CHAPTER 3

Legal Remedies for MSME Trade Debt Recovery in India

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ABSTRACT

MSMEs in India face significant challenges in recovering trade debts, impacting their financial sustainability and growth potential. Despite various legal remedies available under Indian law, many MSMEs struggle to effectively utilize these mechanisms due to lack of awareness, cost constraints and procedural complexities. This paper examines the major legal remedies available for MSME trade debt recovery including summary suits under Order 37 CPC, criminal proceedings under Section 138 of the Negotiable Instruments Act, civil suits, provisions under the MSMED Act 2006 and operational creditor rights under the Insolvency and Bankruptcy Code 2016. Through analysis of statutory provisions, case law and practical implementation experiences, this study evaluates the effectiveness, timeline and cost implications of each remedy. The findings reveal that while multiple legal options exist, their practical utility varies significantly based on debt amount, documentation quality and institutional efficiency. Summary suits emerge as underutilized yet highly effective for documented debts while Section 138 proceedings remain popular due to their deterrent value. The paper concludes with recommendations for MSMEs on selecting appropriate legal remedies and suggestions for policy improvements to enhance debt recovery mechanisms supporting MSME sustainability.

Keywords: MSME; Trade debt recovery; Legal remedies; Payment delays; Financial sustainability.

1.0 Introduction

Micro, Small and Medium Enterprises are the backbone of the Indian economy, they contribute approximately 30% to the nation's GDP and employ over 110 million people across various sectors. Despite their critical economic role, MSMEs face recurring challenges in recovering trade debts from buyers, which create severe liquidity constraints that threaten their sustainability.

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Studies indicate that delayed payments exceeding 90 days affect a substantial proportion of MSMEs, forcing them to incur expensive working capital financing costs or curtail operations entirely. The Indian legal framework provides MSMEs with multiple avenues for trade debt recovery including summary procedures under the Code of Civil Procedure 1908, criminal remedies under the Negotiable Instruments Act 1881, specialized provisions under the MSMED Act 2006, arbitration mechanisms, civil litigation and provisions under the Insolvency and Bankruptcy Code 2016. However, despite this comprehensive legal architecture, MSMEs continue to struggle with effective debt recovery due to procedural complexities, institutional inadequacies and lack of awareness.

This research examines the major legal remedies available to MSMEs for trade debt recovery under Indian law, evaluates their effectiveness based on practical implementation and provides evidence-based recommendations for MSMEs facing payment defaults. The study draws upon statutory analysis, case law examination and observations from legal practice to present a comprehensive assessment of debt recovery mechanisms in the Indian MSME context.

2.0 Literature Review

The issue of delayed payments to MSMEs has received considerable scholarly attention. Rajeev and Vani (2017) examined payment delays in the Indian MSME sector and found that delayed receivables significantly impacted working capital management and forced enterprises to resort to expensive short-term borrowing. Their study emphasized that payment delays created cascading effects whereby MSMEs unable to realize receivables were themselves forced to delay payments to suppliers and employees, creating systemic instability in supply chains.

The legislative framework for debt recovery has evolved substantially over recent decades. Datta (2018) analyzed various debt recovery mechanisms available to commercial creditors and categorized them into civil court remedies, summary procedures, criminal proceedings and specialized tribunals. The study highlighted that efficacy varied significantly based on debt quantum, documentation quality and debtor cooperation.

The MSMED Act 2006 represented legislative recognition of payment challenges faced by small enterprises. However, research by Bose and Gupta (2019) analyzing the implementation of this Act observed that while it provided MSMEs with statutory entitlement to interest on delayed payments and access to Facilitation Councils, actual utilization remained disappointingly low due to inadequate awareness, weak enforcement mechanisms and fear of commercial repercussions from larger buyers.

Examining the impact of the Insolvency and Bankruptcy Code 2016 on MSME debt recovery, Sengupta and Roy (2020) noted that provisions enabling operational creditors to initiate insolvency proceedings represented a significant shift in creditor rights. However, the study documented practical limitations including high threshold limits, procedural complexities and risks of debtor companies entering liquidation rather than resolution, thereby reducing recovery prospects.

While existing literature has documented payment challenges and examined individual remedies, there remains a gap in comprehensive comparative analysis integrating statutory provisions, judicial interpretations and practical implementation challenges across multiple remedies. This research addresses this gap by providing an integrated assessment of legal remedies from the perspective of practical utility for MSMEs.

3.0 Research Methodology

This study employs a doctrinal research methodology examining legal frameworks, statutory provisions and judicial interpretations. The research is both descriptive and analytical, examining existing legal remedies and critically analyzing their practical utility for MSMEs. The research is based primarily on secondary data including statutory provisions, case law, legal commentaries and academic publications. Statutory analysis encompassed the Code of Civil Procedure 1908, Negotiable Instruments Act 1881, MSMED Act 2006, Arbitration and Conciliation Act 1996 and Insolvency and Bankruptcy Code 2016 including subsequent amendments. Case law analysis was conducted using legal databases to identify landmark judgments and judicial trends in debt recovery matters. Academic literature was reviewed from peer-reviewed journals and research publications focusing on MSME finance and commercial litigation. Government reports from the Ministry of MSME, Reserve Bank of India and National Judicial Data Grid provided contextual understanding.

Each legal remedy is examined using a structured framework covering statutory foundation and scope, procedural requirements, typical timelines, cost implications, likelihood of successful adjudication, enforcement mechanisms and impact on commercial relationships. Comparative analysis identifies circumstances under which each remedy is most appropriate considering factors such as debt quantum, documentation availability and urgency of recovery.

4.0 Analysis of Legal Remedies

4.1 Summary Suit under Order 37 of Code of Civil Procedure

Order 37 of the CPC provides for summary procedure in suits for recovery of liquidated demands based on written contracts or negotiable instruments. The primary objective is to expedite debt recovery where the debt is clearly documented and defence appears minimal. Rule 1 specifies that the plaintiff may include in the summons a notice stating that judgment may be passed on mere admission or that the defendant may obtain leave to defend. This procedure is particularly well-suited for MSME trade debts arising from supply of goods or services pursuant to written contracts, purchase orders or work orders. The key requirement is that the claim must be for a liquidated sum arising from a written contract. Where the MSME has documentary evidence including agreements, invoices, delivery challans and acknowledgments of receipt, and where the buyer has not disputed quality or quantity of supplies, the summary suit offers an efficient recovery mechanism. The defendant must file an application for leave to defend within 10 days of service along with an affidavit showing substantial defence on merits. The court examines whether the defendant has raised a triable issue. If the defence is merely illusory or amounts to bare denial without substantive grounds, leave to defend is refused and judgment is passed in favour of the plaintiff.

In Mechelec Engineers & Manufacturers v. Basic Equipment Corporation (1976) 4 SCC 687, Supreme Court established initial principles for granting or denying leave to defend, focusing on the substance of the defense raised. In IDBI Trusteeship Services Limited v. Hubtown Limited (2017) 1 SCC 568, Supreme Court updated and refined the standards from Mechelec Engineers, emphasizing a nuanced approach that balances the need for expeditious disposal of commercial suits with fairness to defendants presenting genuine defenses. In case of Executive Trading Company Pvt. Ltd. v. Grow Well Mercantile Pvt. Ltd. (2025), Very recently, the Supreme Court reiterated that allowing leave "as a matter of course" effaces the distinction between summary and ordinary suits.

Summary suits offer significant advantages including speed of adjudication compared to regular civil suits, particularly where leave to defend is refused. The burden on the defendant to establish grounds for defending reduces the evidentiary burden on the plaintiff at initial stages. However, if the defendant succeeds in obtaining leave to defend, the suit converts into a regular suit losing the time advantage. Defendants often raise technical objections regarding jurisdiction, limitation or documentation sufficiency to obtain leave to defend.

4.2 Criminal Proceedings under Section 138 of Negotiable Instruments Act

Section 138 of the Negotiable Instruments Act 1881 criminalizes dishonour of cheques issued in discharge of legally enforceable debt. Where a cheque is returned unpaid due to insufficient funds, the drawer commits an offense punishable with imprisonment up to two years or fine up to twice the cheque amount or both. For an offense to be established, the cheque must have been issued for discharge of debt, presented within validity period, returned unpaid, and the payee must have issued written notice within 30 days of receiving dishonour information with the drawer failing to make payment within 15 days of notice receipt. This remedy is widely utilized by MSMEs particularly where buyers provide post-dated cheques as payment security. The criminal nature of proceedings and possibility of imprisonment serve as strong deterrents, often compelling defaulting buyers to settle dues rather than face prosecution. The presumption under Section 139 that unless contrary is proved, the holder of a cheque received it for discharge of debt significantly reduces the evidentiary burden on the creditor.

The procedure commences with cheque presentation to the bank. Upon dishonour, the payee issues written notice demanding payment within 30 days. If payment is not made within 15 days of notice receipt, criminal complaint is filed before the Judicial Magistrate First Class court.

Section 138 proceedings offer several advantages including strong pressure on defaulting buyers due to criminal stigma, reduced evidentiary burden through statutory presumption and courts' power to award compensation up to twice the cheque amount under Section 148. The deterrent effect often results in out-of-court settlements before trial. However, the provision is applicable only where payment was secured through cheque. Strict procedural compliance is mandatory and any defect in notice or failure to file complaint within prescribed timeline results in dismissal. Even after conviction, enforcement of compensation requires execution proceedings in civil courts.

4.3 Civil suit for recovery of debt

Regular civil suits represent the traditional remedy available to creditors under the CPC. Unlike summary procedures, civil suits are available regardless of whether debt arises from written or oral contract. The suit proceeds through complete trial including filing of plaint, written statement, framing of issues, recording of evidence, arguments and judgment.

Civil suits are applicable to all categories of MSME trade debts without restriction. This remedy is particularly relevant where debt arises from oral agreements, where documentation is insufficient for summary procedures, or where the transaction involves complex factual or legal issues requiring detailed evidence. Cases involving disputed quality of goods, alleged defects in services, counterclaims or interpretation of contract terms typically require the full trial process.

The civil suit process begins with filing of plaint containing the plaintiff's complete case. Court fees are paid based on suit value. Summons are issued to the defendant who files written statement. Issues are framed based on pleadings. Evidence is recorded followed by arguments and judgment. The timeline for disposal of regular civil suits in India is notoriously long, averaging 3 to 7 years depending on court workload and case complexity. The Commercial Courts Act 2015 attempted to address this through establishing Commercial Courts for expedited disposal with a target of one year, though actual timelines often extend beyond statutory targets.

Regular civil suits offer certain advantages including availability for all types of debts without restrictions, comprehensive trial process allowing detailed evidence presentation and wide discretion to grant various reliefs including debt amount, interest, damages and costs. However, extended timelines effectively deny timely justice and render the remedy impractical for MSMEs facing liquidity constraints. The costs including court fees, lawyer fees and incidental expenses over several years can be prohibitive. Procedural complexity requires sustained engagement and legal representation. Defendants can employ dilatory tactics including repeated adjournments and interlocutory petitions to prolong proceedings.

4.4 Proceedings under MSME Development Act 2006

The MSMED Act 2006 was enacted specifically to address challenges faced by MSMEs with particular focus on delayed payments. Section 15 mandates that payment must be made on or before the agreed date or within 15 days from acceptance of goods or services. Section 16 provides that if payment is not made within prescribed period, the supplier is entitled to claim compound interest at three times the bank rate on the outstanding amount. Section 17 establishes Micro and Small Enterprises Facilitation Councils for resolving payment disputes and Section 18 empowers these Councils to conduct conciliation and pass awards having the status of arbitral awards.

The provisions apply to all transactions where goods or services are supplied by registered Micro or Small Enterprises to any buyer. The Council has jurisdiction over disputes regarding amounts due including principal debt and interest claims. An application is filed before the Council having jurisdiction over the supplier's registered place of business. The Council conducts conciliation proceedings and if settlement is not reached, proceeds to hear the matter and pass an award. The Council is required to dispose of references within 90 days.

The MSMED Act provisions offer several potential advantages. The statutory entitlement to compound interest at three times the bank rate provides strong deterrent against payment delays. The 90-day disposal timeline is significantly shorter than court litigation. The conciliation approach allows for amicable settlement preserving business relationships. The Council's award having the status of arbitral award provides finality and enforceability. However, implementation challenges have been significant. Many states have not constituted Councils or have constituted them without adequate infrastructure. Where Councils exist, they often suffer from inadequate staffing, lack of regular sittings and absence of enforcement mechanisms. The 90-day disposal timeline is rarely met. Non-cooperation by respondent buyers hampers proceedings. Awareness about the Act remains low among MSMEs. Perhaps most significantly, many MSMEs are reluctant to invoke the Act against larger buyers for fear of being blacklisted or losing future business.

4.5 Corporate insolvency resolution process under insolvency and bankruptcy code 2016

The IBC 2016 represents comprehensive reform of India's insolvency framework. Section 9 empowers operational creditors including suppliers of goods and services to initiate Corporate Insolvency Resolution Process (CIRP) against corporate debtors who have defaulted in payment. For an operational creditor to initiate CIRP, the default must be of at least one crore rupees. The operational creditor must serve a demand notice on the corporate debtor. If the debtor fails to make payment or settle the debt within 10 days or fails to provide notice of dispute, the creditor can file an application before the National Company Law Tribunal (NCLT).

Upon admission of the application, a moratorium is imposed preventing creditors from initiating proceedings against the corporate debtor. An Interim Resolution Professional is appointed who takes over management. The CIRP must be completed within 330 days after which the company faces liquidation if no resolution plan is approved.

The IBC provides MSMEs with powerful leverage against defaulting buyers who are corporate entities. The threat of insolvency creates strong incentive for corporate debtors to settle dues. The IBC offers significant advantages including substantial leverage that often compels settlement, time-bound process and appointment of independent Resolution Professional. However, the complexity and cost of NCLT proceedings make it unsuitable for smaller debt amounts. Legal fees are substantially higher than regular litigation. If the debtor is genuinely insolvent and proceeds to liquidation, operational creditors rank low in priority and may recover minimal amounts. The procedure requires expertise in insolvency law. Initiation of CIRP permanently damages commercial relationships making it appropriate only where the MSME has no interest in continuing business with the buyer.

5.0 Findings and Recommendations

5.1 Key findings

The analysis reveals that while the legal framework provides multiple remedies, there exists a significant gap between theoretical availability and practical effectiveness. No single remedy is universally optimal; appropriate choice depends on specific circumstances including debt amount, documentation, debtor profile and creditor objectives.

The summary suit procedure under Order 37 CPC emerges as an underutilized but highly effective remedy for documented trade debts, offering significant time advantages over regular civil litigation. Criminal proceedings under Section 138 NI Act remain the most popular remedy among MSMEs due to their deterrent value and settlement-inducing effect, though effectiveness is limited by strict procedural requirements and overburdened criminal courts. The MSMED Act 2006 provisions, while progressive in intent, have failed to deliver expected outcomes due to non-functional Facilitation Councils in many states and low awareness among MSMEs. The IBC provides powerful leverage to MSMEs against corporate defaulters but its complexity and cost make it suitable only for larger debts. Regular civil suits, despite being the most comprehensive remedy, are the least attractive option for MSMEs due to extended timelines averaging 3 to 7 years.

Enforcement of decrees and awards remains a persistent challenge across all remedies, with obtaining favourable judgment being only the first step in a potentially lengthy recovery process. Commercial considerations including fear of losing future business often deter MSMEs from pursuing legal remedies even when legally justified.

5.2 Recommendations for MSMEs

MSMEs should adopt proactive measures to prevent payment defaults and facilitate debt recovery. At the transaction stage, written contracts or purchase orders should be insisted upon for all significant transactions with payment terms clearly documented. Security mechanisms including post-dated cheques, bank guarantees or letters of credit should be obtained wherever commercially feasible. Registration under the MSMED Act should be obtained by eligible enterprises to access statutory benefits.

When payment default occurs, MSMEs should consult qualified lawyers early to understand available remedies and select appropriate options based on specific circumstances. Legal notices should be issued promptly and in proper form, particularly for Section 138 proceedings where timelines are strict. Documentation should be meticulously maintained to support legal proceedings. Cost-benefit analysis should be conducted before initiating proceedings, considering legal costs, expected timelines and recovery probability against debt amount. For small debts below INR 5 lakhs where written contracts exist and there is no genuine dispute, summary suits under Order 37 CPC represent the optimal remedy. Where payment was secured by dishonored cheques, Section 138 proceedings should be the first choice. For high-value debts above INR 50 lakhs where the debtor is a corporate entity deliberately defaulting despite capacity to pay, IBC proceedings provide strong enforcement leverage.

5.3 Policy recommendations

Policymakers should undertake reforms to strengthen MSME debt recovery mechanisms. MSME Facilitation Councils should be constituted in all states with adequate infrastructure, regular sittings and trained personnel. The Councils should be empowered with stronger enforcement mechanisms including ability to attach bank accounts pending disposal of references. The 90-day disposal timeline should be strictly monitored and enforced. Commercial Courts should be established in all districts to ensure specialized handling of commercial disputes. Time-bound disposal targets should be enforced through performance monitoring. Case management hearings and strict adherence to procedural timelines can reduce delays. Training programs for judges on commercial law and MSME issues would enhance adjudication quality.

The threshold for IBC proceedings should be calibrated to balance accessibility for MSMEs with preventing misuse. Electronic platforms for invoice discounting and supply chain finance should be promoted to provide MSMEs with alternative liquidity options. Buyer rating systems tracking payment practices of larger companies could create market pressure for timely payments.

6.0 Conclusion

MSMEs in India face significant challenges in recovering trade debts, with delayed payments representing a critical threat to their financial sustainability. While the Indian legal system provides multiple remedies for debt recovery, their effectiveness varies substantially based on specific circumstances and suffers from systemic implementation challenges. The research demonstrates that summary suits under Order 37 CPC offer the best balance of speed and cost-effectiveness for documented trade debts but remain underutilized. Criminal proceedings under Section 138 are effective as settlement-inducing mechanisms but require strict procedural compliance. The MSMED Act provisions provide strong statutory rights but their impact is limited by non-functional Facilitation Councils. The IBC empowers operational creditors but its complexity makes it suitable primarily for larger debts. Regular civil suits provide comprehensive adjudication but their extended timelines make them an unattractive option.

Beyond specific remedies, systemic challenges including judicial delays, enforcement difficulties, power imbalances and lack of awareness significantly impede effective debt recovery. Addressing the MSME payment crisis requires not only strengthening individual legal remedies but also broader reforms in judicial infrastructure, enforcement mechanisms and commercial practices. MSMEs must adopt proactive measures including proper documentation, security mechanisms and early legal action when defaults occur.

Policymakers should focus on making Facilitation Councils functional, expanding Commercial Courts, simplifying procedures and creating market incentives for timely payments. The gap between legal rights and practical remedies for MSMEs highlights the need for continued evolution of India's commercial dispute resolution framework. Strengthening institutional foundations alongside improving specific remedial mechanisms will enhance the ability of MSMEs to recover trade debts, thereby contributing to their sustainability and the broader objective of fostering responsible entrepreneurship and inclusive economic growth.

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