

REDUCING COST OF LITIGATION FOR MSMEs



'Accelerating Justice, Empowering MSMEs, Unleashing India's Economic Potential'



Seminar Proceedings

Jointly organised by



&

FRIENDS OF MSMEs
IN PARLIAMENT



Proceedings of Seminar

Reducing Cost of Litigation for MSMEs

Accelerating Justice, Empowering MSMEs, Unleashing India's Economic Potential

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Minister of Law and Justice of India



Guest of Honour
Shri Rajendra Agrawal
Hon'ble MP & Convenor, 'Friends of MSMEs in Parliament'

Inaugural



Welcome Address
Mr. Prashant Patel
President FISME



Inaugural Address
Justice R.S. Sodhi (Retd.)



Special Address
Mr. T.K. Arun
Former Editor, The Economic Times

Panel Discussion



(Moderator)
Mr. Bishwajit Dubey
(Independent Lawyer & former Partner, CAM)



Mr. Neeraj Kedia
(Past President FISME & Chairman,
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Mr. Sumant Batra
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Mr. J.P. Sengh
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Dr. Swati Jindal Garg
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(Host-Legally Speaking, NewsX)

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List of Acronyms

ADR	Alternate Dispute Resolution
BHEL	Bharat Heavy Electricals Limited
CAM	Cyril Amarchand Mangaldas
CATC	Central Administrative Tribunal
CGFSF	Credit Guarantee Fund Scheme for Factoring
CIRP	Corporate Insolvency Resolution Process
CKYC	Central Know Your Customer
CoC	Committee of Creditors
CPC	Civil Procedure Code
DIAC	Delhi International Arbitration Centre
FISME	Federation of Indian Micro and Small & Medium Enterprises
GJHPL	Golden Jubilee Hotels Private Limited
IBBI	Insolvency and Bankruptcy Board of India
IBC	Insolvency and Bankruptcy Code
IPR	Intellectual Property Rights
MSEFC	Micro and Small Enterprises Facilitation Council
MSME	Micro Small & Medium Enterprises
NCDRC	National Consumer Disputes Redressal Commission
NCGTC	National Credit Guarantee Trustee Company
NCLAT	National Company Law Appellate Tribunal
NCLT	National Company Law Tribunal
NGT	National Green Tribunal
NI	Negotiable Instrument
NITI	National Institution for Transforming India
OC	Operational Creditors
ODR	Online Dispute Resolution
UPPTCL	Uttar Pradesh Power Transmission Corporation Limited
WTO	World Trade Organization

Executive Summary

- The detrimental effects of protracted and costly legal proceedings on the growth of Micro, Small and Medium-sized Enterprises (MSMEs) are widely recognized. However, the extent to which extended legal processes can cripple MSMEs remains largely underappreciated. Against this backdrop, FISME in collaboration with 'Friends of MSMEs in Parliament'- a group of MPs, organized a seminar on "Reducing the Cost of Litigation for MSMEs" on August 10, 2023. The theme of the seminar was: "Accelerate Justice, Empower MSMEs, Unleash India's Economic Potential".
- Actual cases were presented during the seminar before legal luminaries, including a cabinet minister (Law), a legal counsel from the MSME Ministry, a retired High Court Judge, and counsels with expertise in contracts, insolvency, and mediation. The report on the proceedings of the seminar captures key takeaways.
- Impact of the high cost of litigation: The high litigation cost has far-reaching implications for various aspects of the economy. Not only does it drag down GDP growth by approximately 1.5% every year, but it also imposes a significant compliance burden on businesses, leading to the informalization of the economy.
- Challenges within Arbitration: Prolonged resolution timelines and concerns surrounding arbitration clauses, particularly the provisions outlined in Section 34 of the Act, which allows for appeals to the High Court from arbitration orders.
- The Mediation Bill and efficient mediation process: MSME Act of 2006 introduced provisions related to mediation but fell short in terms of implementation. The absence of mandatory mediation and a lack of awareness among facilitation council members hampered its effective adoption. The recently enacted Mediation Bill was a focal point, with participants highlighting its potential to decrease both time and expenses for MSMEs. The significance of an effective mediation process enabled by this legislation was emphasized.
- Addressing delayed payments: The seminar drew attention to the urgent issue of delayed payments to MSMEs. Recommendations put forward included the imposition of penalties for failure to adhere to payment schedules and the requirement for companies to address non-payment issues through arbitration. In this regard, a recommendation was made for the creation of independent credit rating agencies focused on evaluating companies' performance in meeting vendor liabilities. The advent of the GST payments system and advanced data analytics capabilities provide the means to track the time gap between invoice issuance and payment execution.
- Reducing the number of litigations: There was a strong emphasis on the significance of decreasing the overall volume of legal disputes. To achieve this, the proposals included promoting transparent and uncomplicated business transactions, ensuring accountability in government actions, and embracing swift alternative legal methods such as arbitration, mediation, and conciliation.
- Effectiveness of the IBC policy: Participants expressed concerns about the efficacy of penalizing business failures as outlined in the Insolvency and Bankruptcy Code (IBC). Despite the presence of protections for MSMEs under the MSME Act, they find themselves treated at par with other Operational Creditors (OCs) under the Insolvency and Bankruptcy Code (IBC) in India. This equivalency with larger unsecured creditors, often including bigger companies, puts MSMEs at a significant disadvantage during insolvency proceedings. A cohesive interpretation of the IBC was recommended in harmonization with the MSME Act, 2006, to streamline the recovery process and reduce legal disputes for MSMEs.
- Issues with High Courts and NCLT: Even if the party wins, execution and implementation of the award open up another case as it goes to the High Court again. Also, cases exceeding Rs. 1 crore are taken to the National Company Law Tribunal (NCLT), whereas cases below Rs. 1 crore have only the execution option, which, according to MSMEs, is dysfunctional.

- It was emphasized at the seminar that government procurement agencies should be encouraged to prioritize mediation and arbitration over court litigation when resolving disputes concerning contracts below a specified value. Such a shift in approach would serve to protect small-scale suppliers from the financial hardships caused by delays in the legal process. Specific cases were highlighted where disputes were ongoing for extended periods, demonstrating the inefficiencies of the current legal system. Commercial disputes, particularly those related to issues like cheque bouncing, were discussed, highlighting the lack of capacity in lower courts and administrative infrastructure issues. Participants also stated that contrary to the letter and spirit of the rules, arbitration awards get invariably challenged in courts.
- A notable recommendation that emerged from the panel discussion was the establishment of a comprehensive dashboard. This digital mechanism would meticulously track cases across Civil Courts, High Courts, and the Supreme Court. By fostering transparency and accountability, such a system could instill a sense of urgency among stakeholders to expedite the resolution of disputes. The seminar yielded various additional recommendations, such as establishing predefined figures for legal expenses in litigation, enhancing the accessibility of Alternative Dispute Resolution (ADR) methods, incentivizing public sector enterprises to embrace mediation, and implementing a rating system for purchasers to alert suppliers about their payment behaviors.
- Conclusion: Arbitration, among the Alternative Dispute Resolution mechanisms, seeks to resolve contract disputes in India. However, MSMEs face specific legal and procedural challenges within the arbitration process. Firstly, MSMEs often experience delays in appointing arbitrators, compelling them to seek court intervention. Secondly, arbitration remains costly for MSMEs, hindering their access to justice. More importantly, MSMEs encounter challenges in the form of arbitration awards being frequently challenged in High Courts and even escalated to the Supreme Court.
- To address the failures of arbitration process in delivering justice to MSMEs, the following measures need to be taken:
 - Expedite arbitrator appointments through legal amendments, ensuring adherence to stipulated timelines. Let the Arbitration Council of India choose arbitrators from its panel of qualified arbitrators.
 - Implement cost-effective arbitration mechanisms tailored to MSMEs' financial capabilities.
 - Discourage Frivolous Challenges: Strengthen adherence to Section 34 of the Arbitration Act, deterring frivolous challenges. The terms “Public Policy / Fundamental Policy of Indian law” in Section 34 of the Arbitration and Conciliation Act, 1996 should be clarified and the judiciary should be sensitized so cases are not accepted in High Courts on frivolous grounds.
 - Legislative Correction: Address issues surrounding neutrality by prohibiting existing employees from acting as arbitrators in matters involving PSUs.
 - All government buying agencies should quarterly report pending arbitration cases and the number of payments pending to their MSME vendors.
 - Arbitral Awards should include interest and not just the principal amount. This ambiguity generally occurs due to the phrase 'unless otherwise agreed' under Section-31 allowing arbitrators to decide on interest in government contracts.
 - Award Enforcement: It should be ensured that the company is obligated to fulfil payment obligations upon confirmation of the arbitral award. If the arbitral award gets challenged under Section 34, the company should be made to deposit the amount awarded in arbitration with the court. Also, separate execution proceedings should not be required for the transfer of arbitral award to the decree holder.



“Government is cognizant of the concerns of MSMEs about lengthy and costly litigation and we shall push for resolution of disputes through Mediation centers all over India to reduce cost”.

***-Shri Arjun Ram Meghwal,
Hon'ble Minister of
Law & Justice***

The seminar was addressed by Hon'ble Law Minister Shri Arjun Ram Meghwal. He pointed out that the government is fully aware of the challenges that MSMEs face in navigating the complex legal system and it is taking proactive steps to address the concerns of MSMEs.

He acknowledged the passage of Mediation Bill in the monsoon session as a significant step towards making dispute resolution process more efficient and cost effective for MSMEs. The Bill provides for legal support to enforce mediated settlement and outlines appointment of trained mediators. The Bill seeks to promote and facilitate institutional mediation for resolution of disputes before approaching courts and would therefore reduce the burden of litigation costs on MSMEs. He emphasized government's strategy which involves establishment of mediation centers across India. These centers will serve as forums for resolving disputes through mediation in a cost effective and time bound manner.

The Minister also said that the government is open to feedback and suggestions from all stakeholders and these suggestions will be considered during the rule making process to ensure that the legislation aligns with the practical needs and expectations of MSMEs. Shri Meghwal noted that the government is committed to promoting the concept of Alternate Dispute Resolution (ADR) mechanism and as part of this effort, establishment of India International Arbitration Centre is currently in progress.



“Mediation should always be the first step to resolve disputes and for that the mediation process should be efficient.”

*-Shri Rajendra Agrawal,
Hon'ble MP & Convenor,
'Friends of MSMEs in
Parliament'*

Shri Rajendra Agrawal, Member of Parliament and Convenor of 'Friends of MSMEs in Parliament', expressed a robust perspective regarding the use of mediation as the primary approach for resolving disputes. He emphasized the need for an efficient and effective mediation process and expressed optimism about the potential of the Mediation Act to help resolve various disputes. Shri Rajendra Agrawal's address underscored the importance of making mediation the initial step in addressing disputes.

This approach aligns with the belief that mediation is a more amicable and cost-effective way to resolve conflicts compared to traditional litigation. He also emphasized that for mediation to be a viable option, it must be efficient. This efficiency implies that the mediation process should be structured, accessible, and capable of delivering timely resolutions. The Mediation Act, once enacted, is expected to provide a legal framework for conducting mediation proceedings in India.

He also provided an assurance to MSMEs that they will be actively included in the official consultation process during the formulation of rules for the Mediation Act and that their concerns will be addressed. This commitment is significant as it demonstrates a proactive approach to addressing the concerns of MSMEs, including those related to delayed payments. This approach demonstrates a willingness to work collaboratively with MSMEs to create a legal framework that serves their best interests.

Background

FISME and 'Friends of MSMEs in Parliament'- a forum of Members of Parliament created to support Micro, Small and Medium Enterprises (MSMEs) in association with WeVaad, online dispute resolution institution, as their Knowledge Partner, organized a seminar to address the critical issue of “Reducing the Cost of Litigation for MSMEs” on August 10, 2023, at India Habitat Centre. The seminar was organized with the objective to explore innovative strategies for mitigating the financial burden of litigation on MSMEs. The seminar brought together legal luminaries, esteemed experts, and stakeholders to delve into the pressing issue of reducing litigation costs for MSMEs in India. This comprehensive report encapsulates the insights and deliberations at the seminar.

Impact of high cost of litigation

The high litigation cost has far-reaching implications for various aspects of the economy. It not only drags down GDP growth, as reported by Prof. Bibek Debroy in Mint, by approximately 1.5% every year but also imposes a significant compliance burden on businesses, diverting their attention away from core activities. Moreover, it places a severe financial strain on companies, tying up their working capital and disproportionately affecting MSMEs. This high cost acts as a barrier to entry, discouraging potential entrepreneurs from venturing into the business landscape.

Furthermore, it adds to the informalization of the economy, with approximately 90% of MSMEs operating informally, resulting in a missing "middle" in the sector. Despite India's large MSME universe of 6 crores, only 3.3 lakh are categorized as Small and 5000 as medium enterprises (EC 2016). This stifling effect on the MSME sector also contributes to stagnant manufacturing, which has remained at around 15-16% of GDP for decades. It inhibits the best minds from pursuing entrepreneurship and often leads firms to remain small "dwarfs" in India, as highlighted in the Economic Survey of 2019. Addressing the high cost of litigation is crucial for unleashing the potential of the Indian economy and fostering a more vibrant and inclusive business environment.

Need to strengthen legal framework

India's World Bank ease of doing business ranking has improved significantly, rising from 142nd in 2014 to a more advantageous 62nd position in 2020. However, when it comes to the enforcement of contracts, progress has been slower, with the country's ranking improving only from 186th place in 2014 to 163rd in 2020. India's position in the World Justice Project's Rule of Law ranking paints a mixed picture. While the country ranks 88th out of 180 nations in overall rule of law, indicating room for improvement, the criminal justice system fares slightly better with a ranking of 89th. However, there is significant room for progress in civil justice, with India currently placed at 111 out of 180 countries in this category. These rankings underscore the need for continued efforts to strengthen the legal and judicial framework in India to create a more conducive environment for doing business.

Traditional court-based dispute resolution processes usually result in lengthy procedures, substantial financial burdens, and uncertainty. Based on the findings of the Access to Justice survey, individuals involved in legal disputes incur daily expenses of approximately Rs. 497 and suffer a business revenue loss of Rs. 844 for each day spent in court for civil matters. To address these challenges, prominent Chief Justices of India, including retired NV Ramana and DY Chandrachud, have consistently emphasized the use of Alternative Dispute Resolution (ADR) mechanisms due to their recognized efficiency.¹

¹ <https://www.moneycontrol.com/news/opinion/why-india-should-encourage-online-dispute-resolution-adoption-11267801.html>

Commercial Disputes

Commercial disputes encompass a broad range of issues in the business world. Some of the major areas of commercial disputes include:

- a. **Contractual Disputes:** Conflicts arising from breaches of contractual agreements, which can include issues related to delivery, quality, payments, or non-performance of contract terms.
- b. **Payment Delay/Denial:** Disputes involving delayed or denied payments for goods or services, often leading to financial strain on one or both parties.
- c. **Land and Property Disputes:** Conflicts related to property ownership, land transactions, and real estate deals, which can include issues like title disputes, land encroachments, or boundary disputes.
- d. **Intellectual Property Rights (IPR):** Disputes concerning the protection and infringement of IPRs, such as patents, trademarks, copyrights, and trade secrets.
- e. **Insurance Claims:** Conflicts arising from disputes over insurance coverage, claims processing, or disagreements between policyholders and insurers.
- f. **Partnership Disputes:** Conflicts within partnerships, whether in a business or legal context, which may involve disagreements over decision-making, profit distribution, or the dissolution of the partnership.
- g. **Section 138, Negotiable Instruments Act:** Additional check bouncing cases under Section 138 of the Negotiable Instruments Act are prevalent commercial disputes.

Some of the significant pain points in dealing with these disputes include:

- a. **Overload of Cases:** There is a significant number of cheque-bouncing cases, and often, these cases do not receive priority in the legal system or with law enforcement agencies.
- b. **Complex Legal Procedures:** The legal processes involved in resolving commercial disputes can be complex and time-consuming. This complexity often results in delays and additional costs for all parties involved.
- c. **Enforcement of Judgments:** Even when a favourable judgment is obtained, enforcing it can be a lengthy and complicated process. Non-compliance with court orders is a common issue, and the enforcement of judgments can take years.
- d. **Lack of capacity in lower courts:** Many subordinate courts confront administrative incapacity and infrastructural issues, resulting in delays in procedures.
- e. **Summons and Warrants:** Issuing and serving summons and warrant on time can be a challenging process, causing further delays in the legal process.
- f. **Execution of Awards:** The execution of arbitral award is another issue. The filing of appeals against the decision, often on frivolous grounds, delays the award's enforcement.
- g. **Burden on Businesses:** Commercial disputes can be a significant burden on businesses, diverting their time, resources, and attention away from their core operations. This diversion can result in financial losses and a detrimental impact on their overall performance.
- h. **Reputational Damage:** Being involved in a commercial dispute, especially if it becomes public, can harm a company's or an individual's reputation. This damage may have long-lasting effects on their ability to conduct business or maintain relationships within their industry.

Addressing these pain points and enhancing the efficiency of dispute resolution mechanisms is critical for promoting a business-friendly environment and ensuring that commercial disputes are resolved in a timely and fair manner. This can be especially beneficial for businesses, including MSMEs, which often face resource constraints when dealing with such disputes. The ultimate objective is to reduce the time, cost, and emotional toll associated with commercial disputes while ensuring a fair and efficient resolution process for all parties involved.

Session One



“MSMEs collectively represent the backbone of the economy, drive innovation, generate employment, and contribute significantly to the nation's GDP. However, exorbitant litigation costs threaten to stifle their growth and potential.”

- Mr. Prashant Patel, President FISME

Mr. Prashant Patel, President of FISME, emphasized the critical role of MSMEs in defining India's economic trajectory in his introductory remarks. These enterprises, collectively represent the backbone of the economy, drive innovation, generate employment, and contribute significantly to the nation's GDP. However, exorbitant litigation costs threaten to stifle their growth and potential. Mr. Prashant Patel addressed the issue of onerous legal process impeding MSMEs growth. He mentioned that Professor Bibek Debroy, a well-acknowledged expert in the field, has stated that the implementation of extensive legal reforms has the potential to increase India's GDP growth by 1.5% annually. This revelation came with a startling realization that the economic toll of the existing legal system amounts to nearly Rs. 4 lakh crores each year.

Against this backdrop, he praised the government's proactive stance. He cited the post- budget interactions of March 2023, where Hon'ble Prime Minister Narendra Modi personally urged MSMEs to identify obstacles and offered his unequivocal support in dismantling these roadblocks. This encouraging signal underscored the government's commitment to fostering a conducive environment for MSMEs to thrive.

He stressed that MSMEs grapple with multifaceted challenges in the legal domain. While arbitration mechanisms have made strides in becoming time bound, MSMEs often struggle to conform to these timelines. The high cost of arbitration for MSMEs remains a key problem, which is exacerbated by unjustified court interventions that undermine the benefits of ADR (Alternative Dispute Resolution) Mechanisms. Although the arbitration process has become increasingly time bound, the MSME facilitation councils have failed to adhere to the timelines. He further emphasized that intended benefits of ADR methods have been impaired by frequent judicial interventions, which have caused delays in the settlement process. This is particularly problematic for MSMEs where time is of great essence. Moreover, if one of the litigants is a government agency, there is no urgency to expedite the dispute resolution process.

One of the primary recommendations made during the Welcome Address was the creation of a dashboard to track the progress of disputes and cases pending in Arbitration tribunals and civil courts. Mr. Patel concluded on a promising note, with a resounding acknowledgment extended to all participants, speakers, and contributors. Their collective dedication and intellectual contributions from the bedrock of the seminar.



“The sector's endurance and vitality are indeed exceptional given the complex global landscape they navigate. The absence of a robust bond market further compounds the challenge, rendering access to affordable funds a significant hurdle.”

- Mr. T. K. Arun, Former Editor, The Economic Times

Mr. T.K. Arun, Former Editor of The Economic Times, delivered the keynote address at the seminar. Mr. Arun's address delved into the specific issues encountered by MSMEs, while also providing solutions to accelerate growth and prevent possible adversities.

He commenced his address by acknowledging the tenacity and remarkable adaptability of India's MSME sector. Despite several challenges, MSMEs continue to prosper, create jobs, contribute to tax revenue, and promote upward social mobility. Given the difficult global context they navigate, the sector's endurance and vigour are truly outstanding.

His talk focused on a fundamental issue plaguing MSMEs: the challenge of obtaining credit from formal banking institutions. Surprisingly, a mere 15% of credit available to the sector emanates from banks, with the bulk secured through informal sources. The absence of a robust bond market further compounds the challenge, rendering access to affordable funds a significant hurdle. Mr. Arun brought attention to the dilemma faced by MSMEs when confronted by unjust tax demands. He highlighted that even in cases where a taxman raises an unjust demand, the only recourse available is to embark on the arduous legal process. Despite the daunting nature of such predicaments, MSMEs manage to endure, due to their remarkable resilience.

Drawing on the example of the Goods and Services Tax (GST), Mr. Arun illuminated the potential within existing frameworks for effecting change. Although the initial transition to GST was difficult, it subsequently led to the standardization of various aspects of business operations, such as invoicing and payment tracking. This formalization, brought about by GST provides opportunities for MSMEs to advocate for fairness and justice. The government now has access to comprehensive invoice data. By harnessing advanced data analytics, it can monitor when payments are made in response to raised invoices and identify any discrepancies in the payment process. This new found transparency provides MSMEs with a unique opportunity to seek justice and fair treatment in their business dealings.

Mr. Arun advocated for a transformative approach to business relationships, emphasizing the need for adherence to timelines and financial obligations. He questioned the prevalent system which allows larger corporations to delay payments to small-scale suppliers for extended periods without penalty. This practice disproportionately affects MSMEs, which often bear the brunt of financial hardship. Highlighting the correlation between timely loan repayments and a positive credit score, Mr. Arun proposed a reciprocal principle. He said that, much as people benefit from keeping a high credit score by repaying loans on time, businesses should suffer costs for failing to honour their vendor agreements on time. He proposed the creation of independent credit rating agencies focused on evaluating companies' performance on the criterion of timely payment to vendors. Such an agency, sponsored by organizations like FISME, would provide an unbiased assessment and amplify the importance of timely payments to vendors. By ensuring that companies repay vendors within the agreed-upon timeframe, this concept seeks to reinforce a social norm, recognizing that payment

delays can hinder a company's growth. He stressed that a company's ability to adhere to payment timelines should be a key criterion for assessing its creditworthiness.

It is imperative for the government to take a proactive role in ensuring that both the government departments and the Public Sector Undertakings (PSUs), that are owned and controlled by government prioritize timely payments to vendors. Timely payment to MSMEs should be viewed as an essential component of facilitating a favorable environment for doing business. To set a leading example, the government should demonstrate a commitment to making prompt payments.

Addressing the prevailing reluctance among government officials to expedite payments and open themselves to scrutiny is crucial. With the introduction of the GST payments system and enhanced data analytics capabilities, it is now possible to trace the time lag between invoice issue and payment execution. This valuable information should be made publicly accessible and included in a company's annual report, alongside other financial data. By doing so, the government can foster transparency in the payment process. Recognizing the power of social media, Mr. Arun advocated for its use in holding corporations and governments responsible. He encouraged MSMEs to use platforms like social media to highlight instances where claims of promoting business-friendly environments clash with the reality of payment delays. By mobilizing social media, the sector can initiate a dialogue that fosters transparency and accountability. He underscored the significance of government-led initiatives in setting precedence for prompt payments. While conceding the difficulty of including political issues into decision-making, he emphasized the need of open payment systems. He also emphasized the need of government agencies aggressively fulfilling their obligations to promote similar conduct across industry.

The special address concluded with a powerful call for collective action. He urged MSMEs to unite and demand fair treatment, timely payments, and accountability through collective advocacy. He highlighted the potential impact of such a united front on transforming the business landscape and instilling a culture of respect for vendor-vendor relationships. His address echoed the need for comprehensive reforms to empower MSMEs. His observations offer light on realistic solutions for improving the sector's stability, competitiveness, and equitable growth. The MSME community must seize the opportunity to drive change, leveraging existing frameworks and demanding accountability to foster a vibrant and thriving ecosystem.





“The legal system was designed to perpetuate control over a vast populace with minimal resources. However, this antiquated framework continues to shape the present legal landscape, perpetuating inefficiencies.”

- Justice R.S. Sodhi (Retd.)

Justice R.S Sodhi (Retd.) addressed the elephant in the room, 'How to reduce the cost of litigation and how to control the litigation among yourselves'. He presented an essential principle: the reduction of litigation itself is the foundation for reducing the cost of litigation. To achieve this, he emphasized identifying the root causes of litigation, a task that entails recognizing disputes within organizations and those involving the government. While internal disputes are manageable, those involving the government pose challenges. He delved into the historical origins of India's judicial system, tracing its roots back to the British colonial era. He noted that the system was designed to perpetuate control over a vast populace with minimal resources. However, this antiquated framework continues to shape the present legal landscape, perpetuating inefficiencies.

Furthermore, he questioned the prevalent concept of independence in India, claiming that the history of colonial control continues to impact contemporary views. He stressed the importance of evolving with the changing times and cultivating trust and collaboration between citizens and the government. The symbiotic relationship between government and enterprises is critical and that the prosperity of one is intrinsically tied to the other. Further, he drew attention to the debilitating impact of convoluted regulations on business operations. He bemoaned the inordinate amount of time spent in navigating regulatory hurdles, which hampers business innovation and growth. He shared anecdotes illustrating how even government officials are entangled in the very system they are meant to uphold. Further, he underscored the critical balance between power and accountability, highlighting that the government's success hinges on the prosperity of its citizens. He advocated for a transformation where government policies support ease of doing business, underpinned by clear and unambiguous regulations. Accountability was heralded as the key driver of change.

Justice Sodhi called for a reformation of the litigation landscape. He debunked the notion that the courts are the ultimate solution, instead urging for a proactive approach to reduce the time taken to resolve disputes. He cited personal experiences where timely resolutions were achieved, emphasizing the pivotal role of accountability and streamlined processes. He urged for laws that facilitate easy and transparent business practices, aligning with international standards. He highlighted the excessive harassment by tax inspectors who often coerce small factory and business owners into paying high penalty amounts. This is because they recognize that fighting a challan in a court of law is a time-consuming and onerous process.

The divergence between China and India's economic trajectories was cited as an example of the profound impact of regulatory frameworks on growth. He concluded his address with a strong plea for structural reform. He advocated for a holistic approach that focuses on legislative clarity, decreased bureaucracy, and elimination of unnecessary impediments. Accountability, transparency, and ease of doing business were identified as the cornerstones of a progressive legal framework. Institutional grinding of businesses can only stop if there is accountability at all levels of government. In essence, his address offered a poignant analysis of India's legal and business landscape. His insights underscored the urgency of reform, arguing for a harmonious relationship between government and enterprises guided by accountability and trust. The ultimate purpose of legislation and legal system should be to promote entrepreneurship and support individuals who seek to engage in lawful business activities with dignity. It should not be an impediment to doing business. The address gave a clear imperative to advocate for a progressive legal framework that promotes fairness, efficiency, and above all, the empowerment of both individuals and corporations.



Issue 1. Arbitration

Contract disputes highlight the critical importance of Alternative Dispute Resolution mechanisms, including Arbitration, Mediation, and Conciliation. When compared to traditional litigation, these alternatives are more efficient and expeditious for resolving commercial disputes. However, the process of choosing an arbitrator is fraught with difficulties, which may prompt dissatisfied parties to approach courts, if appointments are not made within the time frame specified.

While there have been some improvements in reducing delays through amendments in Arbitration laws, prohibitive costs continue to burden MSMEs. Several challenges persist in the ADR landscape:

- a. **Appointment of Arbitrator:** While the appointment of an arbitrator is a key step in the arbitration process, there have been issues with delays in appointment. If an arbitrator is not appointed within the stipulated time, the aggrieved party may have to approach the lower courts. However, recent legislative changes may require them to approach the High Courts, which can be more time-consuming and costly, especially for MSMEs.
- b. **Award challenged in High Courts:** Contrary to both the letter and spirit of the Arbitration Act, arbitration awards are frequently challenged in High Courts, often overlooking the admissibility criteria outlined in Section 34 of the Act.
- c. **Prohibitive Costs:** Even though the number of disputes has come down following amendments in arbitration laws, the associated costs of arbitration might still be exorbitant for MSMEs. This financial burden can deter smaller businesses from seeking arbitration as a means of dispute resolution.
- d. **Challenges to Arbitration Awards:** In circumstances where parties lose in arbitration, they may appeal the judgement to the High Court under Section 37, and in some cases, to the Supreme Court. These challenges sometimes overlook the admissibility criteria under Section 34 of the Arbitration and Conciliation Act. If an award is contested and overturned in the HC, it can be appealed under Section 37, adding another layer of litigation. Following that, the issue may be escalated to the Supreme Court, further prolonging the dispute resolution process.
- e. **Execution of Awards:** Even when a party succeeds in arbitration and obtains an implementation award, the process of execution opens up another legal case, necessitating yet another recourse to the High Court.

The cumulative effect of these challenges is prolonged disputes, increased legal costs, and an inefficient ADR system, making it important for stakeholders to address these issues to ensure that ADR remains an effective and accessible method for resolving contractual disputes, especially for MSMEs.

One of the focal points of the 246th Report of the Law Commission of India was to address the issue of neutrality of arbitrators. The practice of appointing existing employees as arbitrators by the public sector enterprises is a glaring aberration to the intended objectives of the Arbitration and Conciliation act which needs to be corrected legislatively.²

² The Reform Decade: Corporate and Commercial Law in India: Edition: 1st Edition 2019, Reprinted 2023. Chapter XI- 'Dispute Resolution'. (p. 490)

These difficulties in the ADR system highlight the need for comprehensive reforms, not only to streamline the process but also to make it more cost-efficient, particularly for MSMEs, and to discourage frivolous challenges that might clog the judicial system. Addressing these issues could contribute to a more efficient and accessible ADR framework in India.

a. Difficulties in enforcement of arbitral award

Over the years, various High Courts have held differing opinions regarding the appropriate jurisdiction for initiating the execution of an arbitral award. Courts in Himachal Pradesh and Madhya Pradesh have maintained that the initial step in executing such awards should involve filing with the court having jurisdiction over the arbitral proceedings. This interpretation is based on Section 42 of the act. Interpreting these provisions in conjunction with Section 36 of the act, which specifies that an award should be enforced akin to a court decree, these High Courts have concluded that executing an arbitral award necessitates obtaining a transfer of decree pursuant to Section 39 of the Code of Civil Procedure. In contrast, other High Courts, namely, Delhi, Madras, Rajasthan, Karnataka, and Punjab & Haryana High Courts, have taken the position that an arbitral award can be directly submitted for execution in the courts where the assets are situated. They argue that Section 42 of the Act does not extend to the execution phase of an arbitral award.³

In the case of *Sundaram Finance Ltd. v. Abdul Samad*, the Supreme Court delivered a pragmatic judgment stating that an arbitral award can be directly submitted for execution in the court where the assets are situated, rather than going through the process of obtaining a transfer of decree from the court that originally had jurisdiction over the arbitral proceedings. This judgment was a welcome relief for those seeking to enforce arbitral awards. However, despite this positive development, the delayed execution and enforcement of arbitral awards continues to pose challenges to expeditious dispute resolution.

Notably, the Supreme Court did not explain on a scenario where neither the judgment debtor resides within the jurisdiction nor do their assets fall under the court's jurisdiction. This omission leaves a gap in the practical application of the ruling, as it does not address how execution applications for the enforcement of awards should be handled in such situations.

Significant changes have occurred in the corporate and commercial legal landscape over the past few years. It has become imperative to restrict certain customary practices, reserving court intervention as a last resort for litigants only when they cannot seek relief from the arbitral tribunal. This approach aligns with the Act's objectives of reducing the extent of judicial intervention in arbitration proceedings. Lower Courts must adhere to the precedent set by the *Sundaram Finance* case when executing arbitral awards.

b. Pre-Conditions under Arbitration agreement

It's a common practice in India to incorporate pre-conditions in arbitration agreements that prescribe specific prerequisites before initiating the dispute resolution clause. The primary intent behind these stipulations is to discourage frivolous claims and the unwarranted initiation of arbitration or other dispute resolution processes. However, these provisions can also deter parties with valid concerns from commencing arbitration proceedings due to the vague nature of the conditions or allegations of bias.

³ The Reform Decade: Corporate and Commercial Law in India: Edition: 1st Edition 2019, Reprinted 2023. Chapter XI- 'Dispute Resolution': Where to file for execution of an arbitral award (pp. 494-495)

The legal landscape in India pertaining to these pre-conditions has been marked by inconsistency and ambiguity, with courts expressing conflicting views on the matter. Consequently, there is an urgent need for legislative clarity to address this issue and establish a more uniform framework for arbitration agreements in the country.

The absence of uniformity and clarity in the interpretation of contractual terms and the imposition of additional conditions undermine the dependability and efficiency of arbitration. This fluctuating legal landscape presents substantial hurdles for small businesses seeking swift dispute resolution.

Recent rulings from various Indian courts highlight inconsistencies, a lack of lucidity, and deviations from fundamental arbitration principles. These verdicts seem to hinder parties' freedom to shape their contracts as they see fit and introduce unnecessary procedural complications. Such judicial shortcomings give rise to apprehensions about the reliability and effectiveness of the arbitration process in India. The question of whether pre-condition clauses in arbitration agreements in India have a mandatory or directory nature remains intricate and continues to develop. The 2015 amendment to the Arbitration and Conciliation Act, 1996, signaled a move towards a more arbitration-friendly approach, constraining the court's involvement and placing emphasis on adhering to pre-conditions. Nonetheless, the interpretation of these clauses still grapples with a lack of uniformity and consistency within the Indian judiciary, leading to ambiguity for parties engaged in arbitration proceedings.⁴

Industry Perspective on Arbitration



“Litigation poses a significant cost for entrepreneurs, often leading them to avoid it due to its cumbersome nature and enduring impact on their businesses. Prolonged duration for issue resolution arises due to complications stemming from unclear arbitration clauses, leading to protracted proceedings.”

-Mr. Neeraj Kedia (Chairman, Banking & Finance Committee, FISME)

Mr. Neeraj Kedia, former President of FISME and Chairman of the Banking and Finance Committee, FISME, provided a comprehensive insight into the challenges faced by entrepreneurs in the realm of commercial dispute resolution.

He shared his personal experience of delivering goods valued at Rs. 60-70 lakhs to Bihar State Industries Corporation, with a significant outstanding payment of Rs. 25 lakhs that remained unpaid. The corporation redirected the funds it had received from the government, intended for distributing products to farmers, towards covering the salaries of its staff. Although the Bihar Court issued a timely order instructing the corporation to fulfil the outstanding payment liability, the designated amount was never received. Furthermore, a contempt petition filed in this regard is yet to be resolved.

His presentation emphasized on the industry perspective, where he shed light on the issues entrepreneurs encounter in the process of resolving commercial disputes. He noted that litigation poses a significant cost for entrepreneurs, often leading them to avoid it due to its cumbersome nature and enduring impact on their businesses. His viewpoint closely aligned with that of Justice R.S. Sodhi, underlining the considerable cost of litigation that entrepreneurs strive to evade, given its potential to stifle their ventures.

⁴ <https://www.livelaw.in/articles/decrypting-arnesh-kumar-guidelines-for-making-arrest-239715?infinitescroll=1>

One of the focal points of his presentation was the role of arbitration in commercial dispute resolution. He highlighted that arbitration reflects the government's intent to provide an alternative to traditional litigation. However, he identified a challenge within the arbitration process—the prolonged duration of 12 to 15 months required for issue resolution. In cases where there is ambiguity regarding the appointment of an arbitrator, the recourse to the High Court is a time-consuming ordeal. This extended timeline often arises due to complications stemming from unclear arbitration clauses, leading to protracted proceedings.

His presentation addressed challenges within the lower courts. He noted the lack of capacity, administrative infrastructure, and delays in issuing and serving summons and warrant. Further, he identified the dysfunctionality of the execution of awards, which exacerbates delays in the resolution process. One of the key issues within the arbitration act, as emphasized by Mr. Kedia from the perspective of MSMEs, is the provision outlined in Section 34 of the act, which allows for appeals to the High Court from arbitration awards. Despite the existence of well-defined criteria for the admissibility of appeals by the High Courts under Section 34, it has been observed that the High Courts often grant appeals in most cases. In several instances, organizations resort to Section 34 against awards issued by arbitrators they themselves appointed.

While remedies for delayed payments have been expedited through the facilitation councils, there are still certain obstacles. These include issues such as insufficient staff at the Facilitation Councils and lack of judicial staff to interpret the orders. As a result, there is often a need to approach courts for the execution of awards issued by the facilitation councils.

M. Kedia's address brought to light the multifaceted challenges that entrepreneurs face in the realm of commercial dispute resolution. He underscored the impact of prolonged litigation on the business ecosystem and used specific case studies to exemplify the complexities involved. Reduced litigation costs would not only enhance the efficiency of businesses but also have a substantial impact on raising per capita income. He estimated the increase in per capita income to be approximately Rs. 3000. He therefore recommended exploring the notion of reducing litigation costs from a broader perspective. The presentation served as a call to action for streamlining the dispute resolution process, enhancing the efficacy of arbitration mechanisms, and creating a more conducive environment for entrepreneurs to navigate disputes without enduring undue hardships.



Cases: Arbitration

Case 1: MSME v Railways

In this case, the dispute revolved around the abrupt and illegal termination of a contract, accompanied by incorrect encashment of Bank Guarantees (BGs). The arbitration process took 13 months to reach an award. Notably, the railway proposed an arbitrator, and an appeal was made under Section 34 of the Arbitration Act to the High Court. Astonishingly, 27 hearings have taken place, involving changes of five judges over 48 months, reflecting the prolonged and arduous nature of the process.

Case 2: MSME v BHEL

This case involved a dispute concerning the unilateral and arbitrary deduction of maximum Liquidated Damages (LD) from an entire contract, under the concept of unjust enrichment. The resolution process spanned 3 years and 4 months, with 5 months in conciliation and 1 year 9 months in arbitration. The journey also involved 3 months of appeal process in a commercial court under Section 34, which was dismissed due to jurisdictional issues. An appeal under Section 34 at the High Court of Delhi has been ongoing for 11 months, highlighting the extended duration and complexity of the process.

Case 3: MSME & its JV Partners Vs UPPTCL

The dispute in this case centered around the unilateral deduction of LD and the non-appointment of a competent arbitrator. The appointment of an arbitrator alone took 11 months, exemplifying the delays that entrepreneurs face within the arbitration framework.



Issue 2: Insolvency and Bankruptcy

Insolvency and bankruptcy issues can be particularly challenging for Micro, Small, and Medium Enterprises (MSMEs) due to their limited resources, financial vulnerability, and unique characteristics. The MSMEs face the following challenges in Insolvency related issues.

- **Lack of awareness:** MSMEs often have difficulty in accessing affordable credit, making it difficult for them to withstand unexpected financial shocks. There is also lack awareness of the insolvency and bankruptcy processes and the benefits they can provide. This results in delayed or inadequate action when facing financial distress. Complex MSME systems also deter MSMEs from resorting to formal procedures to tackle financial distress.
- **Limited Resources:** MSMEs typically have fewer financial resources as compared to larger corporations. This makes it difficult for them to bear the costs associated with insolvency proceedings, such as legal fees, court expenses, and insolvency resolution professionals' fees. Further the Insolvency and bankruptcy proceedings can be lengthy and time-consuming. This can disrupt the day-to-day operations of MSMEs, causing further financial strain and business deterioration.
- **Impact on Creditworthiness:** MSMEs face difficulties in obtaining credit or financing in the future if they become insolvent or bankrupt, which can have a detrimental impact on their ability to recover and grow. MSMEs experience lower recovery rates on their assets during insolvency proceedings compared to larger companies.

- **Creditor behaviour:** MSME lenders require personal guarantees to secure loans, which means that the benefit of limited liability corporate structure is significantly reduced. In case of MSMEs, unsecured creditors have little incentive to participate in insolvency proceedings and incur further costs.
- **Social stigma:** MSMEs are often financed by a combination of corporate financing and personal debt taken by entrepreneur. Failure of an MSME can have serious ramifications for the entrepreneur and their family resulting in social stigma. The societal hurdles deter MSMEs from filing for official insolvency.

MSMEs and IBC: Recovery Enhancement and Litigation Reduction

a. Current Treatment of MSME OCs

Despite the presence of protections for MSMEs under the MSME Act, they find themselves treated at par with other Operational Creditors (OCs) under the Insolvency and Bankruptcy Code (IBC) in India. This equivalency with larger unsecured creditors, often including bigger companies, puts MSMEs at a significant disadvantage during insolvency proceedings. In many cases, resolution applicants, who are potential buyers or investors seeking to revive a distressed company, tend to overlook or neglect the unique status of MSME creditors. This neglect can result in MSMEs not receiving the preferential treatment and timely payments they are entitled to under the MSME Act. Such oversight further exacerbates the financial challenges faced by MSMEs when they are already grappling with the economic fallout of their debtors' insolvency.

This situation underscores the need for more effective implementation of MSME protections within the IBC framework, ensuring that these small enterprises receive the consideration they deserve during insolvency proceedings.

b. Special Treatment for MSME OCs

It is imperative that operational creditors (OCs) falling under the Micro, Small, and Medium Enterprises (MSME) category should be treated differently from other OCs within the framework of the Insolvency and Bankruptcy Code (IBC). The MSME Act explicitly designates micro and small creditors as a distinct class, reflecting their unique status and the government's intent to support and protect these small businesses.

One way to ensure this differentiation is by making it explicit in the information memorandum provided to resolution applicants. By highlighting this classification, resolution applicants can be made aware of the specific rights and protections that MSME OCs are entitled to under the MSME Act. This measure serves to ensure that the interests of these smaller creditors are adequately safeguarded during insolvency proceedings and that they receive the preferential treatment they are legally entitled to.

By making these distinctions clear in the Information Memorandum, it promotes transparency and fairness in the insolvency process, ultimately supporting the resilience and sustainability of MSMEs, which are the backbone of the Indian economy.

c. Correlation between MSME Act and IBC:

The correlation between the Micro, Small, and Medium Enterprises (MSME) Act and the Insolvency and Bankruptcy Code (IBC) is crucial to understanding how these two pieces of legislation interact. Both the MSME Act and the IBC have non-obstante clauses, which means that they have overriding

provisions that can prevail over conflicting provisions in other laws. This is essential in ensuring that the rights and protections granted to MSMEs under the MSME Act can still be upheld in the context of the IBC. Under the MSME Act, micro and small companies can be recognized as "Secured Operational Creditors." This designation is significant because it acknowledges the importance of securing the interests of MSMEs and ensuring that they receive their dues with a higher priority, even in insolvency situations.

The MSME Act emphasizes the right to payment of both interest and principal amounts, reinforcing the idea that MSMEs should not only receive their outstanding payments but also be compensated for any delays, in line with the principle of fair treatment. In contrast, the IBC defines secured creditors as those with security interests, which typically include monetary claims backed by collateral. This definition largely encompasses traditional secured creditors like banks and financial institutions. However, it's essential to ensure that the IBC provisions are interpreted in a way that doesn't undermine the unique rights and protections afforded to MSMEs under the MSME Act. The correlation between these two acts is complex but critical, as it ultimately impacts how MSMEs are treated during insolvency proceedings, making it essential to harmonize the provisions of both acts to provide adequate support and protection to this vital sector of the economy.

d. Harmonious Interpretation for Recovery

Interpreting the Micro, Small, and Medium Enterprises (MSME) Act in harmony with the Insolvency and Bankruptcy Code (IBC) as designating MSMEs as secured operational creditors is a reasonable and beneficial approach. MSMEs indeed have vested rights towards money recovery, which align with the IBC's concept of security interest, albeit in a unique way. By considering MSMEs as a special subclass of secured operational creditors, it ensures that their rights and interests are protected during insolvency proceedings. This classification recognizes the distinct nature of their claims and the importance of prioritizing their dues. This approach harmonizes both pieces of legislation and reinforces the principle that MSMEs should be treated with higher priority and provided with preferential treatment under the IBC. This interpretation contributes to a more balanced and equitable resolution of insolvency cases involving these small businesses.

e. Impact on Recovery and Litigation

Treating Micro, Small, and Medium Enterprises (MSME) operational creditors (OCs) as secured operational creditors can indeed significantly enhance their recovery prospects and bring about several benefits. It not only enhances their recovery prospects but also aligns with the broader policy goals of promoting small business growth and economic stability. This approach can contribute to a more transparent, efficient, and equitable insolvency process for all stakeholders involved.

Case law- Insolvency

Case of MSME supplier to Golden Jubilee Hotels (GJHPL), Hyderabad, Telangana Background:

Two hotels, one operational and one under construction, operate on a Build-Operate-Transfer (BOT) model with a 33-year lease from the Government of Telangana (GoT), comprising rental and revenue-sharing agreements.

Lease Terms and Financial Arrangements:

The lease allows for mortgage to raise finance, and it expires in 2041 with a right of first refusal. Insolvency triggered changes in ownership, subject to the payment of dues and the capability of new shareholders. GoT filed claims as an operational creditor (OC), which includes disputed amounts, stayed claims, and arbitration-related claims, leading to pending litigation.

Insolvency and Claim

GJHPL becomes insolvent in Feb 2018.

GoT files claims as operational creditor (OC) with pending litigation. Claims include disputed amounts, stayed claims, and arbitration-related claims.

Resolution Plan and current status

Resolution Professional (RP) admitted contingent claims without mentioning counter claims. Resolution plan was approved, favouring Special OCs and denying others, including MSMEs. Arbitration award later favoured GJHPL, causing distribution inequity. The National Company Law Appellate Tribunal (NCLAT) intervened, staying the distribution due to the inequity among OC classes. The resolution process was also stuck due to non-payment to GoT, and the successful resolution applicant (SRA) awaits plan execution, affecting MSMEs. The decisions of the Committee of Creditors (CoC) have been questioned, both concerning equity within OCs and adherence to commercial wisdom.

Legal issues in Insolvency and Bankruptcy Code (IBC)

a. MSME concerns with IBC

The Insolvency and Bankruptcy Code (IBC) in India primarily focuses on addressing insolvency issues within companies. However, a notable limitation is that it doesn't provide relief for 'firms,' which constitute a significant 97% of the MSME sector in the country. The absence of specific IBC rules for firms leaves these small businesses in a precarious position when facing financial distress, as the threat of insolvency could lead to severe consequences, including imprisonment for the business owners.

Tragically, more self-employed individuals, many of whom operate within the MSME sector, commit suicide due to financial stress than even farmers facing agricultural challenges. This highlights the urgent need for a more inclusive and tailored approach to address the insolvency concerns of this critical sector.

Efforts have been made to introduce a pre-pack insolvency package specifically designed for MSMEs, but its adoption has been limited, with relatively few enterprises opting for this option. Consequently, when a buyer, typically a larger company, undergoes an insolvency procedure, it often leaves MSME suppliers in a vulnerable position. The dues owed to these small suppliers may be at risk, potentially leading to financial strain and, in some cases, even insolvency for the suppliers themselves.

In conclusion, while the IBC has made strides in addressing corporate insolvency in India, there's a pressing need to extend its coverage to include firms within the MSME sector or develop alternative mechanisms to safeguard the interests of these small businesses and their suppliers when dealing with larger corporate insolvencies.

b. Different classes of creditors

The introduction of Regulation 9-A within the Insolvency and Bankruptcy Board of India Regulations, 2016 brings forth a detailed framework for the submission and validation of claims by creditors who don't fall into the established categories. This has a significant impact on how the courts and tribunals interpret the Insolvency and Bankruptcy Code, 2016.

It's worth noting that the Code traditionally grants insolvency process filing rights to only two types of creditors: operational and financial, in addition to the corporate debtor itself. This has led to some ambiguity regarding the possibility of a distinct category of creditors that doesn't fit within the financial or operational classifications. As a result, different benches of the National Company Law Tribunal (NCLT) have expressed differing viewpoints on this issue.

In *Mahesh Kumar v. AMR Infrastructure Ltd.* The NCLT (Principal bench), New Delhi refused to interfere, citing those applicants are neither operational creditors nor financial creditors and therefore do not have any locus standii. There is a general lack of clarity on this aspect, as NCLT benches differ in their opinions.

c. Exclusion of Civil Courts in Monetary matters

The exclusion of civil courts in monetary matters is a significant aspect of the Insolvency and Bankruptcy Code, 2016 (IBC). The IBC designates the National Company Law Tribunal (NCLT) as the primary adjudicatory authority for insolvency and liquidation matters. The Bankruptcy Law Reforms Committee's report explicitly envisions the NCLT as the exclusive forum for handling such disputes.

A crucial question arises regarding whether the IBC restricts the NCLT's jurisdiction solely to insolvency-related disputes or if it grants the NCLT broader authority, potentially overlapping with matters that could be addressed by civil courts.

Furthermore, Section 9 of the Civil Procedure Code (CPC) states that civil courts have jurisdiction over all suits of a civil nature unless their jurisdiction is expressly or impliedly barred. This raises the question of whether the NCLT's jurisdiction in cases related to contract breaches under the IBC acts as a bar to the jurisdiction of civil courts in these matters.

Given that the IBC is still in its early stages of implementation, there is a need for greater clarity in defining the scope of the NCLT's jurisdiction. This clarity will help ensure that disputes are appropriately adjudicated while avoiding unnecessary overlaps or conflicts between the NCLT and civil courts in monetary matters.

Relevance of Insolvency and Bankruptcy Code to MSMEs

In the panel discussion, **Mr. Arjun Shamlal, Co-Chairman Policy Committee, FISME**, touched upon the Insolvency and Bankruptcy Code and its relevance to MSMEs. He initiated the discourse by acknowledging the IBC as a commendable code while also pointing out its limitations. He highlighted the fact that the code's coverage is limited to private companies and Limited Liability Partnerships (LLPs), excluding proprietorship firms and partnership firms from its ambit. Mr. Arjun raised a pertinent question about the judiciary's ability to manage insolvencies at personal and partnership levels, especially considering the existing burden of corporate insolvencies.

His presentation shed light on the inherent challenges of doing business in India, particularly the negative consequences associated with business failures. Mr. Arjun appreciated the government's effort to distinguish MSMEs under the IBC. However, he emphasized that the focus remains predominantly on insolvent MSMEs, overlooking instances where MSMEs face insolvency due to the insolvency of their clients or buyers.

He further introduced the concept of pre-packaged insolvency plans and highlighted the limited success they achieved. Despite being in existence for over a year, only six cases have been initiated, resulting in just one resolved case, four pending cases, and one withdrawal. The pre-packaged insolvency plan allows formal negotiations between creditors and debtors, although legal intervention remains necessary. He reiterated the point that no MSME willingly opts for insolvency. His presentation provided a statistical breakdown of insolvency cases involving MSMEs as operational creditors. During the Corporate Insolvency Resolution Process (CIRP) stage, it was observed that operational creditors held claims of Rs. 84000 crores out of the total financial outstanding of Rs. 7 lakh 48 thousand crores. Significantly, a substantial portion of these claims belong to MSMEs, accounting for an estimated 50%. However, recovery percentages for financial creditors stand at 33%, while MSMEs experience a much lower recovery rate of 10%. Liquidation cases further highlighted the challenges. With operational creditor claims of Rs. 92000 crores from MSMEs, the net recovery under IBC is estimated to be a mere 3-5%, indicating bleak prospects for many MSMEs in terms of recoveries.

He further discussed the intricacies of MSMEs dues in the context of commercial disputes. He referred to a specific case involving an MSME supplier to Golden Jubilee Hotels (GJHPL) in Hyderabad, Telangana. The case highlighted challenges related to the equitable treatment of operational creditors, leading to a distribution halt by the National Company Law Appellate Tribunal (NCLAT). Outstanding payments to the Government of Telangana compounded the issue, questioning the decisions made by the Committee of Creditors (CoC) in maintaining equity among operational creditors.

Mr. Arjun offered pragmatic solutions to improve the plight of MSMEs in the resolution process:

1. **Classification and Differentiation:** He proposed a clear classification of companies into MSMEs/larger enterprises during insolvency proceedings. This straightforward step can be executed by the Insolvency and Bankruptcy Board of India (IBBI), bringing transparency and clarity to the process.
2. **Special Treatment for MSMEs:** Mr. Arjun advocated for legislative action to provide distinct benefits to MSMEs during the distribution of assets among operational creditors. This differential treatment would acknowledge the unique position of MSMEs in the business ecosystem.
3. **Harmonizing Acts:** Section 15 of the MSME Act states that MSMEs have a vested right to the payment of principal and interest. The IBC defines secured creditors as someone who controls security interest. By recognizing the vested rights of MSMEs for payment of principal and interest, Mr. Arjun proposed elevating the MSMEs to secure creditors within the operational creditor category.

Whether IBC is a boon or bane for MSMEs?



“In a free market economy, the state must foster an ecosystem conducive to entrepreneurial dreams, innovation, intellectual property, and wealth creation. A cultural shift that perceives failure as a stepping stone to success is pivotal to unlocking the entrepreneurial potential of the nation”.

- Mr. Sumant Batra, Lawyer specializing in IBC

Mr. Sumant Batra, a lawyer specializing in Insolvency and Bankruptcy Code (IBC), 2016 addressed the issue of the impact of the IBC on the MSMEs. At the outset, he posed a question to the audience: Whether IBC is a boon or bane for MSMEs. And is there something we can learn from other countries in respect of insolvency laws and implement or suggest to the stakeholders in India?

He expounded on the transformative journey of the Indian economic landscape, the significance of nurturing an entrepreneurial culture, and the challenges faced in implementing an effective insolvency framework for MSMEs. His discourse commenced with a call to reshape prevailing mindsets regarding failure. He underscored the essentiality of recognizing failure as an integral aspect of entrepreneurial risk-taking. Drawing parallels with the United States, he highlighted the paramount importance of nurturing a free market economy, where the state fosters an ecosystem conducive to entrepreneurial dreams, innovation, funding, intellectual property, and wealth creation. Within this process, the State plays a crucial role in ensuring that wealth creation occurs in an ecosystem with minimal obstacles. A cultural shift that perceives failure as a stepping stone to success is pivotal to unlocking the entrepreneurial potential of the nation. Successes and failures are integral components of an entrepreneur's journey, and both should be acknowledged and embraced at the societal level. The creation of wealth through risk-taking can only thrive in an environment where there is a "safe to fail" ecosystem, where failures are not stigmatized. He reflected on his two-decade-long endeavour to advocate for policy changes that promote entrepreneurship.

Mr. Batra further addressed the delayed implementation of Part 3 of the law for partnership and proprietorship. He however countered the assertion that the delay in implementation is due to lack of robust infrastructure. Delving into the intricacies of prepacks and IBC, he elucidated the reasons behind their perceived inefficacy. He contended that the complexity of the law undermines its feasibility for MSMEs. He drew attention to the absence of adequate incentives and the lack of policy conviction, underscoring that banks' reservations further hinder the successful execution of prepacks. He highlighted the need to foster a collaborative and conviction-driven environment to propel these initiatives effectively. He further introduced a novel approach to pre-insolvency resolution, emphasizing creditor-led initiatives. He detailed a streamlined procedure that requires the consent of 66% of lenders to initiate a resolution process. Bypassing the need for NCLT approval for the base plan, this approach expedites the process, ultimately empowering creditors to steer the resolution path.

Recognizing the indispensability of mediation in the MSME landscape, he underscored the role of mediation in reducing litigation costs. He envisioned mediation as a complementary facet of the evolving insolvency framework, advocating for its integration as a solution that fosters efficient dispute resolution.

Concluding on a note of optimism, Mr. Batra acknowledged the ongoing efforts to surmount challenges and refine the insolvency landscape. He underscored the evolving journey towards establishing a harmonious ecosystem that encourages entrepreneurship, nurtures innovation, and safeguards the interests of MSMEs.



Issue 3. Mediation

India's mediation legislation provides a legal foundation for institutional mediation. It seeks to promote and facilitate mediation, especially institutional mediation, for resolution of disputes, commercial or otherwise; enforce mediated settlement agreements, provide for a body for the registration of mediators, to encourage community-driven mediation and to make online mediation acceptable and cost-effective.

Dawn Of Mediation: A Relief for Justice? Critical analysis of Indian Mediation Bill 2021

The pursuit of comprehensive legislation for commercial mediation in India culminated in the formulation of the Draft Mediation Bill 2021 ("Bill"). The Bill encompasses various commendable aspects, including the acknowledgment of a mediated settlement agreement within the Indian Civil Procedure Code 1908 ("CPC"), granting parties the right to request immediate interim relief in courts before or during mediation, regulations for expeditious mediation processes, the inclusion of community mediation, and the establishment of the Mediation Council of India for the formalization of mediation practices. Despite the above, there are several gaps in some of the key provisions of the Bill that makes the Bill a work in progress.

- a. Incorporating Conciliation within the ambit of Mediation :** In Section 4 of the bill, the definition of Mediation incorporates conciliation, which raises two noteworthy concerns. Firstly, conciliation and mediation are legally distinct concepts. In conciliation, the conciliator assumes a more proactive role and is authorized to suggest settlement terms (as indicated in Section 67(4) of the Indian Arbitration and Conciliation Act 1996, or the "Arbitration Act"). Conversely, the Bill does not envision such powers for a mediator. Therefore, one suggestion could be that conciliation be excluded from the ambit of mediation under the bill since the law on conciliation already stands codified in the Arbitration Act.
- b. Mandating Pre-Litigation Mediation :** A distinguishing feature of the bill is the introduction of mandatory pre-litigation mediation. As per Section 6(1), parties in a dispute must initially make an effort to resolve their issues through mediation before initiating any legal action in court. What's intriguing about this section is that it applies this requirement irrespective of whether the parties have a pre-existing mediation agreement in place. In essence, parties would be obligated to explore mediation as a preliminary step before pursuing litigation, even in the absence of a prior agreement to mediate. Requiring mediation before resorting to litigation might be seen as encroaching on a party's autonomy. Forcing parties who are unwilling to mediate their disputes can potentially be counterproductive. It's important to keep in mind that mediation is inherently a voluntary process where parties willingly share sensitive information with a neutral third party.
- c. Restricting Party Autonomy in Choosing Mediators :** The provision in Section 10(1) of the bill stipulates that a "mediator of any foreign nationality shall possess such qualifications, experience, and accreditation as may be specified." At present, this provision contradicts the fundamental principle of party autonomy. In a collaborative alternative dispute resolution (ADR) process like mediation, parties should have the freedom to select a mediator of foreign nationality as they see fit without being overly constrained by criteria set by the Mediation Council of India, as outlined in Section 53(2)(b) of the bill. It's worth noting that a similar provision prescribing qualifications for arbitrators was introduced in the Arbitration Act in 2019 through an amendment. However, this provision received significant criticism for being too restrictive, to the extent that it was eventually removed in 2021. Therefore, the provision in Section 10(1) of the Bill also merits a similar reconsideration.⁵

⁵ <https://mediationblog.kluwerarbitration.com/2022/11/28/a-critical-analysis-of-the-indian-mediation-bill-2021/>

d. Importance of trained Mediators : Mediation proceedings always require a congenial atmosphere. When mediation proceedings are conducted by untrained mediators, they may fall short of delivering the desired outcomes. Lack of an adequate number of trained mediators is another impediment to the acceptability of mediation as an effective dispute resolution mechanism. The importance of trained mediators needs to be realized by stakeholders at all levels. These skilled mediators handle settlement negotiations with a heightened level of professionalism. Moreover, they understand that the process of settling disputes is not a rigid win-lose scenario but rather a nuanced and balanced endeavour.

Mr. J P. Sengh, Senior Counsel addressed the following concerns relating to Mediation at the panel discussion.

1. *Mediation as a concept plays a pivotal role in aiding MSMEs. What are the steps that can be taken to address the issues involved with Mediation?*
2. *Concept of Conciliation has not taken off in India. Should we do away with the Conciliation completely?*



“Mediation act has completely done away with the difference between Mediation and Conciliation. Concept of Mediation did not take off because it was not mandatory. There are provisions for mediation under MSME act but it requires sensitization of members of facilitation councils.”

- Mr. J.P. Sengh, Senior Counsel

Mr. J.P. Sengh commenced by dissecting the components that contribute to the cost of litigation, with particular emphasis on the element of time. The lengthy timelines associated with civil court matters and arbitration were identified as significant contributors to escalating costs, leaving litigants entrapped in a seemingly unending cycle. While arbitration was originally conceived as an alternative dispute resolution method aimed at alleviating the backlog of cases in courts, the process itself can be quite time-consuming. From the initial appointment of an arbitrator to the issuance of the arbitral award and the subsequent judicial review in higher courts if the award is contested, the entire procedure can span over 15 years.

This extended timeline implies that we might find ourselves in a situation similar to traditional litigation in terms of the time invested in the resolution process. Recognizing the limitations of traditional litigation, he explained how India began to explore alternative methods to expedite dispute resolution. This exploration led to the formulation of recommendations to amend Section 89 of the Civil Procedure Code, 1908, paving the way for a new era of dispute resolution. It was during this phase that mediation emerged as a promising alternative.

Mr. Sengh clarified the distinction between mediation and conciliation, highlighting the nuanced difference that lies in the role of the facilitator. A conciliator is a domain expert empowered to offer advice. Conversely, a mediator, a neutral facilitator, refrains from providing advice, instead focusing on facilitating communication and collaboration among the parties to help them reach mutually acceptable solutions. He also traced the historical roots of mediation, acknowledging its mention in the Arbitration and Conciliation Act of 1996. However, it was only with the amendment of Section 89 in 2002 that mediation gained prominence through the establishment of court-annexed mediation centers. As a result of this amendment, it became mandatory to go for mediation in matters that were pending before the courts.

Further, he delved into the MSME Act of 2006, which introduced provisions related to mediation but fell short in terms of implementation. The Mediation Act has completely done away with the difference between mediation and conciliation. The absence of mandatory mediation and a lack of awareness among facilitation council members hampered its effective adoption. Mr. Singh highlighted the potential of mediation to resolve disputes within the MSME sector, citing court-annexed mediation centers' impressive success rates. Furthermore, he outlined the steps required to effectively implement mediation within the MSME framework. Sensitizing members of the facilitation council and creating a panel of mediators well-versed in MSME issues were identified as crucial prerequisites.

Addressing the prevailing mindset among MSMEs, He emphasized the importance of shifting focus from prolonged disputes to time-bound resolutions, especially if the process assures the recovery of principal amount within time-bound frame for the MSMEs. This mindset shift, he argued, would foster a greater willingness to engage in mediation and reach consensual settlements. Mr. Singh further highlighted the benefits of mediation process. The majority of mediated settlements are consensual in nature, thereby obviating the need for formal execution, as the involved parties willingly adhere to the agreed-upon terms. The mediation process operates around the clock and doesn't demand extensive infrastructure. He underscored the adaptability of mediation to the digital realm, noting that online mediation remained operational even during lock-downs. This adaptability not only enhances accessibility but also reflects the changing landscape of legal proceedings.

He also addressed the varying perspectives on the arbitration process as outlined in the Arbitration Act and the MSME Act. He delved into the question of whether the MSME Act takes precedence over the Arbitration act in so far, the arbitration proceedings for MSMEs are concerned. In contrast, when it comes to mediation, there is a clear and simple procedure for appointing mediators. If disputing parties fail to reach an agreement on an appointment, they can seek the assistance of a service provider. Another advantage of the mediation process is its adherence to a defined timeline. The 90-day timeframe for mediation in India can be attributed to the absence of dedicated Mediation Bars. But in countries like the USA, where dedicated Mediation Bars exist, disputes are often resolved within a much shorter span, typically within 3 days. Once a settlement is reached through mediation, it is immune from subsequent challenges since it is based on mutual agreement. Consequently, the implementation of such settlements is expedited due to the parties' concurrence.

His address underlined the fact that mediation as a dispute resolution mechanism has the potential to work but needs to be implemented effectively. While concluding, he underscored the urgent need for creating awareness about mediation and sensitizing stakeholders within the MSME sector. By fostering a culture of timely resolution and adopting alternative dispute resolution mechanisms, the MSME sector can significantly reduce litigation costs and expedite growth.



Issue 4: Delayed Payments

From a legal perspective, delayed payments are defined as instances where buyers postpone their payments to Micro & Small Enterprise (MSE) suppliers for a period of 45 days, as stipulated by the MSME Act 2006.

Delayed payments and the absence of formal financing options for MSMEs have had a detrimental impact on India's job creation efforts, as highlighted in a report by the Global Alliance for Mass Entrepreneurship. Micro-enterprises alone account for approximately 23 percent of India's total workforce. A substantial amount, around Rs.10.7 lakh crores, is tied up in delayed payments from buyers to MSME suppliers, which amounts to an estimated 7.8 percent of the country's GDP. Remarkably, 80 percent of this outstanding sum is owed to micro and small enterprises, totaling Rs. 8.55 lakh crores. In addition to grappling with payment delays, business owners also face challenges from non-representative and exclusive evaluation criteria, which hinder their access to loans and financial support.⁶

Delays in payments present a significant issue within the MSME sector. MSME businesses operate on credit and any delay in payments from customers hinders their ability to pay off working capital loans on time, impacting their creditworthiness. The cost to MSMEs is not just in terms of working capital constraints. It also restricts the ability of MSMEs to access new technology. Occasionally, there are valid quality or commercial reasons that justify payment delays; however, the majority of delayed payments stem from a desire by large buyers to minimize their working capital requirements.

Delayed payments are more of an issue with Public Sector Enterprises (PSUs) often due to their regulated procurement processes. Purchases at the sub-national level are often done without drawing up budgets, and corruption can enter at any stage of the buying process, delaying the payment. From a legal perspective, delayed payments occur when buyers defer payments to their suppliers by 45 days. An astounding Rs.10.7 lakh crores are currently tied up in delayed payments from buyers to suppliers, equating to an estimated 7.8 percent of India's GDP. Notably, 80 percent of this substantial sum is owed to small and micro enterprises, totaling Rs. 8.55 lakh crores.

In essence, the size of the business directly correlates with the extent of suffering caused by buyers who fail to make timely payments. By holding back these substantial sums of capital from India's smallest enterprises, they are denied the chance to expand, provide value to their owners, and support the millions of ordinary households that depend on them. This trend does not align with the entrepreneurial spirit that India's leadership aims to foster, making the establishment of small businesses a risky and tumultuous endeavour.

There's a pressing need for a robust digital ecosystem to bridge the gap and effectively address the challenges associated with delayed payments. Digital solutions that bring together government entities, corporations, financiers, and financial facilitators, such as credit bureaus and fintech companies, play a pivotal role in mitigating and resolving the issue of delayed payments.

⁶ <https://www.thehindubusinessline.com/economy/delayed-payments-lack-of-formal-financing-in-msmes-affect-job-creation/article66576684.ece>

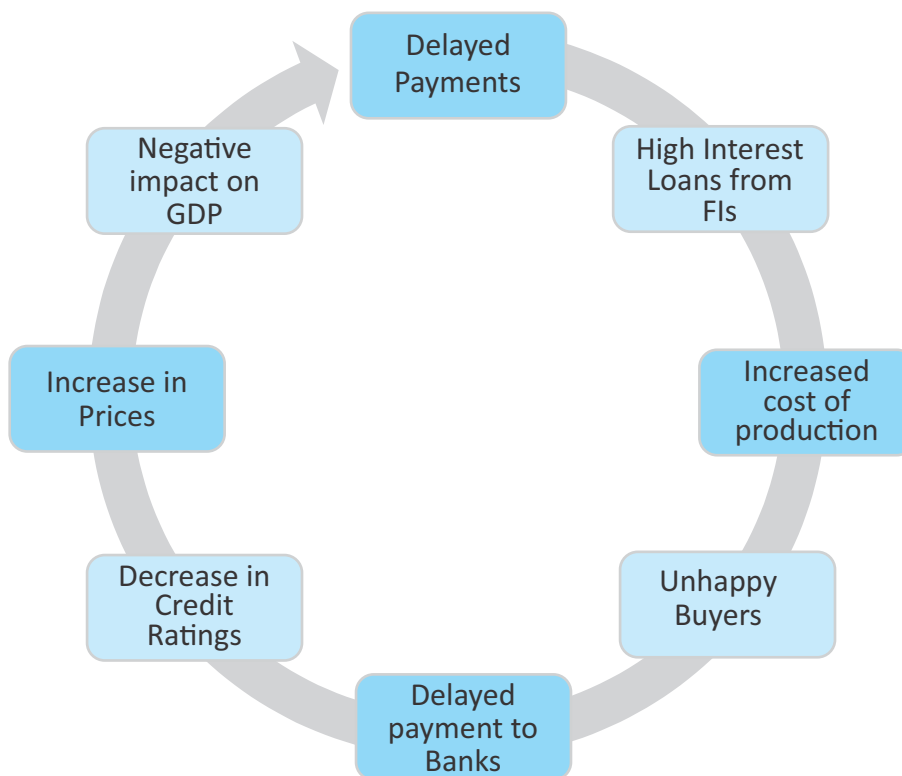
Deficiencies in established safeguards

India possesses an array of laws designed to safeguard MSMEs, prominently among them being the MSME Act of 2006. This legislation empowers state governments to establish Micro and Small Enterprise Facilitation Councils (MSEFC) to expeditiously resolve payment-related disputes through arbitration and conciliation, with a mandated resolution period of 90 days. Despite the optimistic outlook of these safeguards, their practical implementation falls short.

The leadership of MSEFCs often rests with the State Commissioner of Industries, a role laden with multiple responsibilities. This, coupled with a shortage of judicial staff within these councils, results in judgments that lack robust legal reasoning, rendering the awards susceptible to challenges. Although the Supreme Court has unequivocally deemed arbitral awards by Facilitation Councils as final, allowing appeals to higher courts only under exceptional circumstances, a persistent trend of appeals on frivolous grounds continues.

In 2014, the Reserve Bank of India (RBI) introduced the online bill discounting platform TReDS, offering MSME suppliers the opportunity to discount their invoices and raise funds through auctions. However, Central Public Sector Enterprises (CPSUs) and companies with a turnover exceeding Rs. 5000 crores, obligated to register on TReDS, have shown a lack of compliance. Even among the registered CPSUs, the utilization of TReDS remains minimal, with less than 10% of total invoices being discounted through this platform.

Figure: Vicious cycle of delayed payments to MSMEs⁷



⁷ 'Unlocking the full potential of India's MSMEs through prompt payments'- a Report by Global Alliance for Mass Entrepreneurship (GAME) and Dun & Bradstreet (D&B)

Consequences of delayed payments to MSMEs



“True cost of delayed payments to litigants transcends monetary figures. For MSMEs, the prolonged timeframe often results in insufficient resources to sustain operational costs, potentially endangering their very existence.”

- Dr. Swati Jindal Garg, WeVaad Expert on delayed

Delayed payments have a direct, adverse impact on the working capital cycles and cash flows of a business, both of which are critical to its overall profitability and its capacity to expand and grow. When payments from accounts receivable are delayed, a business confronts difficult choices. It must either postpone the acquisition of raw materials or liquidate its raw material inventory, resulting in reduced production and sales within a cycle. Alternatively, it may need to secure short-term financing at high interest rates to maintain cash flows. The latter option can lead to unforeseen hikes in production costs or increases in the prices of goods and services offered, which have to be passed on to customers.

When buyers extend the withholding of payments beyond the agreed credit periods, they effectively gain access to free cash that they can use to finance their own working capital cycles, at the expense of their suppliers. If this practice becomes a recurring pattern across sectors, it suggests that delaying payments is being strategically employed by many larger businesses and even Public Enterprises to benefit at the expense of MSMEs. Cumulatively, delayed payments can trigger disruptions in the supply chain, extending all the way to finished goods, and make it challenging for end products to reach markets on schedule, all the while making it difficult to maintain a fair and reasonable price for end consumers.

Dr. Swati Jindal Garg, a WeVaad expert, in her address delved into the intricacies of the MSME Act and its provisions related to delayed payments, uncovering the far-reaching impact of timely payments on the sector's growth and sustainability. She initiated her address by contextualizing the relevance of the MSME Act, particularly Sections 15-24, which address the vexing issue of delayed payments within the sector. She highlighted that the Act serves as a protective mechanism, stipulating that the buyer must ensure payment within 45 days. Additionally, she emphasized that the Act enforces compound interest, with monthly rates, at three times the bank rate for any payment delay. Drawing attention to the vital role played by MSMEs in India's economy, she noted that these enterprises contribute a staggering 29% to the GDP and account for 40% of India's exports. With a workforce encompassing 21% of India's labour force, translating to 80 million jobs, the significance of the MSME sector cannot be overstated. Despite its substantial contributions, the sector grapples with challenges arising from delayed payments, impairing cash flows, and threatening insolvency. She expounded on the ramifications of delayed payments, emphasizing that the true cost to litigants transcends monetary figures. The irretrievable loss of time, often resulting in prolonged litigation, underscores the adage that "justice delayed is justice denied." Highlighting the severe implications of time lost, she underscored the urgency of addressing this critical issue.

Emphasizing on the post-award phase, she underscored the challenges associated with award implementation. She emphasized that the true test of cost lies in the years it takes to execute an award. For MSMEs, the prolonged timeframe often results in insufficient resources to sustain operational costs, potentially endangering their very existence.

She meticulously dissected Section 16 of the MSME Act, which pertains to delayed payments by buyers. The provision mandates compound interest, at three times the RBI rate, for buyers who fail to meet their payment obligations. She delved into the dilemma faced by MSMEs, where some opt for litigation over increased interest, inadvertently sacrificing time that could be better spent elsewhere.

She proposed remedies for the prevailing issues, suggesting that MSME facilitation councils could play a more impactful role with enhanced authority. She envisioned a scenario where these councils possess powers such as stopping payments from defaulters' accounts, thus rendering them more effective in facilitating timely resolutions.

Furthermore, she advocated for a rating system wherein buyers are assigned ratings based on their payment track record. This innovative approach empowers suppliers with critical insights, enabling them to make informed decisions regarding potential business partnerships. She concluded by emphasizing the pressing need for ADR and ODR mechanisms in addressing delayed payment disputes. Acknowledging their resource-efficient nature and widespread accessibility, she expressed confidence that ADR and ODR could democratize access to justice, aligning with the vision of doorstep delivery of justice.

In her closing remarks, she advocated for the prioritization of timely payments and the adoption of alternative dispute resolution mechanisms, while also underscoring the vital importance of considering litigation as a last resort.

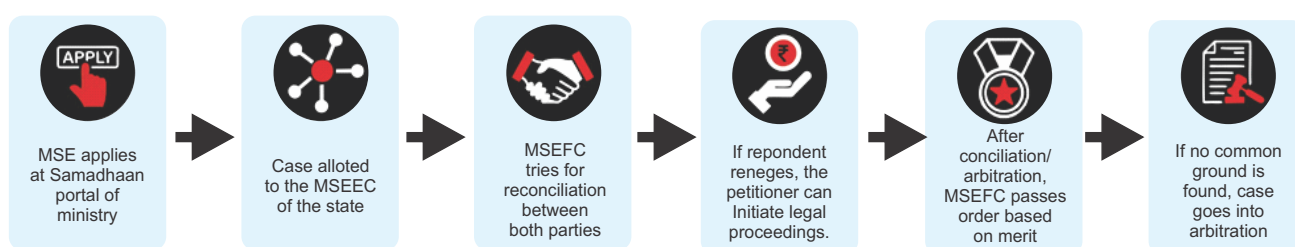
Suggestions to resolve delayed payment issue

- a. **Disclosure of Arbitration Case Details to MSME Vendors** : Government procurement agencies must regularly disclose details of pending arbitration cases, including the corresponding amount to the MSME vendors on a quarterly basis.
- b. **Qualified arbitrators in the Arbitration Council** : The Arbitration Council should choose from a panel of qualified arbitrators. Currently, a conciliator acts as an arbitrator.
- c. **Inclusion of Accrued Interest with Principal Amount** : Arbitral awards should explicitly mention the interest accrued with the principal amount. This ambiguity occurs due to the phrase 'unless otherwise agreed' under Section 31 of the Arbitration Act, which must be removed.
- d. **Clarity in legal standards** : The terms 'Public Policy/Fundamental Policy of Indian law' in Sec. 34 of the Arbitration and Conciliation Act should be clarified and the judiciary sensitized so that cases are not accepted in High Courts on frivolous grounds.
- e. **Ensuring timely enforcement of the arbitral award** : It should be ensured that once the arbitral award is granted, payment is made. If the arbitral award gets challenged under Sec. 34, the company should be made to deposit the amount with the court. Additionally, there should not be any separate execution proceedings for transfer of arbitral award to decree holder.
- f. **Enhancing Cash Flow-Based Lending** : The availability of working capital from financial institutions is crucial for the economic survival of MSMEs. Recent developments in the Indian financial ecosystem, such as the Unified Payments Interface (UPI), Goods and Services Tax Network (GSTN), mandatory e-invoicing for businesses above a certain revenue threshold, Central Know Your Customer (CKYC), and others, have collectively created an ideal environment for the growth of Cash Flow-based Lending.⁸
- g. **Credit Guarantee Inclusion** : Incorporating cash flow-based lending into government-sponsored credit guarantee schemes can be considered. The success of the Emergency Credit Line Guarantee Scheme (ECLGS) in recent years can serve as a blueprint for establishing such a scheme. Furthermore, exploring a state-level credit guarantee scheme in collaboration with fintech companies is a logical step. An initiative like the Raising and Accelerating MSME Performance (RAMP) scheme, initiated jointly by the World Bank and the Government of India, can support this direction.

8 'Unlocking the full potential of India's MSMEs through prompt payments'- a Report by Global Alliance for Mass Entrepreneurship (GAME) and Dun & Bradstreet (D&B)

- h. **Reinforcing TReDS by Integrating GST Data:** The Standing Committee on Finance has suggested integrating TReDS portals with the GST e-invoicing portal. Once invoice information is accessible on TReDS, the buyer's input tax credit reports can be utilized to verify the authenticity of an invoice and use it as an implied acceptance of the bill. This can streamline factoring transactions.
- i. **Credit Guarantee for Factoring Transactions:** The Credit Guarantee Fund Scheme for Factoring (CGFSF) reduces risk aversion among banks. This government scheme aims to promote 'factoring without recourse' by offering a credit guarantee cover where factors bear the initial 10% of the defaulted amount, and the remaining 90% is shared between the National Credit Guarantee Trustee Company (NCGTC) and Factors in a 2:1 ratio. Integrating CGFSF with TReDS can boost financial institutions' willingness to discount invoices with lower credit ratings thereby encouraging buyers to conduct transactions on the platform.

Dispute Resolution Proceedings under MSMED Act, 2006



Study of Functioning of Courts: Important Findings

(A case study in context of Meerut)

The situation in Meerut, with regard to its legal system and judicial infrastructure, presents several significant challenges. The city experiences fewer than 100 working days annually, primarily due to various factors such as strikes, holidays, religious events, and the absence of judges on leave. These collective factors contribute to a substantial reduction in the efficiency of the local legal system.

Furthermore, the state of the infrastructure in Meerut's courts is a cause for concern. Basic amenities, including seating and filing space, are severely lacking, hindering the smooth operation of judicial proceedings. The level of e-readiness, encompassing both hardware and software, is notably low in Meerut, affecting the court's ability to embrace digital technologies for efficient case management and administration.

A striking comparison emerges when examining Meerut's case disposal rates in contrast to the South West District of Delhi. While Delhi boasts a significantly higher utilization of digital technologies, Meerut's usage lags far behind. In terms of new cases instituted, South West Delhi Court records a staggering 50 times more cases than Meerut. However, despite this disparity in case load, Meerut's backlog of pending cases is a staggering 60% higher than in Delhi.

A crucial aspect contributing to this backlog is the remarkably low case disposal rate in Meerut, which stands at a mere 1/82 of that observed in Delhi. This glaring disparity underscores the urgent need for systemic reforms and investments in Meerut's legal infrastructure, including the adoption of modern technologies and an increase in judicial efficiency, to ensure that justice is delivered more swiftly and effectively to its residents.

Cases- Delayed Payments

Case-1 : **MSME Vs MPG Hotel, Trivandrum (subsidiary of Muthoot Finance)**
Type of Dispute: Non-payment of dues after taking delivery of goods.
Date of Supply: Fiscal Year 2013-14.
Outstanding Amount: Rs. 92 lakhs, unpaid until 2015.
Case Filed in U.P FC: March 2015, claiming Rs. 92 lakhs as principal amount plus interest.
Award in Favor: February 2017, totaling Rs. 1.92 crores after nearly 2 years.
Current Status: The defendant obtained ex-parte stay from Allahabad High Court in 2017, and the case has remained pending since then.

Case-2: **MSME Vs Madhyanchal Vidyut Vitran Nigam Ltd (MVVNL)**
Type of Dispute: Non-payment of dues for supplied in 2017-19 Arbitral award in favor of MSME Rs. 9.97 crores on 27.01.2022.
Execution of Award: Process delayed for execution of decree by non-appearance & frivolous petitions by MVVNL, the litigant in the Commercial Court.
Current Status:

- MVVNL filed an appeal in HC on such frivolous grounds as challenging jurisdiction of the Commercial Court of Lucknow.
- Alongside, MVVNL appealed to Commercial Court at Kanpur, requesting for grant of stay without depositing 75% of the amount defying MSME Act.
- After Kanpur court disposing of all their objections, MVVNL filed an appeal before Allahabad HC seeking stay from depositing 75% of the amount.
- No payment even after 18 months securing decree.
- Unit employing 100 people comes to verge of closure.



“The biggest challenges MSMEs face in litigating against the Government for their payments is that the Government changes the rules and hence the award is never honoured. Unless MSMEs proactively highlight their concerns, their issues will be get sidelined by Media.”

***- Mr. Tarun Nangia,
content ideator of the show-
'LEGALLY SPEAKING'***

Mr. Tarun Nangia, content ideator of the show- 'LEGALLY SPEAKING', outlined strategies for MSMEs to amplify critical issues. He stated that the biggest obstacle faced by MSME vendors when pursuing legal action against the government for overdue payments is that the government has the power to modify regulations and other mechanisms, effectively nullifying arbitral awards. This not only affects the vendors and contractors who suffer from delayed payments but also increases the procurement costs for the government in the long run. This is because bidders for future projects factor in litigation costs and potential delays or non-payments.

Mr. Nangia highlighted this aspect with the case of a vendor who secured an arbitral award against a Metro project. However, things took a turn when the Ministry of Housing and Urban Affairs proposed an amendment to the Metro Railways (Operations and Maintenance) Act, rendering Metro Railways' assets immune from attachment, which made it challenging for the vendor to receive payments from the government.

He raised concerns about the extensive scrutiny of arbitration awards by the courts. He emphasized the need for judicial restraint, as frequent court interventions tend to undermine the sanctity of the arbitration process. On a positive note, he mentioned a recent observation by the Chief Justice of India in a case where the government challenged a relatively small arbitration award of Rs. 9 lakhs in the Supreme Court.

In his concluding remarks, Mr. Nangia emphasized the importance of MSMEs using the media as a platform to voice their concerns. He stressed that unless MSMEs proactively bring their issues to the public's attention, the media, which tends to focus more on larger companies, may sideline their problems.



“Government's primary focus is on tackling litigation expenses through Mediation. The Ministry of MSME is currently in the process of upgrading the Samadhan portal to transform it into a comprehensive ODR platform.”

***- Ms. Isha Aggarwal (RAMP,
Ministry of MSME)***

The government's perspective on reducing litigation costs for MSMEs was shared by Ms. Isha Aggarwal, who represented the RAMP project of the Ministry of MSME. Raising and Accelerating MSME Performance” (RAMP) is a World Bank- assisted Central Sector Scheme that aims at improving access to markets and credit for MSMEs and strengthening institutions and governance at the central and state levels.

Ms. Isha underscored that the government's primary focus is on tackling litigation expenses through mediation. She pointed out that Alternative Dispute Resolution (ADR) is the initial step towards expediting the resolution of commercial disputes, and the next step in this direction is Online Dispute Resolution (ODR). SEBI has already taken a significant step in this regard by issuing a circular. The Ministry of MSME is currently in the process of upgrading the Samadhan portal to transform it into a comprehensive ODR platform.

Additionally, she highlighted the government's plan to provide legal aid when disputes reach the Facilitation Councils. One of the key challenges she raised was the shortage of trained mediators. To address this, the government is actively working on bringing in expert mediators and arbitrators to enhance the quality of arbitral awards.

Ms. Isha concluded her remarks by mentioning several other initiatives. The government is working on implementing a rating system to evaluate the timeliness of payments made to vendors. Furthermore, they aim to offer vernacular support to assist MSMEs in accessing the Samadhan Portal and are planning to establish a legal help desk to further support MSMEs in navigating the complexities of the legal process.

Conclusion

The seminar on 'Reducing Cost of Litigation for MSMEs', provided a comprehensive platform to explore innovative strategies for alleviating the financial burden of litigation faced by MSMEs. Esteemed legal experts, stakeholders, and luminaries gathered to deliberate on this pressing issue, paving the way for a more conducive business environment.

The majority of the litigation pursued by MSMEs is for claiming payment of outstanding invoices raised by them for their clients. A whopping Rs. 11,282 crores have been claimed as outstanding invoices owed to micro and small enterprises (MSEs) in the cases registered with the MSME Facilitation Centers across the country.⁹ In relation to these Centers, there has been a consistent drop in the disposal of cases. In fact, in the financial year 2022-23, out of a total of 29,252 applications filed by MSEs for claiming outstanding payment of Rs. 7,093 crores, only 3.5% of the same were disposed off.¹⁰ Accordingly, there is an immediate need for alternatives that can provide time-bound and cost-efficient modes of proceedings which can help MSMEs recover their outstanding invoices faster. Outstanding invoices pose a threat to the survival of these MSMEs. The seminar's discussions revealed that litigation costs present a significant challenge to the growth of MSMEs. These enterprises, constituting the backbone of India's economy, contribute to innovation, employment, and GDP but are stifled by the exorbitant costs of legal proceedings.

The insights shared by the speakers emphasized the need for reform to enable MSMEs to thrive. The government plays a crucial role in this context because it is a major contributor to procurement from MSMEs. Additionally, government policies have a significant impact on the overall business environment. The success of mediation will inevitably depend on government's willingness to participate in the mediation process.

The seminar's roster of speakers, including Mr. Prashant Patel, Justice R.S. Sodhi, Mr. T.K. Arun, Mr. Neeraj Kedia, Mr. J.P. Sengh, Mr. Sumant Batra, and Dr. Swati Jindal Garg, illuminated various facets of the issue. Key takeaways include the imperative to recognize failure as an inherent part of entrepreneurial risk-taking, the need for a reformed legal framework to expedite dispute resolution, and the potential of mediation and arbitration to streamline processes and reduce costs.

Concrete recommendations emerged, such as the creation of a comprehensive dashboard to track cases, promoting timely vendor payments through independent credit rating agencies, and embracing online mediation. The speakers highlighted the importance of legislative reforms, raising awareness, and fostering a culture that values timely resolution to ameliorate the hurdles faced by MSMEs.

In cases where payments to small enterprises are pending, the MSME Act offers a glimmer of hope. One of the demands from MSMEs is to expedite the execution of arbitral awards. Previously, these awards could be taken to the NCLT, but now an embargo of Rs. 1 crore has been introduced, which has excluded 70% of MSMEs. Moreover, High Courts tend to grant stays on arbitral awards, and it's important that there be a valid reason for challenging such awards. Under no circumstances should ex-parte stays be granted. To address this issue effectively, fast-track courts should be established where the disputed amounts can be deposited promptly. It is essential to introduce penal provisions for parties that fail to adhere to arbitral decisions and do not fulfil their payment obligations. There is also a

9 MSME Delayed Payments: Amount disposed so far crosses Rs. 5,000 crores, The Financial Express, 7 June 2023.

10 <https://www.financialexpress.com/business/sme-msme-fin-msme>.

pressing need to enhance the accessibility of mediation centers. These centers should not be limited exclusively to High Courts. Additionally, it is essential to reevaluate the Partnership Act of 1932. The government could consider establishing a specific timeframe after which partnerships must be converted into Limited Liability Partnerships (LLPs).

Online Dispute Resolution (ODR) mechanisms align well with modern requirements. These methods of resolving disputes encompass arbitration, mediation, conciliation, and negotiation, among others. In India, we currently have institutional ODR mechanisms in place, enhancing transparency and clarity in the procedural aspects of any case. For MSMEs, managing time and reducing litigation costs are of paramount importance. Therefore, streamlining the arbitration process to ensure that cases are resolved within specified timeframes is crucial. According to the NITI Aayog ODR Handbook 2021, the adoption of ODR has the potential to contribute approximately Rs. 1,99,000 crores to the GDP. This contribution arises from savings in legal expenses, opportunity costs related to the productive working days of a resource being invested in court hearings, and savings on mental well-being. Hence, these alternatives play a vital role in minimizing litigation. The seminar underscored the urgency of tackling the litigation cost for MSMEs. By fostering an ecosystem that values timely resolution, transparency, and accountability, India can pave the way for a flourishing MSME sector that drives economic growth, innovation, and job creation. The collective wisdom shared at the seminar serves as a catalyst for reform and lays the foundation for a more equitable and prosperous business landscape. While there were various systemic and structural amendments to the legal regime to ensure that the costs incurred by MSMEs in litigation were reduced, it is important to understand and analyze if there are alternatives available which MSMEs could avail of.

In conclusion, to ensure the effectiveness of the arbitration process in delivering justice to MSMEs, it is crucial to implement a comprehensive set of measures that address the key shortcomings of the current system. These measures include expediting arbitrator appointments, adopting cost-effective arbitration mechanisms, discouraging frivolous challenges, clarifying legislative ambiguities, enhancing transparency through quarterly reporting, ensuring interest inclusion in arbitral awards, and streamlining award enforcement procedures. By implementing these measures, we can create a more fair and efficient arbitration system that truly serves the interests of MSMEs.

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Speakers' Profile



Chief Guest

Shri Arjun Ram Meghwal is Minister of Law and Justice (independent charge). He has also been a member of Lok Sabha since 2009 representing the Bikaner constituency in Rajasthan. He was awarded the Best Parliamentarian in 2013. He is also Co-Chairman of the Committee on the Reservation in Judiciary, under the National Commission for SCs



Guest of Honour

Shri Rajendra Agrawal is a member of the Lok Sabha of India from the Meerut- Hapur Lok Sabha constituency in Uttar Pradesh. He is the Chairman of the Committee on Government Assurances and a member of the Panel of Chairpersons of the Lok Sabha. He has introduced several private members' bills in the Parliament on very important issues. He has consistently raised issues concerning MSMEs in Parliament and outside.

Speakers



Mr. T.K. Arun Editor, Opinion of The Economic Times, India's leading business paper. He headed the economy bureau and looked after the editorial page in another stint in the past. He has also worked as a technical advisor at the Kerala State Planning Board before beginning his career in journalism in 1992 at the Observer of Business and Politics, New Delhi. He did his Master's in economics from the Centre for Economic Studies and Planning, Jawaharlal Nehru University.



Mr. Prashant Patel is Director of R.K. Synthetics Ltd, Ahmedabad, & Prashant Industries, Surat. Mr. Patel is a veteran of working with industry associations. He served Secretary of the Gujarat Dyestuffs Manufacturers' Association and has worked extensively in industry associations. He has been Secretary to Vatva Industries Association (Ahmedabad) and General Secretary to Saykha Industries Association (Bharuch) and played an instrumental role in turning around the infrastructure in Vatva and Narora industrial areas. He was elected President of FISME in 2022.



Justice R.S. Sodhi (Retd.) enrolled as an advocate in the High Court of Delhi on July 27, 1972. He practiced constitutional, civil, criminal, land revenue and excise matter in the High Court as well as the Supreme Court of India. He was the Advocate-on-Record in the Supreme Court of India for the State of Punjab from 1987-89. He was appointed as Additional Advocate General for the State of Punjab from 1997 till 6th July 1999. He was appointed as Judge of the Delhi High Court on 7th July 1999. He retired on 7th November 2007.



Mr. Neeraj Kedia hails from the reputed marwari business family in Muzaffarnagar. From the traditional commodity business of the family, he set up a plant to manufacture zinc sulphate in Muzaffarnagar, which is one of the largest integrated plants in India. He also has set up plants in Gandhidham, Gujarat and in Bangalore, Karnataka. He has been President of FISME and true to his Marwari spirit, he continues to be Chairman of the Banking and Finance Committee of FISME.

Speakers



Mr. Bishwajit Dubey is an independent lawyer & former partner at CAM (Cyril Amarchand Mangaldas). He has advisory, litigation and arbitration experience spanning over 19 years in dispute resolution, insolvency, debt recovery, product liability, infrastructure, corporate, commercial, contractual, and intellectual property. He assisted the Solicitor General of India in successfully defending the Insolvency Code in the Supreme Court of India.



Mr. Sumant Batra is an insolvency lawyer of global eminence with three decades of experience in the areas of insolvency, bankruptcy and related laws. His work ranges from policy making to the drafting of legislation and regulations, designing best practices, assisting the courts in the development of jurisprudence, and delivering capacity-building programmes for stakeholders. He also holds the distinction of being the youngest and the first President of INSOL International from Asia.



Mr. J.P Sengh is a well-known civil, commercial and arbitration lawyer. He is the founder organizing secretary of Samadhan, the Delhi High Court Mediation and Conciliation Centre. He has been a part of the training programs for mediators, lawyers, and judicial officers held within India and abroad. He was appointed by the Mediation and Conciliation Project Committee of the Supreme Court of India as an observer of several training programs. He is the Secretary General of Maadhyan International Council for Conflict Resolution.



Dr. Swati Jindal Garg is the founder of the law firm - Swati Jindal Garg & Associates and practices in the Supreme court of India, Delhi High Court, NCDRC, NGT, CAT, and all district courts and tribunals in Delhi. She is also on the legal panel of various private and government organizations. She is also an Advocate on Record, Supreme Court of India. She is also a specialist in Intellectual Property Rights.

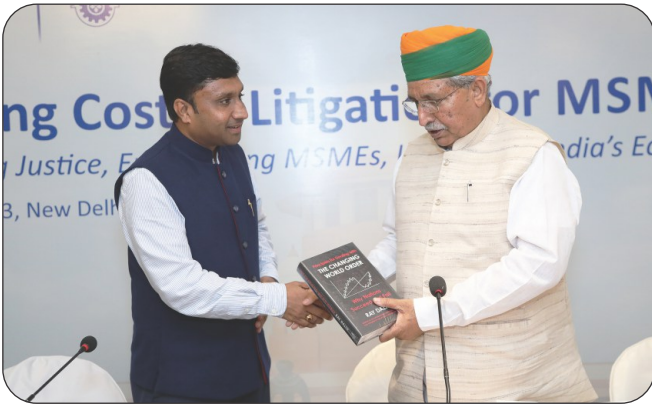


Mr. Tarun Nangia is the content Ideator & creator/communication strategist. Tarun Nangia was the first editor host to interview a sitting Supreme Court Judge on TV for 'Legally Speaking with Tarun Nangia'. The 'Legally Speaking' news platform provides the latest news, finest editorials and detailed evaluations of legal policies and law. A brainchild of Mr. Tarun Nangia, 'Legally Speaking' has emerged as one of the most coveted legal segments across various platforms.



Ms. Isha Aggarwal represented the Ministry of MSME. She has been associated with the RAMP project of the Ministry of MSME. Raising and Accelerating MSME Performance” (RAMP) is a World Bank assisted- Central Sector Scheme that aims at improving access to markets and credit for MSMEs and strengthening institutions and governance at the central and state levels.

Event Gallery





About Federation of Indian Micro and Small & Medium Enterprises (FISME)

Federation of Indian Micro and Small & Medium Enterprises (FISME) evolved into a large national Federation of geographical and sectoral associations of MSMEs in 1995 following India's embarking upon liberalization in 1991 and India's accession to the WTO in 1995. Till then, it used to be known as National Alliance of Young Entrepreneurs which was established in 1967. FISME works in three thematic areas: Market access (including domestic public procurement and bilateral/ multilateral trade issues such FTAs and WTO), Advocacy for reforms for ease of doing business for MSMEs and execution of MSME development projects assisted by Gol and multilateral agencies.

More at www.fisme.org.in

About 'Friends of MSMEs in Parliament'

Over a dozen Members of Parliament cutting across party lines have come forward and formed a group named 'Friends of MSMEs in Parliament'. A senior Lok Sabha Member from Meerut, Shri Rajendra Agrawal was chosen as Chairman of the group. The group intends to study and focus on resolving some of the binding constraints that impede the growth of MSME sector in India. The group plans to hold consultations with MSMEs before each session of Parliament to identify the major issues and raise their concerns at various parliamentary forums and to the government. Federation of Indian Micro and Small & Medium Enterprises (FISME) - the national MSME body, is to function as the Secretariat for 'Friends of MSMEs in parliament'. The key objectives of the forum are: ensuring that legislation incorporates the MSME perspective, leveraging parliamentary institutions for the benefit of MSMEs, facilitating dialogue among government institutions and MSMEs.

More at www.friendsofmsme.org.in

About WeVaad

Started in 2021, WeVaad is an Online Dispute Resolution forum that offers negotiation as a technology-assisted mediation. It offers online dispute resolution services to parties, which helps in faster recovery of outstanding invoice amount through ADR (Alternate Dispute Resolution) WeVaad helped individuals and businesses in resolution of their legal disputes such as recovery of money disputes, cheque bounce cases, divorce cases, family disputes, property disputes etc. WeVaad provides for completion of the case within 90 days from the date of filing of the case. WeVaad provides access to its panel of lawyers for other services including agreement drafting, legal consultation etc. WeVaad was the Knowledge Partner for the seminar.

More at www.wevaad.com

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