



## NEW ADDITION TO IBC: PRE – PACKAGED INSOLVENCY RESOLUTION

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### ABSTRACT:

### KEYWORDS:

The introduction of the Insolvency and bankruptcy Code, 2016 ('IBC') had given a new model for corporate distress resolution framework in India. IBC worked as an antidote for the companies who were unable to survive even though plethora of debt restructuring schemes was introduced in the past. The result of failure of such schemes was that the story of distress was never ending. The companies were struck with a situation of sitting over unproductive assets whose value continued to deteriorate with passage of time. IBC worked as panacea for such companies.

The IBC provides a time bound manner for resolving insolvency of the corporates. The application for insolvency resolution can be filed by any of the creditor or the debtor itself in the event of default. During the resolution period an insolvency professional takes over the management of the debtor company. He investigates into the affairs of the company and in accordance with the finding of the insolvency professional the corporate debtor is either revived or liquidated. Till the year 2020, 4 years since its enactment, IBC was largely able to live up to the requirements of the corporate sector in India. The smooth journey of the Code was affected with the onset of the unprecedented spread of COVID – 19 pandemic.

The effect of the pandemic was not only on the public health but was also upon the economy. The government with its foresight made efforts to curb the effect of the pandemic. But the situation was unprecedented and all the preparations were futile. India's economy is projected to contract by 10.3% by International Monetary Fund (IMF), 9% by Asian Development Bank, and 9.6% by World Bank in 2020-21, reflecting impact of nationwide lockdown and the income shock experienced by households and firms.

As per provisional data, Gross Domestic Product (GDP) at constant prices in Q1 of 2020-21 recorded a contraction of 23.9% as compared to 5.2% growth in Q1 2019-20. The real GDP is projected to contract by 9.5% in 2020-21 with risks tilted to the downside: (-) 9.8% in Q2, (-)5.6% in Q3

and 0.5% in Q4. The macro stress tests indicate that the Gross Non-Performing Asset ratio of all Scheduled Commercial Banks may increase from 8.5% in March, 2020 to 12.5% by March, 2021 under the baseline scenario and may escalate to 14.7% under the very severely stressed scenario. The system level Capital to Risk Weighted Assets Ratio is projected to drop from 14.8% in March, 2020 to 13.3% in March, 2021 under the baseline scenario and to 11.8% under the very severe stress scenario.

Business Assessment Index for Q1:2020-21 hit its lowest mark in the survey's history. The manufacturing Purchasing Manager's Index remained in contraction, shrinking further to 4346.0 in July from 47.2 in the preceding month. These economic parameters were the result of the nation wide lockdown introduced by the government to control the COVID – 19 pandemic. The outcome of drop in economic parameters pointed towards increase in the non payment of debts by the debtors. This would have in-turn attracted provisions of IBC and floodgates of litigation would have opened. To curb this, the Central Government also issued Notification F. No. 30/09/2020 dated March, 24 2020. The notification issued by the Ministry of Corporate Affairs amended the minimum threshold of default from one Lakh Rupees to Rupees One Crore under Section 4(1) of the Code.

*"Section 4: Application of this Part.*

*\*4. (1) This part shall apply to matters relating to the insolvency and liquidation of corporate debtors where the minimum amount of default is one lakh rupees:*

*Provided that the Central Government may, by notification, specify the minimum amount of default of higher value which shall not be more than one crore rupees.*

*[Provided further that the Central Government may, by notification, specify such minimum amount of default of higher value, which shall not be more than one crore rupees....."*

Section 4 provided under Part II of the IBC is a substantive

provision which sets out the minimum threshold of monetary default to be met by the creditors for filing an application before NCLT. The threshold provided under the statute before the amendment was one lakh rupees.

The proviso to the section provides that the central government may change the minimum threshold to any amount to the extent of one crore rupees. Consequently, by virtue of power given under the proviso the threshold for filing of insolvency was increased from minimum to maximum.

This attempt was made by the government to restrain unnecessary litigations which were filed for non payment of debt as the overall impact of the lockdown and pandemic on the economy was evident and majority of the business were forced towards financial distress as it was difficult in sustaining the cash flow. Closure of business affected generation of profit and it became inconceivable for the business to discharge its debt. It litigations would have slapped on them the survival of the debtors would have been even more difficult. The filing of application under the IBC would have pushed many business towards insolvency as resolution would have been difficult due to poor economic condition. It would have been inevitable that large number of businesses would have ended in liquidation. In light of the COVID - 19 crises, the World Bank identified two key challenges for insolvency framework around the world. They were: the need to prevent otherwise viable firms from prematurely being pushed into insolvency and increase in the number of firms that will not survive the crisis without resolution of insolvency. To aid the businesses in these circumstances the IBC (Amendment) Ordinance, 2020 was promulgated on June 5, 2020. The mentioned amendment inserted Section 10A to the Code by operation of which the right of creditors to initiate insolvency resolution process against corporate debtor under Section 7, 9 and 10 of the Code remained suspended for a period of six months or such further period, not exceeding a period of one year arising on or after March 5, 2020.

***“Section 10A: Notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March, 2020 for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf:***

*Provided that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period. Explanation.—For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply to any default committed under the said sections before 25th March, 2020.”*

After initial suspension of IBC for a period of six months, it was further suspended for another period of 6 months on September 23, 2020. Both the Ordinances prohibit initiation of insolvency proceedings during the specifically

mentioned period. Although, the step was undertaken by the government to protect the corporate debtor from moving towards insolvency but it has caused hardship not only on the creditors but also upon the corporate debtors. On one hand, there is a need to safeguard companies which were viable before the pandemic and whose insolvency was temporary from being prematurely pushed towards insolvency. On the other hand, a complete suspension of insolvency proceedings may take away a distressed company's opportunity to seek recourse under the IBC framework. Also, there was difficulty in finding adequate number of resolution applicants during the period of pandemic. It is not necessary that all distress is caused due to pandemic but still all the proceedings for recovery of debt were at halt. Also, the Ordinance categorically states that no insolvency proceedings can ever be initiated against defaults occurred during the specified period.

Many stakeholders have welcomed the suspension of the IBC for the mention period although it has caused hardship on the creditors as they are left alone to suffer. However, it worked like a double edged sword. While the amendment do protect the corporate debtor from facing liquidation, however the embargo casted also resultantly takes away an effective trusted channel which helped small and medium businesses to realise their debts expediently without being burdened by the long process of law. To protect the interest of small and medium business and remove the hardship caused the government introduced the pre-pack insolvency resolution process ('PPIRP') for micro, small and medium enterprises ('MSMEs') under the IBC.

### **MEANING OF PRE PACK INSOLVENCY RESOLUTION**

Pre pack insolvency resolution does not have a statutory definition. The term has evolved with usage. The United Nations Commission on International Trade Law ('UNCITRAL') uses the term 'expedited reorganisation proceedings' for pre-packs, as these proceedings follow the procedure of reorganisation, but on an expedited basis, combining voluntary restructuring negotiations, where a plan is negotiated and agreed to by the majority of affected creditors, with reorganisation proceedings commenced under the insolvency law to obtain court's confirmation of the plan in order to bind dissenting creditors. Pre-pack has emerged as an innovative corporate rescue method that incorporates the virtues of both informal (out-of-court) and formal (judicial) insolvency proceedings. It seems to be preferred hybrid framework, as it empowers stakeholders to resolve the stress of a corporate debtor as going concern, with the minimum assistance of the State. It is considered fast, cost efficient, and effective in resolution of stress, much before value deteriorates, with the least business disruptions and without attracting the stigma attached with the formal insolvency process. PPIRP is an alternative insolvency resolution for MSMEs where the management of the company will remain with the debtor. In the Indian context, most of the organisations are largely promoter

driven and presently, IBC under Section 29A bars the company management and its related parties responsible for pushing the company into insolvency, to regain control over the business of such companies. The result of bar created by Section 29A is that the earlier management is completely ousted which is unfair to some extent as the management is not always the cause of insolvency. Pre package insolvency will help to salvage this situation.

Pre – pack resolution of debt is kind of resolution process where a distressed company is salvaged by mutual agreement between the creditors and the debtor company. Pre pack is revamp scheme where the debtor negotiates with the creditor to remain in control of the business and continue the business as a going concern. It is a practical alternative to those business enterprises which are going into insolvency due to external factors rather than faulty management. A Sub – Committee of the Insolvency Law Committee was formed by the Government of India in June, 2020 to provide the framework of pre- pack insolvency under the Code. The interim report of the Bankruptcy Law Reforms Committee, February 2015 debated over the viability of the PPIRP and opined that pre – pack schemes are not workable mechanism for insolvency resolution as the Indian market does not have infrastructure to allow out of court restructuring without intervention of the Court. But due to pandemic pre – pack insolvency became the need of the hour.

The President promulgated the insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 on April 4, 2021. It was approved on March 31, 2021 by the cabinet. The basic aim of the amendment was to provide an efficient alternative for insolvency resolution framework for corporate person classified as MSMEs which will help in quicker, cost effective and value maintained outcomes for all the stakeholders.

To give way to the Ordinance, Chapter IIIA has been inserted in the IBC which will provide for provisions relating to pre – pack insolvency. Section 54A (1) provides that an application for initiation of pre – pack insolvency resolution may be made by corporate debtor who is classified as MSME under Section 7 (1) of the Micro, Small Medium Enterprises Development Act, 2006. According to the revised definition of MSMEs the capital investment in the micro enterprise shall not be more than One Crore Rupees and the turnover shall not be more than Five Crore Rupees . For small enterprises the capital investment shall be more than Ten Crore Rupees and turnover shall not be more than Fifty Crores Rupees and for medium enterprises the capital investment shall not be more than Fifty Crore Rupees and the turnover should be less than or equal to two hundred and fifty Crores.

#### **PRE REQUISITES FOR INITIATION OF PPIRP UNDER SECTION 54A (2)**

- The Corporate Debtor should not have undergone PPIRP or completed corporate insolvency resolution process during the three years preceding the initiation date.

- The Corporate Debtor shouldn't be already undergoing corporate insolvency resolution process.
- No liquidation order has been passed under Section 33 against the Corporate Debtor.
- The Corporate Debtor should be eligible under Section 29A of IBC to submit a Resolution Plan
- 66% of the unrelated financial creditors in value of financial debt due to such creditors should approve the appointment of the Resolution Professional and the base proposal
- Partners or Directors of Corporate Debtor shall make declaration in terms of Section 54A(2)(f).

#### **ADDITIONAL DEFINITIONS INTRODUCED BY THE INSOLVENCY AND BANKRUPTCY (AMENDMENT) ORDINANCE, 2021**

- **Section 5 (2A):** Base Resolution Plan means a resolution plan provided by the Corporate Debtor under sub section 4 of Section 54A.
- **Section 5 (23A):** Preliminary Information memorandum submitted by the Corporate Debtor under clause (b) of sub-section (l) of Section 54G
- **Section 5 (23B):** Pre-Packaged Insolvency Date means the date of admission of application for initiating the pre-packaged insolvency resolution process by the Adjudicating Authority.
- **Section 5 (23D):** pre packaged insolvency resolution process period includes the period from the date of acceptance of application for initiation of the PPIRP till the order passed by Adjudicating Authority for acceptance / rejection of the plan.
- **Section 11A:** Preference of disposal of application under Section 54C and under Section 7 or 9 or 10 of IBC.
- **Section 67A:** creates an offence for penalizing an officer of the Corporate Debtor who manages the Corporate Debtor during PPIRP with intent to defraud its creditors.
- **Section 77A:** provides for punishment for offences related to the PPIRP.
- Further, the Insolvency and Bankruptcy Board of India('IBBI') has notified the IBBI (Pre-Packaged Insolvency Resolution Process) Regulations, 2021.

#### **STEPWISE DESCRIPTION OF THE PROCESS TO BE FOLLOWED BY THE CORPORATE DEBTOR BEFORE FILING AN APPLICATION FOR INITIATION OF PPIRP**

- The Corporate debtor shall prepare a base resolution plan to be submitted to the financial creditors confirming the requirements provided under Section 54K.

- The corporate debtor must submit the following documents to the financial creditors namely, base resolution plan, declaration by majority of directors, special resolution by the members and other documents as provided under S.54C.
- The corporate debtor shall inform all the financial creditors its intention to initiate PPIRP and request all the financial creditors to attend the meeting for the same.
- The financial creditors shall be given a prior notice of 5 days of the meeting which shall include date, time and venue of the meeting. It shall also provide the list of creditors and their dues. (Regulation 14 of the IBBI has notified the IBBI (Pre-Packaged Insolvency Resolution Process) Regulations, 2021)
- The financial creditors having 10% share, shall propose the name of the resolution professional. The appointment and the terms for the resolution professional shall be provided under form P3.
- The financial creditor shall verify the base resolution plan, the eligibility of the financial creditors and the MSME status of the corporate debtor and their status under section 29A of the Code.
- The approval for application by financial creditor for PPIRP is to be filed in Form P4 with 66 percent approval by the financial creditors.
- Before making an application for initiation of PPIRP to the Adjudicating Authority, the corporate debtor shall through the resolution professional serve a copy of application to the IBBI which should include the list of financial creditors, list of operational creditors, approval of financial creditor for appointment of resolution professional as per Form P3 and written consent of resolution professional as per Form P1, declaration of majority of directors in Form P6, copy of special resolution of members etc.

#### **THE PROCESS FOR ADMISSION OF APPLICATION BY ADJUDICATING AUTHORITY FOR COMMENCEMENT OF PPIRP**

- The adjudicating authority will examine the application and the application if complete will be admitted or rejected within 14 days of its submission. The PPIRP shall be considered commenced from the date of admission of application. [Section 54C(4)]
- The adjudicating authority shall appoint a resolution professional whose name has been proposed in the application. There shall be no disciplinary proceeding against him. In case there is any disciplinary proceeding pending against the said resolution professional appointment will be based on the recommendation of IBBI. [Section

54E(1)(b)]

- The adjudicating authority shall direct the resolution professional to make a public announcement in accordance with Form P9 within two days from the commencement of the PPIRP. [Regulation 19]
- The whole process of PPIRP shall be completed within 120 days from the date of initiation of PPIRP and the resolution professional has to submit the resolution plan duly approved by the committee of creditors ('CoC') within 90 days of initiation of the PPIRP application. If the resolution plan is not submitted within a period of 90 days then the resolution professional shall file an application for termination of the PPIRP. [Section 54D]
- The moratorium period will start from the date of initiation of PPIRP and the adjudicating authority shall declare the moratorium by an Order. [Regulation 19]
- Moratorium shall be limited for purpose referred to in Section 14(1) read with Section 14(3) of the IBC, restricting the institution or continuation of any suit or proceedings against the corporate debtor and any transfer, alteration, disposing of etc. of any assets by the corporate debtor. [Section 54E(1)(a)]
- Within 90 days of initiation of PPIRP, the resolution professional has to submit an application to adjudicating authority for approval of resolution plan accepted by the CoC. [Regulation 49, Form P12]
- If the adjudicating authority approves the resolution plan, the resolution professional shall intimate to each claimant the principle formula for payment of debt under such resolution plan. If the adjudicating authority rejects the resolution plan, the resolution professional will file an application for termination of the PPIRP.
- In case of termination, the next PPIRP cannot be initiated within 3 years. [Section 54A(2)(a)]

#### **ADVANTAGES OF PPIRP**

- PPIRP takes less time in comparison to corporate insolvency resolution process.
- It is cost effective as less time is taken and many steps are already undertaken towards resolution before going to the adjudicating authority like preparation of the base resolution plan so the money spent is also less comparatively.
- Management of the corporate debtor remains in the hands of the Board of Directors of the Corporate Debtor. Therefore, the operation of corporate debtor continues smoothly.

- As the ownership of corporate debtor does not undergo a change, the management of the corporate debtor is more supportive towards PPIRP.
- There is less judicial interference in the PPIRP and once PPIRP is approved by the adjudicating authority it becomes binding on all the stakeholders.

- A distressed asset has a life cycle and the longer it stays in a state of stress, the more value depletion occurs. Pre-pack preserves this value depletion by cutting down the time frame.

**DIFFERENCE BETWEEN CIRP AND PPIRP**

Even though the PPIRP is part of the IBC, the difference in its resolution process and that of corporate insolvency resolution process are numerous. Some of them are:

Point of difference	Corporate insolvency resolution process	Pre – pack Insolvency resolution process
Who can initiate the application	Anyone of the following can initiate the application: <ul style="list-style-type: none"> <li>• financial Creditor</li> <li>• Operation Creditor</li> <li>• Corporate Debtor</li> </ul>	Only the Corporate Debtor itself can initiate the application.
Applicability	This method is available to any company as defined under the Companies Act, 2013 or limited liability partnership as defined under the Limited liability Partnership Act, 2008	This option is available only to MSMEs as defined under the Micro, Small and Medium Enterprises Development Act, 2006.
Time frame for the completion of process	The maximum time provided for completion of corporate insolvency resolution is now 330 days.	The maximum time limit for completion of PPIRP is 120 days
Minimum Threshold Limit	The minimum threshold value of default amount for filing an application for Corporate Insolvency Resolution process is Rs. One Crore now.	The minimum threshold value of default amount for filing an application for PPIRP is Rs. 10 Lakhs
Resolution Plan	Resolution plan is submitted after the application is made.	A base resolution plan is pre requisite to file PPIRP.
Submission of approved resolution plan	There is no timeline as such from the insolvency commencement date to submit the resolution plan. The timeline is for completion of the entire process.	After the commencement of PPIRP, the Resolution Professional has to submit the resolution plan approved by the Committee of Creditors to the Adjudicating Authority within 90 days.
Management of the Corporate Debtor	The management of the corporate debtor shifts from the promoters to the resolution professional.	The management remains with the promoters.

**CONCLUSION**

Introduction of pre pack resolution will further help to strengthen the insolvency framework of the country. It is treated as a welcomed step as it favours the promoters and helps them to remain in the management of the corporate debtor. The scheme of pre pack appears to be simple but it too has its share of disadvantages. The disadvantages associated with pre packs are lack of transparency, concerns regarding valuation, and confidentiality etc. Lack of transparency might lead to abuse of the entire process and it is necessary to prevent such abuse so that a proper framework is laid before any such scheme is rolled out.

However, it is too early to point out the disadvantages of the scheme but the fact cannot be ignored that the success of pre pack schemes is highly dependent upon the co operation between different stake holders of the corporate debtor. Nevertheless, it is a step ahead towards the development of the insolvency regime and if successful

with the MSMEs the government can introduce it for other corporate debtors also.

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