

UNDERSTANDING THE PRE-PACKAGED INSOLVENCY RESOLUTION PROCESS FOR MICRO, SMALL AND MEDIUM ENTERPRISES.

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ABSTRACT

The spread of Covid-19 pandemic has affected the economies of all countries since January, 2020. All the nations were forced to take measure like lockdown, restriction on international movement and other measures to contain the spread of Coronavirus. The pandemic has impacted negatively on the global economy, putting enterprises in practically every jurisdiction under financial stress. India was no exception to this. Indian government also imposed a nationwide lockdown on March 24, 2020. The lockdown has impacted all the businesses in India which resulted into huge financial losses to these micro, small and medium scale businesses.

The unprecedented spread of this pandemic has impacted every sector in the country, having a major impact on the economy and employment of the country. However, the most visible victims of this lockdown have been Micro Small Medium Enterprises, who have faced the imminent threat of going out of business, due to the nature of these businesses. Due to non- operation of business activities most of the owners are not able to meet the working capital requirements of running the organization.

As a result, in order to assuage their fears, the government took some steps to strengthen them, and in the same process, certain laws were recently enacted after corporate entities an effective alternative to the resolution process, particularly for micro, small, and medium enterprises, with the amendment of the Insolvency and Bankruptcy Code, 2016. Its purpose is to provide a method for resolving bankruptcy that is cost-effective, rapid, and maximises value while causing the least amount of disruption to business operations as feasible. To make the pre-pack procedure more operational, the Central Government and the Indian Insolvency and Bankruptcy Board have issued notifications, rules, and regulations.

Keywords: Insolvency and Bankruptcy Code, Corporate Insolvency Resolution Process, Micro, Small and Medium Enterprises, Insolvency Resolution Professional and Resolution Plan.

1. Introduction:

The insolvency and Bankruptcy Code, 2016 went into effect on May 28, 2016 with the aim of speeding up process of resolving insolvencies, which was historically a lengthy process that did not an economically feasible solution. Further the code also aims to protect the interests of small investors and making ease of doing process less cumbersome.

However, the main concern of Corporate Insolvency Resolution Process is the time taken for completion of resolution process. At the end of December 2020, over 86 percent of the 1717 ongoing insolvency resolution proceedings had crossed the 270-day threshold as defined in the Code. One of the key reasons behind delays in the Corporate Insolvency Resolution Process are prolonged litigations by erstwhile promoters and potential bidders. Key examples are Bhushan Steel and Essar Steel India Ltd etc.

The Corporate Insolvency Resolution Process once initiated, does not leave any scope of out of court settlement due to involvement of Adjudicating Authority. The need of involvement of Adjudicating Authority is for enforcement of resolution plan once approved by the Committee of Creditors (Committee of Creditors). If a company in financial distress reaches an agreement with its main creditors on the terms of a chapter 11 plan and solicits approval for a restructuring plan prior to filing for bankruptcy protection, the bankruptcy court will confirm the plan and approve the associated disclosure statement and solicitation procedures on an expedited basis, according to the US Bankruptcy Code. Pre-packs have gained popularity in the United Kingdom since the Enterprises Act of 2002, which rendered administration of the dominant insolvency process. The UK regime is mature, and the pre-pack phase has become more of an evolution than a revolution. While there are some controversies in some cases, the pre-pack procedure is used successfully in the United Kingdom.

Now that almost five years of implementation of Code, India is still struggling with the strict adherence of the statutory timelines given under the code, apart from the delays, engagement of third-party advisors, litigations etc. Further, this delay in process results in increase of the cost of resolution hugely.

2. Need for Pre-Packaged Scheme of Corporate Insolvency Resolution Process:

One of the main concerns posed by creditors about the Corporate Insolvency Resolution Process under the Insolvency Bankruptcy Code is the slow and time-consuming progress in the resolution of troubled firms. Corporate Insolvency Resolution Process is the method of resolving a corporate debtor's insolvency in compliance with the Code's provisions and regulations. Stakeholders are expected to complete the Corporate Insolvency Resolution Process within 330 days of the start of insolvency proceedings under the code, according to the Insolvency Bankruptcy Code.¹

3. Motivation for Introduction of Pre-Packaged Scheme of Corporate Insolvency Resolution Process:

Pre-pack scheme of resolution largely aimed at providing Micro, Small Medium Enterprises with an opportunity to restructure their liabilities and start with a clean slate while still providing adequate protections to the creditors so that the system is not misused by firms to avoid making payments to creditors.

“Prepacks will help corporate debtors to enter into consensual restructuring with lenders and address the entire liability side of the company,” said Rajiv Chandak, partner at Deloitte India, ²noting that the

¹ Pre-Pack Insolvency Resolution Process, available at: <https://www.drishtiiias.com/daily-updates/daily-news-analysis/pre-pack-insolvency-resolution-process>.

² Govt. amends insolvency law; introduces pre-packaged resolution process for MSMEs, available at: <https://www.livemint.com/news/india/govt-amends-insolvency-law-introduces-pre-packaged-resolution-process-for-msmes-11617638457411.html>.

government should consider setting up specific benches of the National Companies Law Tribunal to deal with pre-pack resolution plans to ensure that they are implemented in a time-bound and effective manner.

4. Eligibility of Enterprises as Micro, Small Medium Enterprises:

Micro, Small and Medium Enterprises are defined by the Micro, Small and Medium Enterprises Development Act, 2006, which provides an overall structure for promoting and developing MSMEs and increasing their competitiveness,³ which are defined as under:

- **Micro Enterprises:** Enterprises with an annual turnover of less than five crore rupees and an investment in plant and machinery or facilities of less than one crore rupees.
- **Small Enterprises:** Enterprises with an annual turnover of less than fifty crore rupees and an investment in plant and machinery or facilities of less than ten crore rupees.
- **Medium Enterprises:** Enterprises with an annual revenue of less than two hundred fifty crore rupees and a plant and machinery or equipment expenditure of less than fifty crore rupees.

The Micro, Small and Medium Enterprises, will be deliver benefits to the businesses in the tourism and the hospitality sector in terms of turnover limits and investments.⁴ India has approximately 6.3 crore Micro, Small and Medium Enterprises. The number of registered Micro, Small and Medium Enterprises is 25.13 lakh. The registered Micro, Small and Medium Enterprises are dominated by Micro Enterprises with a number 22.06 lakh out of total registered Micro, Small and Medium Enterprises. The Micro and Small Medium Enterprises sector contributes 29% of GDP through its national and international business.⁵ According to World Bank reports, the Micro, Small and Medium Enterprises sector in Asia, Africa and Middle East, they contribute over 35% and its contribution to employment is a staggering 60% plus in economic activity.⁶

5. Pre-Packaged Scheme of Resolution:

In the last year owing to COVID-19 pandemic, the Government of India has suspended the start of new insolvency proceedings on March 24, 2020 on default by corporate debtor. Under the Insolvency and Bankruptcy Code, the government had hoped to include a pre-packaged resolution system for stressed small businesses.

In the last few decades, the Micro, Small and Medium Enterprises have emerged as a dynamic backbone of the Indian economy.⁷ Under the Micro, Small and Medium Enterprises Development Act, 2006, the government has introduced an ordinance for a pre-packaged insolvency resolution process for Micro, Small and Medium Enterprises, which examines the factors affecting the promotion and development of Micro,

³ Puja Chhabra Sharma Amrinder, *A Study of Small and Medium Enterprises (SME) in India on Sustainability Strategy: Highlighting Critical Challenges and Constraints* (Journal of Asia Entrepreneurship and Sustainability, 2016).

⁴ Dr. Savita Sharma, *Understanding Pithoragarh's Cultural Jewel: it's Fair & Festivals, Worldwide Hospitality & Tourism Themes (WHATT)* (Worldwide Hospitality and Tourism Themes, ISSN: 1755-4217 Emerald group publishing limited, Vol. 7, No. 4, 2015).

⁵ MSME Industry in India, available at: <https://www.ibef.org/industry/msme.aspx#:~:text=India%20has%20approximately%206.3%20crore,its%20national%20and%20international%20trade>.

⁶ Amrinder Kaur & Puja Chhabra Sharma, *Global Organisations and SME in India: A Comparative Study of Sustainability Initiatives* (Journal of Sustainable Development. ISSN 1913-9063 E-ISSN 1913-9071, 2015).

⁷ Purnima Rao, Satish Kumar, *Reflection of Owners Attributes in Financing Decision of SMEs* (Small Enterprise Research, 2017).

Small and Medium Enterprises, reviews existing policies and programmes, and makes recommendations to the government in the policies and programmes.⁸ India has 6–7 lakh Micro, Small and Medium Enterprises companies and many of them could benefit from the recently implemented pre-packaged insolvency system under the code. The ordinance amends the Insolvency and Bankruptcy Code, 2016, allowing the government to alert pre-packaged processes for defaults of up to one crore rupees.

A pre-packaged settlement entails a corporation/corporate debtor working out a restructuring agreement with the creditors. This helps to reduce the overall time and costs of the process by avoiding the formal process. The Centre stated that "due to the particular nature of their companies and simpler organisational structures," a special scheme for Micro, Small and Medium Enterprises was urgently needed.

A pre-packaged insolvency is a resolution process of the company's business which is negotiated by the corporate debtor with a buyer before the appointment of an insolvency professional under the code.

It's a mix of informal and formal processes of Corporate Insolvency Resolution Process, with the informal process extending up to National Company Law Tribunal entry, then the current National Company Law Tribunal supervised resolution process as defined by the Insolvency and Bankruptcy Code, 2016. In India, such a scheme will most likely see financial creditors negotiate on terms with prospective investors/bidders/buyers and then apply to the National Company Law Tribunal for approval of the agreed-upon resolution plan.

To deal with the pre-packaged insolvency settlement processes, a new chapter, Chapter IIIA, has been added to the main Act of 2016. Under the Insolvency and Bankruptcy Code, the pre-packaged insolvency resolution phase must be completed within 120 days of the pre-packaged insolvency start date. The moratorium will last from the beginning of the pre-pack process until it is completed, whether by National Company Law Tribunal approval of a resolution plan or otherwise.

In a pre-packaged process, the corporate debtor's key stakeholders, such as creditors and shareholders, come together to identify potential buyer(s)/bidder(s)/investor(s) and negotiate a resolution agreement before sending the plan to National Company Law Tribunal for formal approval.

The primary goal of implementation of this principle is to assist the insolvency framework, avoiding wasting time and resources on court cases and legal challenges, and instead focus on getting a just and effective resolution for the business, which was the Insolvency and Bankruptcy Code's original goal.

Under Sections 7, 9, and 10 of the Insolvency and Bankruptcy Code, such a pre-pack procedure may also be called a process preceding the normal course of insolvency. A pre-pack procedure is used by stressed corporate debtors who are attempting to hold their business solvent when negotiating with creditors for a debt settlement. If such a procedure fails, a financial or operational creditor may always file an application under Section 7 or 9 of the Insolvency and Bankruptcy Code, causing insolvency.

⁸ Parul Munjal, *Built Heritage in Small Towns a Unique Tourism Opportunity: Case of Shiv Kund, Sohna*, (Journal of Services Research. ISSN-0972-4702, 2017).

6. Features of Pre-Pack Scheme of Corporate Insolvency Resolution Process:

The main features of the pre-pack scheme of Corporate Insolvency Resolution Process are as follows:

- The scheme has been designed in a manner to provide a more friendly mechanism of resolution of stressed assets of Micro, Small and Medium Enterprises while ensuring the protection of interests of creditor.
- During the process, creditors of the corporate debtors are in control however the management of the company remains in control of the corporate debtor. It allows the debtor to control and run the enterprise till resolution happens.
- The pre-pack resolution plans have to be submitted within ninety days and National Company Law Tribunal will have another thirty days to approve them. Thus, reducing the total time needed for resolution to one hundred and twenty days only.
- It will help in reducing the costs and litigations involved in the resolution process and providing an effective resolution of corporate insolvency.
- This process can be initiated only by the companies with consent of sixty six percent majority of creditors which will lead to the smooth process of Corporate Insolvency Resolution Process.
- The Committee of Creditors at any time during the process of pre-packaged Corporate Insolvency Resolution Process, may dissolve the management of the corporate debtor and vest the management of the corporate debtor to the Resolution Professionals which shall be decided by the Adjudicating Authority.
- The Ordinance provides for the strict penalties for fraudulent management of corporate debtor or providing false information or any material omission in the application or list of claims.

7. Comparison of Pre-Packaged Scheme with Corporate Insolvency Resolution Process:

Parameter	Pre-packed	Corporate Insolvency Resolution Process
Objective	Resolution through resolution plan	Resolution through a resolution plan
Initiation	On default of more than ten lakh rupees (earlier less than one crore) excluding Covid19 default	The prepacked scheme can only be initiated where default amount is more than one crore rupees.
Initiation by	Financial Creditor, Operational Creditor or Corporate Debtor	Corporate Debtor with the consent of the unrelated Financial Creditors
Management of debtor	Vest with RP with Committee of Creditors in control	Vest with Corporate Debtor with Committee of Creditors in control

Appointment of Resolution Professionals	Insolvency Resolution Professionals is appointed by Corporate Debtor and RP by Committee of Creditors	RP is appointed by the majority of unrelated Financial Creditors
Role of Resolution Professionals	Management of affairs of corporate debtor and conducting of process.	Conducting of process.
Claims collation	Insolvency Resolution Professionals to invite and collate the information	Provided by the Corporate Debtor and verified by the RP.
Information memorandum	Prepared by RP	Draft prepared by corporate debtor and verified by RP.
Moratorium	Moratorium under section 14	Limited moratorium
Insolvency Resolution Professionals Costs	Includes cost of running operations	Cost of running operations not included.
Invitation of resolution plans	Public invitation	First right of offers to promoters (swiss challenge)
Early closure of process	On request of applicant under section 12A	With the approval of sixty six percent of voting share present and voting or suo-moto by Committee of Creditors.
Approval of resolution plan	With the approval of sixty six percent of voting share	With the approval of sixty six percent of voting share (voting and present)
Termination of process	No termination allowed	Liquidation with the approval of seventy five percent voting share of Committee of Creditors.
Consequence of failure of process	Liquidation of corporate debtor	Closure of process only. Creditor may go for formal insolvency proceedings.
Role of Insolvency Professionals and Adjudicating Authority	Relatively more	Relatively less

Timeline	One hundred eighty days till approval of resolution plan by AA	Ninety days for filing of resolution plan to the AA and 30 days to AA to approve it.
Cooling off	Twelve months between two Corporate Insolvency Resolution Process	Three years between two pre-packs.

Source: Report of sub-committee of LIC on pre-packaged insolvency resolution process⁹

8. Insolvency and Bankruptcy Code and Pre-Packaged Insolvency Resolution Process for Corporate Micro, Small and Medium Enterprises

An economy is an excellent environment to do business when there are several competitive solutions for resolving stress. In line with this philosophy, the Insolvency and Bankruptcy Code, 2016, was amended by Ordinance to provide for a Pre-Packaged Insolvency Resolution Process (PPIRP) for corporate Micro, Small, and Medium Enterprises as an alternative insolvency resolution process to ensure faster outcomes.

The rigour and discipline of the PPIRP are comparable to those of the Corporate Insolvency Resolution Process. It is informal until a certain point and then becomes formal. It combines debtor-in-possession and creditor-in-control situations. It is neither a fully private nor a fully public process; it permits the firm to submit the base resolution plan, which is subject to challenge for value maximisation if it is eligible under section 29A. It protects stakeholders' rights in the same way as CIRP does, and it has enough checks and balances to avoid any potential abuse. The courts and insolvency experts play a limited involvement in this procedure (IPs).

The informality of the pre-initiation stage allows the CD and its creditors to quickly explore and negotiate the best method to alleviate stress in the business, whereas the post-initiation stage maximises value and provides statutory protection to the resolution plan. The entire process must be completed within 120 days after the start date. During the PPIRP, the CD's affairs will be managed by the CD's Board of Directors / partners, and the resolution expert will lead the process under the guidance and supervision of the creditors.¹⁰

9. Process of Pre-Packaged:

The applicant shall serve a notice of meeting (Form P2) to the unrelated financial creditors of corporate-debtor at least five days before the date of meeting indicating the date, time and venue of the meeting and enclose a list of creditors along with amount due to them. The notice of such meeting can be given at a shorter period of time if agreed by all of them.

⁹ Silent features of Proposed Pre-packaged Insolvency Resolution Process under Insolvency and Bankruptcy Code, 2016, available at: <https://ibclaw.in/silent-features-of-pre-packaged-insolvency-resolution-process-under-insolvency-and-bankruptcy-code-2016-report-of-the-sub-committee-of-the-insolvency-law-committee-on-pre-packaged-insolvency-resolu/>.

¹⁰ Insolvency and Bankruptcy Code in Economic Survey, available at: <https://ibclaw.in/insolvency-and-bankruptcy-code-in-economic-survey/>.

In case, a corporate debtor has no financial debt or where all financial creditors are related parties, the applicant shall convene a meeting of operational creditors who are not related parties of the corporate debtor and the provisions of subsection (1) to (7) of section 14 shall be applicable mutatis mutandis.

The financial creditor who are unrelated to the corporate debtor and have not less than ten percent of the value of total financial debt of such creditor may propose the names of the Insolvency professionals for the purposes of clause (e) of subsection (2) of Section 54A. The terms of appointment of resolution professional shall contain:

- a) fee payable to him for performing duties u/s 54B,
- b) fee payable to him and expenses to be incurred by him for conducting the process; and
- c) fee payable to him and expenses to be incurred by him in case the management of corporate debtor is vested with him.

After examination of form P2, resolution professional shall ascertain the class of creditor for representation of creditors in a class identify three IPs and select the such IP who is the choice of highest number of creditor in class to act as the authorized representative of the creditors of respective class. The name of such IP shall be informed to the applicant in Form P5.

The applicant shall furnish resolution professional following information:

- a) Audited financial statements of corporate debtor for the last two years
- b) Provisional financial statements for the year up to the date of declaration under clause (e) of subsection (2) of Section 54A; and
- c) Form P5 submitted by the authorised representatives selected by creditors.

The resolution professional makes a public announcement within two days of commencement of process and such announcement shall be in Form P9, sent to every creditor listed in Form P2, sent to Information Utilities and publish on the website, if any, of the corporate debtor and the Board.

RP shall publish brief particulars for invitation of resolution plan in Form P11 not later than twenty-one days from the date of pre-packaged insolvency commencement date.

The corporate debtor provides a list of claims in Form P10 to the resolution professional. Based on the records RP will confirm the details received in Form P10. RP will inform every creditor regarding its dues and seek objections, if any. Creditors may submit their objection within seven days from the receipt of communication with supporting documents. RP can ask for additional information to substantiating such objection as he deems fit. RP will consider every objection received by him and will modify the claims of creditors if required. Creditors are required to update their claims, if satisfied fully or partially in any manner, after commencement of pre-packaged insolvency process. This list of claims (P10) shall be available for inspection to the parties related to process.

Meetings of the committee will be called as and when the RP deems appropriate, or at the request of members of the committee who represent at least 33% of the voting share. The meeting notice must include a list of

topics to be discussed, a list of topics to be voted on, and copies of all related documents for the topics to be discussed and issues to be voted on. The meeting must have a quorum of at least 33% of the voting shares in attendance.

The resolution plan/ plans are submitted by the resolution applicant in accordance with the Code and regulations within the time given in the invitation for resolution plan. The resolution plan/plans are evaluated by the RP. The resolution plan which gets the highest score shall be selected for competition with the base resolution plan.

The resolution plan so selected shall be considered by the committee for approval, if it is significantly better than the base resolution plan. The submitter of resolution plan who has lower score shall have option to improve its resolution plan by at least a tick size. Further, the other submitter with higher score will also have the option to improve its resolution plan by at least a tick size. This process of improvement continues till any one of the submitters of resolution plan fails to exercise the option within the time specified in the invitation for resolution plan. The process of improvisation shall be completed within a time window of forty-eight hours. After the process of improvisation, the resolution plan with higher score shall be considered by the committee for approval.

However, in case, no resolution plan is received, the committee may consider the base resolution plan for approval.

Once a resolution plan is approved by the committee, the resolution professional will submit an application, along with a compliance certificate in Form P12, to the Adjudicating Authority for approval. The order of Adjudicating Authority conveying acceptance or rejection of resolution plan, shall be sent to the participants and resolution applicant by the RP. On approval of resolution plan by Adjudicating Authority, RP shall inform each claimant, the principle or formula, as the case may be, for payments of debts under such resolution plan. If the no resolution plan is approved by the committee or committee has approved the termination of process, the RP shall file an application in Form P13 to the Adjudicating Authority for termination of process.¹¹

10. Advantages of Pre-Packaged:

- **Quick resolution:** Pre-packaging allows a quicker resolution, retains and maximises value (of a stressed-out company), and increases the likelihood of resolution.
- **Lighter on courts:** Because of its informal existence, the pre-packaged system is "Lighter on Courts." It has the ability to minimise litigation. The courts have limited infrastructure resources and can only fulfil their responsibilities within that capacity. In informal nature of the process, the court does not require involvement and during the formal process the court requires minimum role.
- **Job preservation:** The pre-packaged scheme of resolution has more probability of resolution. The quick resolution of insolvency helps in keeping afloat a company which ultimately results in lower elimination of jobs. Thus, the process helps in job preservation.

¹¹ Insolvency and Bankruptcy Board of India (pre-packaged insolvency resolution process) Regulations, available at: <https://www.ibbi.gov.in/uploads/legalframework/0dd40b82af7a770d5e89c0d9e37bdb45.pdf>.

- **Value maximisation and cost effective:** The resolution plan with higher score is considered in comparison to the base resolution plan which helps in value maximization of the corporate debtor whereas the shorter period of time of process of insolvency resolution helps in reducing cost of resolution.

11. Drawbacks of Pre-Packaged:

- **Lack of Transparency:** Pre-packaged insolvency resolution reduces transparency as compared to Corporate Insolvency Resolution Process, in which financial creditors enter a private arrangement with a prospective bidder rather than through an open bidding procedure, and it leads to stakeholders such as operational creditors.
- **Insufficient marketing:** When there is no competition, the pre-packaged returns less money to creditors due to inadequate promotion.

12. Conclusion:

The pre-packaged scheme of Insolvency Resolution process which came into effect recently in India has a huge scope of success. The informal process of the pre-pack may help in unclogging of books of accounts of Indian lenders. The process needs the co-ordinated efforts of the corporate debtor along with financial creditors and stakeholders for reaching on a successful conclusion of process. The Govt. of India can help by setting up special benches of National Company Law Tribunal to hear cases for pre-pack only. The pre-pack scheme if implemented properly may resolve the cases much faster than the pace in Corporate Insolvency Resolution Process.

