant litigation expenses. This further exacerbates the challenges posed by delayed payments that these businesses already face. The financial strain of additional litigation costs obstructs small enterprises' pursuit of justice. Discussions have highlighted the necessity to tackle the exponential litigation costs faced by MSEs through appropriate policy and legal interventions, ensuring that justice is accessible and affordable.

III. **Capacity Building:** The discussions underscored the importance of enhancing the capabilities of Facilitation Councils and various stakeholders to address challenges related to arbitral awards and to facilitate quicker dispute resolution.

IV. **Challenges to Arbitral Awards:** Prolonged challenges to the arbitral awards under Sections 34 and 37 of the Arbitration and Conciliation Act of 1996 and further appeals in courts result in substantial delays in the resolution of delayed payments of micro and small enterprises. The protracted legal battles disproportionately benefit lawyers and increase financial burden due to litigation costs.

V. **Enforcement of Arbitral Awards:** Despite obtaining a favourable arbitral award, entrepreneurs have to seek court intervention for enforcement, leading to further challenges and delays. The deliberations emphasised that unless the execution of awards is expedited, they will be reduced to mere 'paper decrees.'

VI. **Compliance Burden:** The discussions highlighted the compliance challenges faced by MSMEs, which adversely affect their productivity and increase their costs due to the numerous regulatory requirements imposed by various government departments and agencies.

VII. **Knowledge Gap:** There exists a significant lack of awareness among Micro and Small Enterprises regarding the beneficial provisions of the MSMED Act, 2006, which offers a specialized framework for the recovery of dues owed to them. This lack of knowledge frequently leads MSEs to seek legal recourse through the courts, a process that is typically more formal and expensive.

VIII. **Challenges in the I&B Code, 2006 for MSMEs:** Micro, small, and medium enterprises face significant challenges as operational creditors when insolvency proceedings are initiated against their clients. In many instances, they are unable to recover outstanding payments, which may lead them to enter the insolvency process as corporate debtors. While Section 240A of the I&B Code of 2016 provides some relief, this option is rendered inaccessible if the MSME is identified as a willful defaulter or is facing allegations of fraud.

IX. **Exclusion of Medium Enterprises:** The deliberations highlighted the need for the inclusion of medium enterprises for the beneficial provisions of Chapter V of the MSMED Act, 2006.

X. **Lack of a centralized MSME database:** The conference underscored the necessity of creating a centralized database for MSME units, aimed at aiding foreign investors and importers in locating local MSME partners.

KEY RECOMMENDATIONS

The deliberations have delineated the way forward as summarized below:

I. **Developing Micro Enterprises:** The Hon'ble Union Minister for MSME highlighted the importance of sustainable development for micro enterprises and underscored the necessity of conducting 'Micro sector-specific studies' to gain insights into their challenges and concerns, thereby facilitating a timely and precise policy approach.

II. **Building a Gender-Inclusive MSME Ecosystem:** The Hon'ble Union Minister of State (MSME) highlighted the necessity of developing gender-inclusive MSMEs to enhance and promote women's entrepreneurship in India. Furthermore, she suggested the formulation of women-centric programs and schemes aimed at addressing the specific needs of female entrepreneurs across the country.

III. **Mediation as a panacea to prolonged and costly litigation:** The introduction of the Mediation Act of 2023 signifies a transition from conciliation to mediation, which is required to be finalized within a period of 120 days, with the possibility of a 60-day extension. This timely approach to dispute resolution, facilitated by skilled mediation service providers and supported by the Mediation Council's cost-effective measures, will enhance access to justice for Micro, Small, and Medium Enterprises. Furthermore, the alignment of the Mediation Act of 2023, with the MSMED Act of 2006, is expected to optimize the mediation framework, leading to quicker, more affordable, and definitive resolutions of disputes. The establishment of structured timelines and the formalization of processes under the new Act marks a significant improvement over the previous ad hoc conciliation practices, thereby facilitating quicker dispute resolution and lessening the financial burden on MSMEs.

IV. **Institutional Mediation and Arbitration:** A divergent view emerged regarding the conduct of institutional mediation and arbitration. Some stakeholders have emphasized the role of Facilitation Councils in dispute resolution, highlighting lower litigation costs for micro and small enterprises. Conversely, others advocated that mediation and arbitration be conducted by experienced neutrals to ensure: (i) superior quality of arbitral awards; (ii) systematic arbitration processes; (iii) reduced interference from the courts; and (iv) heightened efficiency.

V. **Reduction in Litigation Cost:** Several measures were proposed to reduce the litigation cost for MSMEs. Among these, a recommendation was made to impose a limit on arbitration fees for MSME-related disputes through an amendment in the MSMED Act to address the affordability issue. Furthermore, it was suggested that legal aid be extended to these businesses to help lessen the financial burden of litigation.

VI. **Time-bound Arbitration Proceedings:** Delays in the appointment of arbitrators coupled with protracted arbitration proceedings result in escalating costs. A recommendation was made to establish a dedicated panel of arbitrators that would ensure proceedings are carried out within a specified timeframe. This would assist businesses in efficiently recovering delayed payments.

VII. **Imposition of Penalty:** The panel has recommended the introduction of penal provisions under the MSMED Act of 2006 to discourage frivolous challenges to arbitration awards that seek to delay the payment of dues to MSMEs. A suggestion includes the introduction of penalties similar to those outlined in the Negotiable Instruments Act.

VIII. **Online Dispute Resolution for resolution of delayed payment cases:** The integration of technology into the dispute resolution process is likely to facilitate speedier and more cost-effective resolution of delayed payment disputes. The panellists suggested enhancing the Samadhaan Portal to create a robust platform dedicated to resolving MSME claims, which could significantly minimize both delays and associated costs. Furthermore, this initiative would enhance access to justice.

IX. **Enforcement of Arbitral Awards:** Timely enforcement of arbitral awards will help MSMEs realize the fruits of arbitral awards, thereby enhancing the 'ease of doing business'. The panelists highlighted the necessity of a dedicated enforcement mechanism to ensure the rapid execution of arbitral awards. Additionally, a suggestion was made to consider the framework outlined in Schedule II of the Income Tax Act, which provides a streamlined process for recovery.

X. **Intersection between the I&B Code and MSME:** It has been suggested that MSMEs be designated as a separate class of operational creditors under the Insolvency and Bankruptcy Code. The recommendation also includes the classification of dues owed to MSMEs as statutory dues. Furthermore, it has been proposed that the voting threshold for secured lenders and the Committee of Creditors (CoC) in the pre-packaged insolvency process be reduced from the existing 66% to 50%.

XI. **Decriminalisation of Section 27 of the MSMED Act:** It has been suggested that Section 27 of the MSMED Act of 2006 should be decriminalised to improve the Ease of Doing Business. Section 27 imposes criminal punishment of fines in case of regulatory non-compliances, which can be addressed through civil penalties.

XII. **Legal Helpdesk:** MSMEs possess insufficient understanding of their legal rights and liabilities. Establishing a legal helpdesk within an institutional framework can enhance the legal capacity of these enterprises, thereby increasing awareness of their rights.

XIII. **Reducing Compliance Burden:** The establishment of a single-window compliance mechanism for micro, small, and medium enterprises can significantly alleviate the compliance burden faced by them. This initiative will not only improve the 'Ease of Doing Business' but also lower the expenses associated with regulatory compliance.

XIV. **Central Regulatory and Supervisory Board:** A suggestion was made to constitute a statutory board responsible for developing a database concerning delayed payments and for strengthening the capacity of the Facilitation Councils.

XV. **Training of Facilitation Councils:** Timely and comprehensive training for Facilitation Councils in legal processes can improve the quality of arbitration orders and awards, thereby lessening the likelihood of challenges in courts. It can also contribute to lowering litigation expenses and expediting the resolution of delayed payment disputes faced by MSMEs.

XVI. **Partnering with Academic and Research Institutions:** Academic institutions and research organizations can play a pivotal role in implementing legal awareness programs designed to enhance understanding of the legal rights and schemes available to MSMEs.

XVII. **MSME Integration into the Global Value Chain:** The idea has been put forward to create a database aimed at offering information about competitive MSMEs to foreign investors and enterprises in search of export collaboration.

Address By Guest of Honour

Shri Jitan Ram Manjhi,
Union Minister (MSME)

The six pillars of growth will foster the next round of development in the sector which are: formalisation and access to credit, increased access to market and e-commerce adoption, increased productivity through modern technology, enhancing skill levels and digitalisation in the service sector, support to khadi, rural and coir industries, and empowerment of women and artisans through enterprise creation.

Shri Jitan Ram Manjhi, the Hon'ble Union Minister of MSME, stated that the amendment to the MSME Development Act of 2006 aims to more effectively meet the changing requirements of the sector while improving and fortifying the dispute resolution process concerning delayed payments. He also mentioned that the Ministry intends to upgrade the Samadhaan Portal, which is presently utilized for resolving disputes related to delayed payments to Micro and Small Enterprises, into a comprehensive online resolution platform.

The Hon'ble Minister underscored the significance of prioritizing microenterprises in rural areas as a means to enhance the quality of life and tackle unemployment challenges. He highlighted that 70% of the rural populace resides below the poverty line, with 90 to 95% struggling to subsist on minimal incomes. Shri Manjhi praised the Hon'ble Prime Minister for his understanding of the issue and his dedication to fostering the growth of micro-industries. He delineated the six priority areas of the Ministry:

1. **Formalisation and Access to Credit:** Ensuring MSMEs have access to necessary financial resources.
2. **Increased Access to Market and E-commerce Adoption:** Helping MSMEs leverage digital platforms to expand their market reach.
3. **Increased Productivity through Modern Technology:** Promoting the use of advanced technologies to boost efficiency and productivity.

4. **Enhancing Skill Levels and Digitalisation in the Service Sector:** Upskilling workers and integrating digital tools in services.
5. **Support to Khadi, Rural, and Coir Industries:** Providing targeted assistance to traditional and rural industries.
6. **Empowerment of Women and Artisans Through Enterprise Creation:** Encouraging entrepreneurship among women and artisans, particularly in Tier-2 and Tier-3 cities.

The Hon'ble Minister launched the Trade Enablement & Marketing (TEAM) Initiative, which seeks to integrate five lakh micro and small enterprises (MSE) into the Open Network of Digital Commerce (ONDC) to facilitate their access to the digital marketplace. With a financial allocation of Rs. 277 crore to be utilized over the next three years, this initiative will support MSEs in areas such as cataloguing, account management, logistics, and packaging.

Shri Jitan Ram Manjhi also pointed out the significant strides made in the formalization of micro, small, and medium enterprises, with more than 1.1 crore new UDYAM registrations and 1.73 crore informal micro-enterprises now recognized within the formal sector. He highlighted the importance of raising awareness among rural populations regarding the Act and the need to incorporate their economic, social, and cultural requirements into policy development.

Furthermore, he reiterated the government's commitment to supporting remote MSMEs in enhancing product quality and addressing unemployment challenges. The Hon'ble Minister concluded his remarks by emphasizing the transformative potential of converting informal skilled industries into formal ones through collaborative partnerships, aiming to establish India as a global business hub.

Address By Guest of Honour

Sh. Arjun Ram Meghwal,
Union Minister of State (I/C)
Law & Justice)

It is imperative to undertake reforms to facilitate the 'ease of doing business' and the 'ease of living' through the introduction of legal reforms and the adoption of technological innovations that will strengthen micro, small, and medium enterprises.

Shri Arjun Ram Meghwal, the Hon'ble Union Minister of State (I/ C) Law and Justice, addressed the topic of legal reforms within the MSME Sector, highlighting its significant contribution to industrial advancement, GDP enhancement, and export growth. He stressed the importance of keeping pace with technological innovations as the world transitions into the era of Industry 4.0 and artificial intelligence. The Minister emphasized that the integration of advanced technologies, including robotics and 3-D printing, into business operations is essential for positioning India as the third-largest economy globally.

The Minister emphasized the significance of alternative dispute resolution for micro, small, and medium enterprises and acknowledged the efforts of the India International Arbitration Centre (IIAC) in advancing this initiative. In his concluding address, the Minister noted the removal of over 1,500 minor offenses from the legal system and the passage of three new criminal laws, which aim to establish a just and equitable society that treats all members fairly. Shri Meghwal additionally advocated for the decriminalization of offenses that significantly influence the ease of living and business environment.

Address By Guest of Honour

Sushri Shobha Karandlaje
Union Minister of State
(MSME)

The role of MSMEs in the nation's employment, manufacturing production, and export activities is substantial. To maintain their competitive edge, MSMEs should concentrate on fostering innovation, creativity, and sustainable development practices.

Sushri Shobha Karandlaje, the Hon'ble Union Minister of State (MSME), addressed the august gathering, representing twenty crore citizens from the MSME sector, which extends its reach to the most remote areas of India. She articulated the vital role of MSMEs in establishing India as the third largest economy and in fulfilling the Prime Minister's vision of Viksit Bharat 2047. Furthermore, she underscored that the development of the MSME sector aligns with one of the United Nations' sustainable development goals, to which the Government of India is fully committed. In her address, Sushri Shobha Karandlaje emphasized the importance of marketing and advertising, indicating that robust brand development will position MSMEs as significant players in the global export market.

During her address, the Hon'ble Minister stressed the importance of women entrepreneurs, who constitute more than 35% of all MSME entrepreneurs. She reaffirmed that the income generated by women is typically invested in the welfare of their families. The Minister also pointed out the untapped potential of the khadi and coir industries. Moreover, she discussed the Vishwakarma Scheme launched by the Ministry, which offers technological support and machinery to traditional artisans and craftspeople.

Address by Secretary, Ministry of MSME

Shri S.C.L. Das
Secretary, MSME

The ecosystem of MSMEs should advance towards integration with the global value chain. The government's role is to prioritize the essential needs for financing, technological support, market accessibility, and training initiatives. These initiatives should be undertaken through a cooperative federalism approach, which includes collaboration with civil society, various ministries, industry associations, and, importantly, the state governments and their institutions, to improve the ease of conducting business in India.

Shri S.C.L. Das, the Secretary of the Ministry of Micro, Small and Medium Enterprises (MSME), initiated his address by recognizing the pivotal role of MSMEs, which contributes 30% to the Indian GDP and ranks as the second largest employer after agriculture. He acknowledged the sector's contribution of 30% to the overall GST collection and paid tribute to the tireless efforts of MSMEs in shaping the developmental landscape of various economies. He underscored the vital role of MSMEs in fulfilling the national vision of Viksit Bharat, as espoused by the Hon'ble Prime Minister.

Shri Das noted the necessity for MSMEs to integrate into the global value chain, highlighting the government's role in addressing the needs for financial resources, technological support, and training assistance. He reiterated that these strategies would be implemented through a framework of cooperative federalism, involving civil society, industry associations, and, most importantly, state governments and their institutions to facilitate a more conducive business environment in India. In his closing remarks, Shri Das reaffirmed the government's commitment, in conjunction with state governments, industry, and other stakeholders, to empower MSMEs for transforming India into a Viksit Bharat and an economic powerhouse.

Address by Secretary, Ministry of Law & Justice

Dr. Rajiv Mani
Secretary, Law & Justice

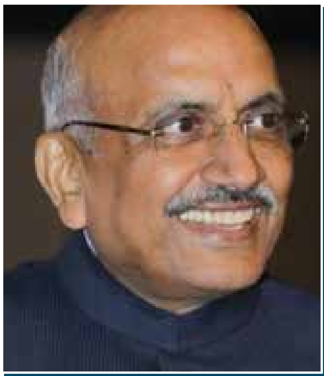
The enactment of the Commercial Courts Act of 2015 and the Indian International Arbitration Centre Act of 2019 has established specialised infrastructure and judicial resources tailored to address the requirements of conflict resolution, thereby expediting the resolution of commercial disputes. Moreover, the recent introduction of mediation mechanisms under the MSMED Act, coupled with arbitration regulations for MSMEs, seeks to enhance clarity and ensure timely resolutions.

Dr. Rajiv Mani, the Secretary of the Ministry of Law and Justice, commenced his address by highlighting the significant role of micro, small, and medium enterprises in the Indian economy. He emphasized the necessity of establishing a supportive legal framework to empower entrepreneurs, which is essential for promoting innovation and improving competitiveness within the MSME sector. During his address, Dr. Mani outlined two primary focus areas: (i) credit guarantee schemes; and (ii) cluster development programs, aimed at boosting the productivity of MSMEs. Additionally, he discussed the landscape of start-ups, emphasizing the role of investments and government initiatives, and noted that the total number of recognized start-ups has surpassed 98,000 as of the previous year.

Dr. Mani succinctly discussed the Commercial Courts Act of 2015 and the Indian International Arbitration Centre Act of 2019, which have created specialized infrastructure and judicial personnel to facilitate conflict resolution. He indicated that the enactment of these laws has accelerated the resolution of commercial disputes.

In discussing recent legislative developments, Dr. Mani elaborated on the introduction of mediation in the framework of the MSME Development Act of 2006 and the IIAC Arbitration Regulations for MSMEs, which seek to eliminate uncertainties regarding timely resolutions. He also emphasized the importance of the Digital India Bhashini Division, which facilitates the translation of legal pleadings into regional languages and promotes technological advancement. Dr. Mani praised the comprehensive consultative efforts of the Ministry of MSME in fostering innovative concepts to promote an MSME-driven economy.

Address by Chairperson, IIAC



Hon'ble Justice (Retd.)
Hemant Gupta
Chairperson, IIAC

The IIAC signifies a commitment to positioning India as a prominent center for institutional arbitration, with an outreach that spans the entire country rather than being confined to specific cities. Key attributes include the provision for parties to argue in vernacular languages, which fosters diversity in the dispute resolution process, alongside the removal of filing and advocate fees. While the MSMED Act supports statutory arbitration, it is crucial to explore ways to enhance the party-centric nature of the process.

Hon'ble Justice (Retd.) Hemant Gupta, the Chairperson of the India International Arbitration Centre, commenced his address by acknowledging the vital contributions of micro, small, and medium enterprises. He pointed out that MSMEs are often subjected to delays in receiving payments, which can sometimes extend over prolonged periods. Justice Gupta outlined the various types of disputes prevalent in the MSME sector and asserted that cases unresolved within one hundred and twenty (120) days should be directed towards arbitration to facilitate a stress-free operation for MSME units and to prevent further delays. He also brought attention to a discrepancy within the MSMED Act, which permits the Facilitation Council to function as both an arbitrator and mediator, while Section 17 of the Mediation Act prohibits a mediator from serving as an arbitrator. He suggested that this inconsistency could be rectified through a legislative amendment.

He highlighted the recent notification regarding IIAC Regulations that govern arbitration for claims made by MSMEs. He stated that the IIAC represents the goal of positioning India as a prominent hub for institutional arbitration, with an outreach that is not confined to metropolitan areas but spans the entire country. Furthermore, while addressing the need to strengthen the enforcement mechanism, he recommended exploring a procedure similar to that outlined in the Second Schedule of the Income Tax Act. He concluded his remarks by advocating for a more party-centric approach within the provisions of the MSMED Act.

Background Note

The Micro, Small, and Medium Enterprises (MSME) ecosystem is one of the significant contributors to the country's economic and social development. To ensure the continuous growth of MSMEs, the Parliament enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, with the objective of facilitating the promotion and development and enhancing the competitiveness of micro, small, and medium enterprises for matters connected therewith or incidental to it. The legislation enabled the government to classify the enterprises into micro, small, and medium so as to develop and implement various targeted policies and programmes for their growth, the constitution of the National Board for targeted policy interventions from time to time, and the establishment of a special forum for the resolution of delayed payments to micro and small enterprises.

The Central Government carried out key reforms, such as

(i) Easy and streamlined system of registration under the Act, Udyam, which is online and free,

(ii) Composite criteria for defining the manufacturing and services sector, based on investment and turnover, and

(iii) Mandatory procurement from micro and small enterprises, thus providing an impetus for their sustained development.

Despite being progressive legislation, the MSMED Act of 2006 is not reflective of the transformation brought by the economic and technological growth since the enactment of the Act, nor is it reflective of the challenges brought by the COVID-19 pandemic (2020-2022). In the interregnum, the Goods and Services Tax (2016) regime was introduced, which can be leveraged to provide solutions such as risk assessment for credit and mandatory uploading of invoices on electronic discounting platforms. The various statutes – the Limited Liability Partnership Act, 2008; the Companies Act, 2013; the Commercial Courts Act, 2015; the Insolvency and Bankruptcy Code, 2016; and the Mediation Act, 2023 - were introduced to promote the ease of doing business interface with the MSME ecosystem and hence, the MSMED Act.

Technology has changed the business landscape altogether in the last decade. Disruptive technologies such as artificial intelligence/ machine learning, blockchain, IoT, and robotics can provide businesses with opportunities to gain a competitive edge in domestic and international markets. Therefore, the government must use these technologies to design customised sector-specific solutions for the existing and emerging challenges faced by MSMEs.

Presently, the MSMED Act of 2006 does not reflect the changes enumerated above and hence requires amendments to align it with other legislative and current and emerging economic and technological changes. The MSMED Act needs amendment to effectively empower the government to deal with the conventional and evolving challenges through innovative and novel solutions.

The panel discussions during the event focused on amending the MSMED Act of 2006 on the following fronts:

(i) **Enhancing inclusivity and broadening the scope of the Act:** The panel discussed the widening of the scope of Chapter V of the Act for the inclusion of medium enterprises. The discussion also centred around the inclusion of the autonomous institutions of the Central Government for the preferential procurement policy as well as empowerment of the Central Government and appropriate authorities to take policy measures that promote entrepreneurship through MSMEs among women and members of the Scheduled Castes and Scheduled Tribes.

(ii) **Future-proofing the Act:** The panel deliberated on future-proofing the MSMED Act of 2006 by empowering the Central Government to frame programmes, policies, guidelines, directions, advisories, or instructions regarding enhancing access to finance, technology, market, exports, ease of business, development of physical and digital infrastructure, promotion of sustainability, and skill development. The bill may also empower the Central Government to timely respond to the legislations and regulations that impact the MSME ecosystem.

(iii) **Improving coordination under the Act:** The promotion and development of the MSME ecosystem requires close inter-ministerial and centre-state coordination. The discussions stressed on bringing them under a common umbrella for the purpose of developing programmes, policies, guidelines, directions, advisories, rules, regulations, or instructions for the MSME sector. Further, the panel suggested the enlargement of the functions of the Board to enhance Centre-Centre and Centre- State coordination, formalisation of the enterprises, ease of doing business, opportunities for investments including green investments, etc.

(iv) **Enhancing the ease of business in the ecosystem:** The discussions suggested that the enterprises may be protected from fluctuation during upward transition by enabling the enterprises to enjoy benefits under the Act during the transition period. It was also proposed that criminal penalties under the Act be decriminalised to enhance the ease of doing business.

As the stakeholders' consultations are under way for the amendment of the MSMED Act, 2006, this event provided a unique opportunity to deliberate upon the legal reforms required in the MSMED Act, 2006 to accelerate the growth and development of the MSME enterprises. The conference was comprised of four sessions to identify the reform areas and potential solutions.

Session 1: Reducing the cost of litigation for MSMEs

One of the constraints in the recovery of delayed payments is litigation cost. The micro and small enterprises, already burdened by the financial stress, have to bear the further cost of litigation. The said costs get exacerbated by the time taken in litigation. Even after the pronouncement of arbitral awards, the enterprises remain stuck in courts either during the appellate or execution proceedings. The proposed session aims to discuss the impact of the cost of litigation on enterprises, how the Mediation Act can reduce the time and cost involved in the legal proceedings, challenges involved in the arbitration proceedings, particularly with respect to Sections 34 and 37 of the Arbitration and Conciliation Act, challenges in enforcement of arbitration awards, and the intersection between the Insolvency and Bankruptcy Code, 2016 and the MSMED Act, 2006.

Session 2: India International Arbitration Centre (Conduct of Micro, Small and Medium Enterprises Arbitration) Regulations, 2024

The India International Arbitration Centre (IIAC) has been established by the India International Arbitration Centre Act - a statute promulgated by the Parliament of India. This enactment aims to create an independent and autonomous regime for institutional arbitration. The institution has notified the regulations for arbitration under the MSMED Act of 2006, for effective and speedy dispute resolution. A brief presentation on the said regulations will raise awareness and understanding amongst the stakeholders for effective and speedy conduct of arbitration.

Session 3: Use of Bhashini’s Artificial Intelligence (AI) Software for conduct of MS Earbitration under the aegis of IIAC

This session aims to provide an overview of the AI software developed by Bhashini. This software will be useful for conducting MSE arbitration under the aegis of IIAC, translating documents from one language to another, etc.

Session 4: Legal Reforms in the MSMED Act, 2006 (1 hour)

This session aims to steer a comprehensive discussion on the present legal framework under the MSMED Act of 2006, the challenges thrown by the economic, legal, and technological changes that have happened since the enactment of the MSMED Act, and the reforms needed in the MSMED Act to deal with the traditional challenges faced by the enterprises as well as the emerging and future challenges. The session will also discuss the substantive and procedural legal reforms needed in the Act for the coordinated, synergised, and holistic development of the MSME ecosystem, thereby adopting the ‘whole-of-government’ approach. The panellists will also share their expert views on the systemic, operational, and substantive reforms needed in the MSMED Act.

SESSION 1:
REDUCING THE COST OF LITIGATION FOR MSMEs

PANELISTS

1. Shri Avnit Singh Arora, Director, Department of Legal Affairs, Ministry of Law and Justice.
2. Shri Kirti Uppal, Senior Advocate.
3. Ms. Purti Gupta, Advocate-On-Record, Supreme Court of India.
4. Dr. Prem Chand, Assistant Professor of Law, National Law University, Delhi.
5. Shri Vinod Kumar, President, India SME Forum.

MODERATOR

Ms. Radhika Bishwajit Dubey, Central Government Standing Counsel.

The panel discussion began by highlighting a critical issue: Micro, Small, and Medium Enterprises (MSME) are facing prolonged litigation periods that intensify their financial difficulties. In light of this, what legislative reforms could be introduced to reduce their litigation expenses, and how might the Mediation Act of 2023 contribute to effectively decreasing these costs? It holds great significance, as the time and financial resources expended by MSMEs in resolving disputes are considerable. The panellists deliberated on how legislative modifications could lessen litigation expenses for MSMEs and the beneficial role of mediation in this regard.

ALTERNATIVE DISPUTE RESOLUTION MECHANISM FOR MSMEs

Shri Avnit Singh

Recognised ADR institutions should handle arbitration rather than relying solely upon the Facilitation Councils, as it would ensure higher quality and more structured arbitration processes, reducing court involvement and improving efficiency.

Shri Avnit Singh Arora, Director of the Department of Legal Affairs, Ministry of Law & Justice, provided an in-depth analysis of the current dispute resolution framework established by the MSMED Act of 2006. Section 18 of this Act stipulates that the Facilitation Council must initiate conciliation proceedings upon receiving a reference.

Upon the termination of these proceedings, the Council is required to refer the matter to arbitration. The MSMED Act of 2006 enforces statutory conciliation and arbitration to facilitate a more efficient dispute resolution process for micro and small enterprises. The introduction of the Mediation Act of 2023 subsumes the concept of conciliation into mediation, and as this new Act amends the MSMED Act, mediation under the MSMED Act of 2006 will henceforth be governed by the provisions of the Mediation Act of 2023 once the latter is notified.

The Mediation Act of 2023 has significantly redefined the approach to ad hoc conciliation by establishing a framework for institutional mediation to be carried out by Mediation Service Providers. This legislation has also set a statutory timeframe for the mediation process, typically lasting one hundred and twenty (120) days, with the possibility of a further extension of sixty (60) days. Consequently, it facilitates a timely resolution of disputes through mediation. Further, Section 25 of the Mediation Act of 2023, mandates that the Mediation Council of India determine the costs associated with mediation. This provision allows the Council to establish reduced mediation costs specifically for micro and small enterprises. Thus, the linkages between the Mediation Act of 2023 and the MSMED Act of 2006 are aimed at creating a structured framework for mediation that is both time-efficient and cost-effective for MSEs, thereby enhancing affordability and accessibility. Shri Singh highlighted that these reforms are intended to expedite the dispute resolution process and reduce the financial burden on MSEs.

Shri Singh also highlighted that the Mediation Institute under the Mediation Act of 2023 can develop and train mediators in the nuances of the MSME ecosystem to enable them to resolve the disputes of the MSMEs more effectively. He recommended that Facilitation Councils be encouraged to refer matters to arbitral institutions for the resolution of disputes to ensure: (i) better quality of arbitral awards; (ii) structured arbitration proceedings; (iii) reducing court interference; and (iv) improving efficiency.


Shri Kirti Uppal

While sections 34 and 37 of the Arbitration and Conciliation Act provide mechanisms to challenge and appeal against arbitration awards, they often lead to prolonged legal battles that disproportionately benefit lawyers. Avoiding lengthy litigation is the key, as it only serves to enrich legal professionals while burdening the litigants.

On addressing the challenges posed by Sections 34 and 37 of the Arbitration and Conciliation Act, 1996, **Shri Kirti Uppal, Senior Advocate,** underscored the need to minimise court interference in the arbitral awards. He argued that while these sections provide mechanisms to challenge and appeal against arbitration awards, they often lead to prolonged legal battles that disproportionately benefit lawyers. Shri Uppal advised that avoiding lengthy litigation is the key, as it only serves to enrich legal professionals while burdening the litigants.

He emphasized that during mediation, the mediators should lay down the actual cost of litigation before the parties. Even after the passing of arbitral awards, the parties remain stuck in courts for years as the enforcement mechanism is again a timely process. Thus, awareness may be generated amongst MSMEs to resolve their disputes in mediation to avoid lengthy and time-consuming court proceedings. Shri Uppal promoted the settlement of matters even during arbitration and post-arbitration proceedings for faster recovery and better returns for MSMEs. Conversely, he suggested that arbitration processes must be more time-bound and cost-effective to truly benefit MSMEs.

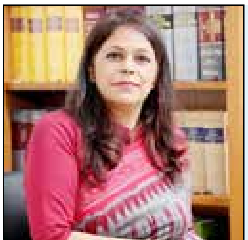
Shri Vinod

The Samadhan Portal can be developed into a comprehensive platform for dispute resolution, and all MSME-related orders and decisions should be consolidated to improve accessibility. The introduction of online dispute resolution for MSEs at district level would fasten up dispute resolution under the MSMED Act. There is a need for the introduction of a specialised enforcement mechanism under the MSMED Act for speedier recovery of delayed payments.

Shri Vinod Kumar, President of the India SME Forum, highlighted the challenges faced by unincorporated and incorporated MSMEs and stated that even less than one percent of the enterprises pursue a legal recourse in case of delayed payments due to limited resources. He advocated for establishing the online dispute resolution mechanism at the district level to allow legal recourse to the maximum number of MSMEs in case of delayed payments. He emphasised that it would make the dispute resolution process more accessible and less costly for MSMEs.

Shri Kumar discussed the potential amendments to the MSME Development Act, emphasising the need for a robust Samadhaan Portal. He proposed that (i) the portal be developed into an all-encompassing platform for dispute resolution, and (ii) all orders and decisions pertinent to MSMEs be consolidated to improve both accessibility and transparency for stakeholders. Moreover, Shri Kumar pointed out the necessity of providing legal training to Facilitation Councils to enhance the quality of arbitration orders and awards, thereby reducing the incidence of challenges to these awards in the legal system. This strategy could effectively diminish litigation costs and mitigate delays in resolving payment disputes involving MSMEs.

He also stated that mediation is the need of the hour and serves as an effective means to resolve disputes related to MSMEs at a lower expense. Once mediation concludes a dispute, the resolution is final and cannot be contested, underscoring the necessity of addressing more disputes at this stage to bring litigation to a definitive end. He further advocated for the government to create mediation centers to promote quicker and more cost-effective dispute resolution. In conclusion, he observed that even after arbitration awards are passed, parties often remain in court for prolonged periods due to the lack of a specialized enforcement mechanism for awards. Thus, he recommended that the amendment should propose a specialized enforcement mechanism to facilitate quicker recovery of MSME dues.


Ms. Purti Gupta

A dedicated panel of arbitrators to conduct MSE arbitrations, capping on arbitrators' fees for MSE disputes and introduction of penal provisions in the form of costs to discourage frivolous legal challenges to awards would assist in resolving MSE disputes in time-bound manner and at lesser cost.

Ms. Purti Gupta, Advocate-on-Record, Supreme Court of India, contributed further to the discussion by noting that the composition of the Facilitation Councils consists of representatives from industry associations, banks, and financial institutions. She expressed concern that changes in these members prior to the conclusion of the mediation process could disrupt proceedings and lead to frustration among MSMEs. Therefore, it is essential that the mediation process, whether conducted by the Facilitation Councils or Mediation Service Providers, is carried out by the same individuals to ensure clarity and consistency throughout. Ms. Gupta commended the mandatory and time-sensitive mediation process outlined in the Mediation Act of 2023, asserting that it would significantly enhance the 'ease of doing business.'

Ms. Gupta highlighted that the protracted process of appointing arbitrators under the MSMED Act, coupled with the frequent extensions granted for arbitration timelines, places MSMEs at a significant disadvantage. In light of this, she proposed the formation of a dedicated panel of arbitrators specifically for MSE arbitrations and suggested imposing a cap on the fees charged by arbitrators for resolving disputes involving MSEs under the MSMED Act of 2006. Additionally, to reduce the incidence of challenges to arbitral awards, she advocated for the introduction of penal provisions in the form of costs aimed at discouraging unnecessary and frivolous legal challenges as outlined in Sections 34 and 37 of the Arbitration and Conciliation Act of 1996.

INTERSECTION BETWEEN THE I&B CODE OF 2016 AND THE MSMED ACT OF 2006

Ms. Purti Gupta

There is a dire need for recognizing MSMEs as a distinct class of creditors and easing the process for submission of resolution plans for MSME enterprises under the I&B Code. The voting threshold under the pre-packaged insolvency process may be lowered from the current 66% to 50% for faster resolution and preservation of asset value.

Ms. Purti Gupta delineated the challenges faced by the MSMEs in the event of the initiation of Corporate Insolvency Resolution Process (CIRP) against a big corporate. The intersection of the Insolvency and Bankruptcy Code (I&B Code) and Micro, Small, and Medium Enterprises presents several challenges. When a large enterprise undergoes insolvency and bankruptcy proceedings, it often adversely affects small enterprises that are its suppliers or service providers. These MSMEs, classified as operational creditors, find themselves trapped in the corporate insolvency resolution process without any representation in the Committee of Creditors. Consequently, they struggle to recover their dues. This situation creates a vicious cycle where MSMEs, unable to recover their money, become the next entities to enter the IBC process. While Section 240A of the I&B Code provides some relief by allowing MSMEs to reclaim their entities, this option is closed if the MSME is deemed a willful defaulter or faces fraud allegations. Thus, MSMEs often find themselves in a precarious position, unable to bid for their own entities despite being the most invested in their growth and success.

To encapsulate, the current framework under the Insolvency and Bankruptcy Code, 2016 poses several challenges:

a. MSMEs acting as operational creditors often receive minimal or no compensation in the insolvency process involving larger corporations.

b. MSMEs risk being classified as defaulters, even when they have legitimate justifications for non-payment, as a result of their engagements with insolvent large enterprises.

c. Section 29A of the IBC, despite the concessions made for MSMEs under Section 240A, continues to hinder these entities in their efforts to propose resolution plans for their businesses.

To address these challenges, she suggested the following legal reforms:

a. MSMEs should be classified as a separate group of operational creditors in IBC proceedings, similar to the classification of homebuyers, to ensure their interests are adequately protected.

b. The Insolvency and Bankruptcy Code of 2016 be amended to facilitate a more streamlined process for MSMEs to propose resolution plans, especially when they encounter financial difficulties stemming from external circumstances.

c. The pre-packaged insolvency process for MSMEs should be reconsidered, with a proposal to lower the voting threshold from the current 66% to 50% for secured lenders and the Committee of Creditors, thereby enabling quicker resolutions and the protection of asset value.

She concluded by emphasizing the necessity for the provisions of the I&B Code to be harmonized with the requirements of MSMEs. This alignment would facilitate a more conducive business environment, safeguard essential skills and technologies, and uphold the entrepreneurial spirit that is vital to the MSME ecosystem.

LEGAL TOOLS TO FACILITATE THE DEVELOPMENT OF MSMEs

Dr. Prem Chand

Dr. Prem Chand emphasized the need for legal awareness programs to generate awareness about MSMEs about dispute resolution framework. He advocated for collaboration with academic institutions and funding for research and outreach to aid MSMEs, citing successful initiatives by National Law University Delhi.

Speaking about the lack of awareness, **Dr. Prem Chand, National Law University Delhi,** emphasized the bridging of the knowledge gap by making use of legal tools and spreading awareness about the dispute resolution framework for generating legal awareness amongst MSMEs in case of dispute resolution. He advocated for conducting legal awareness programmes to educate MSMEs and suggested leveraging academic institutions and research centers to provide practical support and effective and efficient assistance. He proposed that such collaborations would help spread legal awareness about MSME's rights. Dr. Prem called for funding educational institutes to facilitate research and outreach activities to assist MSMEs in navigating legal issues. Further, he cited various legal and social institutions, arbitration, and other research centers including that of National Law University Delhi, that have worked in the field of commercial law and can also assist the MSME industry and ecosystem through research, assistance, and grassroots-level programmes and workshops.

Ms. Radhika Bishwajit Dubey

Ms. Radhika emphasized the importance of training mediators on MSME-specific challenges and supported the idea of a dedicated institution or panel of arbitrators for resolving MSME disputes. She also proposed penal provisions for discouraging frivolous challenges and settlement options on the similar lines of the Negotiable Instruments Act.

The moderator, **Ms. Radhika Bishwajit Dubey, Central Government Standing Counsel,** emphasised the need for training for effective utilisation of training as well as awareness generation. She advocated for trained mediators with an understanding of the nuances and challenges faced by the MSME ecosystem to effectively use the mediation as a tool to resolve the disputes of MSMEs. Ms. Radhika also reiterated the need for a dedicated institution or panel of arbitrators to conduct arbitration proceedings under the MSMED Act of 2006. She also stressed the need for the introduction of a penal provision for discouraging frivolous challenges to arbitral awards, on the lines of the Negotiable Instruments Act.

SUGGESTIONS

The session came to a close with audience recommendations, which included a proposal to lower the default amount threshold for operational creditors under the Insolvency and Bankruptcy Code of 2016 from Rs. one crore to Rs. ten lakhs. Additionally, it was proposed that Udyam registration should be made compulsory for MSMEs. Furthermore, there was a suggestion for the creation of a centralized portal to facilitate the uploading of MSME orders and resources, thereby addressing the knowledge gap and enhancing effective dispute resolution.

KEY INSIGHTS

The principal insights derived from Session One are summarized as follows:

(i) The implementation of the Mediation Act of 2023, in conjunction with the MSMED Act of 2006, facilitates expedited mediation at a reduced cost through a structured framework.

(ii) Mediators who are trained in the intricacies and challenges faced by the MSME sector will be more proficient in resolving disputes related to MSMEs.

(iii) The establishment of an online dispute resolution mechanism will provide legal recourse to a greater number of MSMEs at a lower cost and within a specified timeframe.

(iv) A dedicated enforcement mechanism will promote quicker recovery of dues owed to MSEs.

(v) The introduction of penal measures in the form of costs will deter unwarranted and frivolous legal challenges under the Arbitration and Conciliation Act, 1996.

(vi) MSMEs should be recognized as a distinct category of operational creditors (akin to homebuyers) in IBC proceedings to protect their interests, and the voting threshold may be reduced from the current 66% to 50% in the pre-packaged insolvency process.

(vii) Legal awareness initiatives for MSMEs will help close the knowledge gap, empowering them to assert their legal rights for prompt and effective redress.

(viii) The creation of a panel of arbitrators or a specialized arbitral institution for the resolution of MSME disputes will significantly minimize delays and challenges to arbitral awards.

SESSION 2:
IIAC (CONDUCT OF MICRO, SMALL AND MEDIUM ENTERPRISES ARBITRATION) REGULATIONS, 2024


Sh. Vinay Kumar Sanduja

The IIAC was established with pan-India jurisdiction to cater to the diverse regional and linguistic demographics. Key features of the IIAC regulations include the expedited appointment of a sole arbitrator by the Chairperson, no filing fees for claims or counterclaims and minimal arbitration and administration fees thus, making it accessible and cost-effective for MSMEs.

Shri Vinay Kumar Sanduja, Registrar of India International Arbitration Centre, made a presentation on the IIAC (Conduct of Micro and Small Enterprises Arbitration) Regulations, 2024, which were notified on June 7, 2024, and prepared under the guidance of Justice (Retd.) Shri Hemant Gupta.

The India International Arbitration Centre has been established with a pan-India jurisdiction to cater to the varied regional and linguistic demographics of the country. Key features of these regulations include:

(i) the prompt appointment of a sole arbitrator by the Chairperson,

(ii) the elimination of filing fees for claims or counterclaims, coupled with minimal arbitration and administrative charges, and

(iii) accessible and cost-effective dispute resolution for MSMEs.

The Centre offers a fast-track procedure that limits oral hearings, ensuring that awards are issued within a six-month period. A provision for legal aid is also in place, allowing for a potential 50% waiver on administrative fees and access to free legal representation for MSMEs experiencing financial hardships. A distinctive feature includes the submission of draft arbitral awards to the registrar for review, thus ensuring a careful and transparent process.

Emphasising its commitment to modernity and efficiency, the India International Arbitration Centre employs digital tools from the Digital India Bhashini Division, such as live transcription and document translation services, promoting an eco-friendly and timely arbitration process through a robust case management portal.

SESSION 3:
PRESENTATION ON THE USE OF BHASINI'S AI SOFTWARE

Sh. Amitabh Nag

Bhashini has capabilities to provide live transcriptions and document translations from English to 22 Indian languages, facilitated under the IIAC framework. Its objective is to bridge the language barrier by using AI-driven technologies with human oversight and also addressing challenges such as auto-translation and optical character recognition.

Shri Amitabh Nag, the CEO of Bhashini, delivered a detailed presentation on the collaboration between Bhashini and the India International Arbitration Centre (IIAC), focusing on its importance in facilitating access to arbitration for disputes related to micro, small, and medium enterprises (MSMEs). He detailed Bhashini's capabilities, which include live transcription services and document translation from English into twenty-two (22) Indian languages, all supported by the IIAC framework. Shri Nag pointed out Bhashini's commitment to overcoming language barriers through the use of AI technologies, supplemented by human oversight, while tackling issues such as auto-translation and optical character recognition.

Furthermore, he introduced 'Bhashadaan', a crowd-sourcing initiative designed to collect language data, and provided insights into the functionalities of the Bhashini App. Shri Nag concluded by emphasizing the potential of speech to transform the landscape of linguistic and literacy barriers.

SESSION 4: LEGAL REFORMS IN THE MSMED ACT, 2006

PANELISTS

Shri Avnit Singh Arora, Director, Department of Legal Affairs, Ministry of Law and Justice

Dr. Navneet Sharma, Director General, CUTS Institute for Regulation and Competition (CIRC)

Shri Anil Bharadwaj, Secretary General, FISME

Prof. (Dr) Ritu Gupta, National Law University, Delhi

Ms. Ramni Taneja, Advocate & Solicitor of the England & Wales Supreme Court

MODERATOR

Dr. Anant Vijay Maria, Advocate-on-Record, Supreme Court of India

The discussions during this session focused on the necessary legal reforms pertaining to the MSMED Act of 2006. The session explored the new challenges that the MSMED Act must confront, as well as the alignment between the Act and recent technological advancements, including artificial intelligence (AI), machine learning, blockchain, the internet of things (IoT), and robotics, which have emerged since the enactment of the MSMED Act in 2006. Additionally, the integration of micro, small, and medium enterprises (MSMEs) into the global value chain was a key topic of consideration.

AREAS OF LEGAL REFORMS UNDER THE MSMED ACT, 2006

Shri Avnit Singh Arora

There is a need to build capacity of the Facilitation Councils under the MSMED Act of 2006 to reduce challenges to arbitral awards and faster dispute resolution. The role of policymakers is to enable the ecosystem and not be overly prescriptive in their approach. He also suggested the decriminalisation of Section 27 of the MSMED Act of 2006.

Shri Avnit Singh Arora, Director of the Department of Legal Affairs, Ministry of Law & Justice, commenced the discussion on the challenges relating to the statutory framework of the MSMED Act and its implementation. Terming the MSMED Act "well-structured," the Act recognised the institutional framework for conciliation and arbitration in 2006. One of the challenges in the MSMED Act, 2006 is the capacity of the Micro and Small Enterprises Facilitation Councils to facilitate a dispute between the seller and the buyer. Shri Arora emphasized that the Councils should play a facilitating role while the mediation and arbitration be undertaken by the specialised institutions. While speaking about the procedure laid under the MSMED Act, Shri Arora stated that the awards passed by the Councils are set aside by the courts of law as they are passed without the procedure under the Act in letter and spirit, thus emphasizing the need for building the capacities of the Councils and resolution of disputes through institutional mediation and arbitration. It would address the grievances of the MSE sellers and result in faster dispute resolution.

While speaking about the legal reforms required in the MSMED Act, Shri Arora emphasized that the role of the policymakers is to enable the growth and development of the ecosystem without becoming overly prescriptive in their approach. One of the areas that the policy makers may consider is the rule-making power to enable the smooth implementation of the Act as well the holistic growth of the MSME ecosystem.

Shri Arora stated that the legislative amendment may incorporate the decriminalisation of Section 27 of the MSMED Act of 2006, which is in line with the Jan Vishwas Bill and Ease of Doing Business. Section 27 imposes criminal punishment of a fine in case of regulatory non-compliance however, these provisions do not warrant criminal process. Therefore, the decriminalisation of Section 27 may be considered.

He stressed building capacities of all the stakeholders involved – officials, Facilitation Councils, etc. Shri Arora mooted the idea of handholding the enterprises to make them aware of legal processes and legal rights through an institutional framework of a legal helpdesk.

Shri Anil Bharadwaj

The incorporation of works contract, amendment in the definition of 'goods', and introduction of mandatory regulatory impact assessment on the MSME ecosystem before any legal or policy enactment are some of the challenges that needs to be addressed by the MSMED Act.

Shri Anil Bharadwaj, the Secretary General of FISME, described the passage of the MSMED Act as a significant milestone in welfare legislation. The MSMED Act of 2006 was the first to define micro, small, and medium enterprises, broadening its scope to include both the manufacturing and services sectors. Addressing the emerging challenges that the Act must confront, Shri Bharadwaj proposed the inclusion of work contracts within its framework. He also recommended expanding the definition of 'goods' to encompass immovable assets such as machinery. In reference to global best practices, he noted that UK law mandates an assessment of any new legal or policy reform regarding its effects on MSMEs prior to enactment. He urged for the introduction of a similar provision within the MSMED Act of 2006, to address the challenges posed by new legislation on the MSME landscape. Additionally, Shri Bharadwaj called for obligatory consultations with stakeholders as outlined in Chapter IV of the MSMED Act of 2006.

On the issue of delayed payments, he stated that the composition of the Facilitation Councils under the Act has proven effective over time, thus indicating that no modifications are necessary. He proposed the establishment of an appellate tribunal by the States to address appeals concerning arbitral awards under the Act, which would facilitate quicker dispute resolution. Additionally, he emphasized that both mediation and arbitration proceedings should be managed by the Facilitation Councils rather than being referred to ADR institutions or centers, as this would reduce litigation costs for MSMEs. In cases where expertise is required, MSEFCs may appoint a specialist. Shri Bharadwaj also advocated the idea of incorporating medium enterprises into Chapter V of the Act, as this would enable these businesses to benefit from the beneficial provisions of the legislation.

Shri Bharadwaj put forth the idea of the composition of a Central Regulatory and Supervisory Board with the dual responsibilities of furnishing data on delayed payments from government and private entities and building capacities of the Facilitation Councils.

Regarding the convergence between the Insolvency and Bankruptcy Code of 2016, and the Micro, Small and Medium Enterprises Development Act of 2006, Shri Bharadwaj expressed concerns that the provisions of the I&B Code dilute the delayed payment provisions incorporated in the MSMED Act. He noted that while the MSMED Act allows for the recovery of the principal amount along with interest, the I&B Code effectively nullifies these dues through its waterfall mechanism in the event of MSME being an operational creditor. He proposed that MSME dues be recognized as statutory dues under the I&B Code to facilitate the recovery of these amounts. Additionally, Shri Bharadwaj stressed the need for including medium enterprises in the benefits offered by the MSMED Act, as the current incentives primarily encourage micro and small enterprises to remain within those classifications.


Dr. Navneet Sharma

It is essential to establish an institutional framework for regulatory impact assessment in accordance with Chapter IV of the MSMED Act, 2006. Furthermore, the definitions of 'goods', 'services', 'data', and 'algorithm' must be aligned with various Acts to enhance clarity and minimize legal disputes.

Dr. Navneet Sharma, the Director General of CIRC, emphasized that the digital economy is among the foremost emerging sectors for growth, and the same holds true for Micro and Small Enterprises as well. In his remarks regarding the recent legislation, namely the Digital Personal Data Protection Act, 2023, and the Digital Competition Bill, 2024, Dr. Sharma underscored the necessity for an institutional framework for regulatory impact assessment under Chapter IV of the MSMED Act to timely assess the impact of both existing and new legislations on MSMEs. He pointed out that the advantages offered by the digital economy, particularly in logistics, supply chain management, and marketing, can be more effectively leveraged by MSMEs through the schemes of the Ministry.

In discussing the incentive structures for micro and small enterprises, Dr. Sharma noted that these incentives play a significant role in influencing the graduation rates from micro to small enterprises, small to medium enterprises, and medium to large enterprises, as they often encourage businesses to remain small. Nonetheless, the small scale of these enterprises introduces specific challenges, such as a lack of skilled labour and issues related to competitiveness. He emphasized the need for a unified approach to defining 'goods', 'services', 'data', 'algorithm', and other relevant terms across legislative frameworks to reduce legal challenges.

Regarding the legal reforms within the Act, Dr. Sharma recommended the establishment of a flexible legal framework that supports the growth of the MSME ecosystem, rather than imposing rigid definitions within the Act.


Ms. Ramni Taneja

There is a need to offer legal support to small businesses, as insufficient financial resources hinder their access to justice. The Act may introduce a framework for delivering legal aid to micro and small enterprises, thereby also reducing litigation expenses.

Ms. Ramni Taneja, Advocate & Solicitor of the England & Wales Supreme Court, expressed that the legal reforms proposed in the MSMED Act of 2006 could provide a comprehensive and holistic framework aimed at fostering the development and growth of the MSME ecosystem. She advocated for the provision of legal assistance and aid to small businesses requiring support. The absence of adequate financial resources often hinders these enterprises from pursuing legal remedies in court. Furthermore, such assistance would contribute to lowering litigation costs for small businesses and entrepreneurs.


Prof. (Dr.) Ritu Gupta

Micro, Small, and Medium Enterprises (MSMEs) face challenges related to limited outreach and a shortage of skilled personnel, highlighting the necessity for collaboration between various institutions and the Ministry. Academic institutions can contribute by providing MSMEs with information regarding their rights and the latest technological advancements. It is essential to integrate MSME-oriented modules into legal education to enhance capacity building at the grassroots level.

Prof. (Dr.) Ritu Gupta, National Law University Delhi, addressed the issue of insufficient skilled labour within Micro, Small, and Medium Enterprises (MSMEs) and their limited outreach. She suggested that educational institutions could significantly contribute to expanding the reach of MSMEs and assist in fulfilling legislative requirements. Furthermore, she emphasized the importance of academia in providing social support to disseminate information regarding emerging technologies. To this end, she recommended the inclusion of specialized modules on MSMEs in legal education curricula. Additionally, Dr. Gupta underscored the necessity of incentivizing MSMEs that implement green technologies and practices through appropriate policy and legal reforms.

INTERACTION OF MSMED ACT, 2006 WITH EMERGING TECHNOLOGICAL TRENDS


Shri Avnit Singh Arora

The incorporation of technology into the administration of justice has been facilitated by Section 30 of the Mediation Act of 2023. The Facilitation Councils are empowered to utilize technology for the resolution of disputes via online dispute resolution mechanism established under the Mediation Act.t

Speaking about the interaction between the emerging technologies such as artificial intelligence, blockchain, etc., Shri Arora stated that the Mediation Act envisages the conduct of online mediation under Section 30 of the Mediation Act, 2023. With the enactment of the Mediation Act of 2023, the Facilitation Councils can integrate technology with dispute resolution mechanisms and can undertake online dispute resolution as envisaged under Section 30 of the Mediation Act of 2023.

Shri Anil Bharadwaj

Digital technology can be leveraged to reduce the compliance burden on MSMEs. A centralised stored data of MSMEs that can be accessed by different departments would reduce the compliance burden and enhance the ease of doing business significantly for MSMEs.

Shri Bharadwaj emphasised the rapid advancement of technology, cautioning against the regulation of such developments through statutory measures. He proposed that instead of attempting to resolve technological challenges via legislative changes, a more effective strategy would involve a structured consultative process that includes the input of MSMEs regarding these emerging technologies and issues.

He further indicated that digital technology could be harnessed to alleviate the compliance burden faced by MSMEs, as it allows for centralized data storage that government departments can access as required for compliance purposes. Additionally, Shri Bharadwaj highlighted the importance of creating a standardized compliance report format through inter-departmental discussions, enabling MSMEs to submit necessary data in a unified reporting structure. This approach would not only save time but also significantly lower compliance costs, thereby improving the overall ease of doing business for MSMEs.

Dr. Navneet Sharma

The establishment of digital public infrastructure focused on dispute resolution, compliance, and ESG compliance has the potential to greatly improve the competitiveness of the MSME ecosystem, thereby facilitating a more favourable business environment for MSME enterprises.

Dr. Navneet highlighted that the creation of Digital Public Infrastructures (DPIs) can be leveraged for enhancing the competitiveness of the MSME ecosystem. He identified specific areas where DPIs can contribute to the growth of MSMEs:

a. **Online Dispute Resolution:** DPIs can significantly lower the expenses associated with resolving disputes.

b. **Alleviating Compliance Challenges:** DPIs can eliminate redundant information and reduce compliance costs for MSMEs. Additionally, DPIs can facilitate data generation and streamline ESG compliance for these enterprises.

INTEGRATION OF MSMEs INTO THE GLOBAL VALUE CHAIN

Dr. Navneet Sharma

The challenges faced by uncompetitive small businesses require careful consideration. The national trade policy should align with the requirements of micro, small, and medium enterprises (MSMEs), as fostering a competitive domestic industry will enhance the global value chain.

While addressing the topics of inverted duty structure and tariff rationalization, Dr. Navneet Sharma advocated that the national trade policy should be aligned with the demands of MSMEs. He further stated that fostering a competitive domestic MSME sector would facilitate their integration into the global value chain.

Shri Anil Bharadwaj

Enhancing our competitiveness within the Global Export Chain is essential. Additionally, the absence of comprehensive data on Indian SMEs poses a significant challenge for foreign investors seeking appropriate SME partners for export collaboration in India. Establishing a database of SMEs could facilitate export opportunities.

Shri Bharadwaj propounded enhancing the export competitiveness of micro, small, and medium enterprises (MSMEs) within the global value chain, which may also encompass import competitiveness. He identified the absence of comprehensive data on Indian SMEs as a significant obstacle for foreign investors seeking appropriate SME partners in India. Consequently, he proposed the establishment of a dedicated SME database to support export activities, emphasizing the need for collaborative efforts among industry associations and various centers of excellence engaged in the SME sector.

Ms. Ramni Taneja

Foreign investors face challenges in locating MSMEs for potential collaboration, primarily due to insufficient information regarding these enterprises. It is essential to establish a comprehensive database of MSMEs in India, facilitated by diplomatic missions, to aid foreign investors in identifying appropriate MSME partners and directing investments towards Indian SMEs.

While discussing the challenges within the global export value chain, Ms. Ramni Taneja highlighted that the foreign investors encounter difficulties in locating appropriate MSME partners in India, primarily due to insufficient information about Indian MSMEs. She recommended that the Government of India may establish a comprehensive database in collaboration with diplomatic missions to aid foreign investors in identifying suitable MSMEs. This proposed database would also serve to enhance the export capabilities of Indian MSMEs and promote the acceleration of the global value chain in exports.

ENFORCEMENT MECHANISM AND TRIBUNALISATION UNDER THE MSMED ACT, 2006

Shri Anil Bharadwaj

A special enforcement mechanism for arbitral awards can be created on the similar lines as that of Income Tax Act. The district judicial administration is overburdened which leads to delays in disposal of execution petitions and recovery of monies for MSME.

On the issue of enforcement of arbitral awards, Shri Anil Bharadwaj reiterated the suggestion that a special enforcement mechanism for arbitral awards can be created on the lines of the Income Tax Act. The district judicial administration is overburdened, which leads to delays in the disposal of execution petitions, which cause further delay in receiving the fruits of a decree. Hence, there is a requirement for carving out a special forum for the enforcement of arbitral awards for speedy recourse to justice for MSMEs.

Dr. Navneet Sharma

The constitution of the Facilitation Council with one judicial and one technical member might not be an effective solution. The faster recovery of delayed payments can be enabled through effective negotiation and settlement between the parties.

Dr. Navneet Sharma remarked that, although the Facilitation Council functions as a quasi-judicial body under the MSMED Act of 2006, its composition—featuring one judicial and one technical member—may not adequately address the persistent delays in the dispute resolution process stipulated by the MSMED Act. He noted that the creation of statutory tribunals is unlikely to improve recovery rates. Instead, he proposed that the focus on negotiation and settlement approaches is more likely to ensure the prompt recovery of payments owed to MSMEs.

Dr. Anant Vijay Maria

Tribunalisation has faced several challenges concerning the appointment of its members, their salary and emoluments, challenges to these appointments, the decisions made, and the appeals that follow. It may not serve as an effective means to enhance the efficiency of the Facilitation Councils. He suggested reforms may focus on two primary areas: enhancing the enforcement of decisions and limiting the scope of review of arbitral awards.

On the subject of tribunalisation, consisting of one judicial and one technical member, **Dr. Anant Vijay Maria, Advocate-on-Record,** underscored the prevailing challenges associated with tribunalisation, particularly in light of the Supreme Court's rulings in Union of India vs. R. Gandhi and Madras Bar Association v. Union of India. He addressed various concerns, including the appointment of members, their salaries and emoluments, the challenges associated with these appointments, the decisions rendered, and the appeals process. Dr. Maria explored the origins of the concept of tribunalisation, highlighting that although tribunals first emerged in France and proved to be effective there, they have encountered considerable difficulties in India following the L. Chandra Kumar ruling. Thus, he suggested that the establishment of tribunals might not enhance the operational efficiency of Facilitation Councils.

Dr. Maria also noted that enforcement of awards continues to be a challenge, with the awards often being relegated to mere "paper decrees," thereby leading to drawn-out execution proceedings. He indicated that reforms aimed at enhancing the enforcement of decisions and restricting the review of awards represent two significant areas for potential action.

KEY INSIGHTS

The principal insights derived from Session Four are summarized as follows:

a. Policymakers may create a conducive framework while amending the MSMED Act, ensuring that their approach does not become excessively prescriptive.

b. The amendment bill may decriminalise Section 27 of the MSMED Act, 2006, in accordance with the Jan Vishwas Bill and the objectives of Ease of Doing Business.

c. The strengthening of capacities of all the stakeholders, including officials and Facilitation Councils, can significantly contribute to the advancement of the MSME ecosystem.

d. Establishing a legal helpdesk may serve to generate awareness amongst MSMEs about their legal rights and liabilities.

e. Prior to the implementation of any new law or regulation, an institutional regulatory impact assessment focused on micro, small, and medium enterprises (MSMEs) may be mandated.

f. The provisions of Chapter V of the MSMED Act of 2006, may be extended to "medium" enterprises as well.

g. The Central Regulatory and Supervisory Board may be constituted with the responsibility of furnishing information regarding delayed payments and enhancing the capabilities of the Facilitation Councils.

h. Legal assistance may be provided to small businesses, as their limited financial resources often hinder their ability to access justice.

i. Digital public infrastructure has the potential to mitigate the challenges associated with delayed payments and alleviate the compliance obligations faced by MSMEs.

j. The Government of India may develop a database aimed at assisting foreign investors in identifying suitable MSMEs and facilitating exports.

k. The process of tribunalisation is fraught with legal and administrative obstacles, which may hinder the effectiveness of the Facilitation Councils. Two critical areas for potential reform include the enforcement of decisions and limiting the scope of award reviews.

WAY FORWARD

The deliberations held on ‘Legal Reforms in the MSME Ecosystem’ resulted in comprehensive solutions to steer the policy and legal reforms to continue the momentum of the MSME growth and competitiveness. The insights provided by the eminent legal professionals, academicians, industry bodies, and government officials have contributed to fostering a more supportive business environment for MSMEs through legislative amendments. The outcomes of these discussions have also charted a way forward for enhancing the ease of doing business, speedier resolution of delayed payments, alleviating the financial burden of litigation on enterprises, and bolstering the overall competitiveness of the ecosystem.

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The issue of delayed payments has emerged as a persistent pain point that impacts the operational efficiency and competitiveness of the enterprises. Compounding this issue is the substantial litigation expense that businesses face when attempting to recover these delayed payments, which only serves to worsen their financial strain. To address this, the promotion of mediation and settlement mechanisms has been recommended as a means to achieve speedier and more cost-effective resolution of delayed payments. The structured timelines and institutional structure outlined in the Mediation Act of 2023 can be leveraged under the MSMED Act of 2006 to facilitate speedier, affordable, and conclusive dispute resolution.

Prolonged delays in the resolution process frequently lead to increased financial burdens. The lag in the appointment of arbitrators, along with the extended duration of conciliation and arbitration procedures, results in additional litigation costs. To counteract these delays, the creation of a dedicated panel of arbitrators has been recommended. Since the members of the Facilitation Councils are burdened with administrative duties, it was suggested that their role should be restricted to facilitation, with resolution being conducted by institutions or neutrals proficient in alternative dispute resolution techniques.

However, no consensus emerged regarding this issue, as industry associations advocated for dispute resolution through Facilitation Councils. Additionally, it was pointed out that the implementation of an online dispute resolution mechanism could be an effective strategy to address delays in the resolution process.

The topic of establishing a tribunal-like structure for Facilitation Councils was also deliberated. The issues associated with the current tribunal structure were emphasized, including the appointment process for members, their salaries and emoluments, challenges related to appointments, the decisions made, and the appeals process. It was recommended that the introduction of a compulsory legal member could strengthen the legal capacity within the Facilitation Councils.

The stakeholders consistently highlighted the exorbitant cost of litigation. To address this issue, suggested measures included the establishment of a cap on arbitration fees through legislative amendments, the promotion of mediation and negotiation as alternative methods for resolving disputes, and the introduction of legal aid through specific schemes or legislative changes.

Delays in the enforcement of arbitral awards impede the realization of the fruits of arbitral awards. To facilitate swift enforcement, it has been suggested that a dedicated enforcement mechanism be established within the MSMED Act to ensure the speedy execution of arbitral awards. Additionally, it was proposed that the framework outlined in Schedule II of the Income Tax Act be adopted to enable a summary recovery procedure.

The enactment of the Insolvency and Bankruptcy Code of 2016 has, to some degree, diluted the provisions of the MSMED Act of 2006. The initiation of insolvency proceedings against MSME buyers frequently results in minimal or no recovery of delayed payments owed to these enterprises. To enhance the recovery rate for these enterprises, it has been proposed that MSMEs be recognized as a distinct category of operational creditors within the I&B Code or that their outstanding dues be classified as statutory obligations. Additionally, it was also suggested that the voting threshold may be lowered from the current 66% to 50% of secured lenders and CoCs under the pre-packaged insolvency process.

The capacity building of Facilitation Councils has emerged as another focus point during the deliberations. Conducting periodic training for these councils on legal processes will play a vital role in reducing challenges related to awards and in establishing trust. A recommendation was made to constitute a Central Regulatory and Supervisory Board to build a database on MSMEs and facilitate training for Facilitation Councils.

Other noteworthy solutions included the inclusion of medium-sized enterprises to extend the benefit of delayed payments provisions, partnerships with academic institutions aimed at promoting legal awareness among businesses, the introduction of penal provisions to discourage frivolous challenges to arbitral awards, the provision of a legal helpdesk for MSMEs, the implementation of mandatory regulatory impact assessment and a single-window mechanism for reducing the compliance burden, the decriminalisation of Section 27, and the development of a database to provide information about competitive MSMEs to foreign investors and other stakeholders.

SNIPPETS FROM UDYAMI BHARAT EVENT


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Dr. Ambedkar International Centre,
New Delhi
Legal reforms in the MSME Ecosystem
27th June 2024
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