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RESTORING MSMES BACK TO HEALTH: THE PRE-PACK REVOLUTION IN INDIAN INSOLVENCY LAW



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1. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (“**IBC**”) underwent significant amendment on 04.04.2021 when the Hon’ble President passed the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 (“**the Ordinance**”).

Introduced on the backdrop of COVID-19 pandemic, the highlight of the Ordinance was the introduction of Pre-Packaged Insolvency Resolution Process (“**PPIRP**”) for Corporate Debtors (“**CD**”) that qualify as Micro, Small, and Medium Enterprises (“**MSMEs**”) as defined under Section 7(1) of the Micro, Small and Medium Enterprises Act, 2006.

It allows CDs to restructure their debt in a swift and cost-effective manner, which is welcome step towards resolution of insolvent MSMEs that have limited resources and simplified corporate structures.

2. THE FRAMEWORK

While formal CIRP is a time-consuming mechanism having various direct and indirect financial implications, on the other hand, informal resolution processes are flexible and economical minus the statutory backing and legal certainty of CIRP due to lack of approval of court as in the case of CIRP.

PPIRP provides a unique mechanism to bridge the aforesaid lacuna between CIRP and informal resolution processes. It is a strategy in which the re-structuring is pre-arranged and mutually agreed upon with creditors and other involved parties prior to the CD formally declaring its insolvency. Essentially, it is a quasi-formal process where the resolution plan is established before the formal commencement of insolvency proceedings.

3. PRECONDITIONS TO FILING APPLICATION

PPIRP involves a pre-commencement phase prior to formal commencement, during which the CD and its financial creditors must fulfill specific prerequisites.

To be eligible for PPIRP, the CD must be an MSME which has defaulted on its loans having minimum threshold amount of Rs. 10 lacs. The MSME status can be verified through Udyam registration details or financial information related to investment in plant and machinery and turnover. Additionally, the CD must qualify to submit a resolution plan under Section 29A read with Section 240A of IBC.

Certain restrictions apply upon the CD, such as not having undergone a CIRP or PPIRP in the past three years, not being in an ongoing CIRP when applying for PPIRP, or not having received a liquidation order.

In addition, the CD must fulfill other conditions, such as, First, convening a meeting of unrelated financial creditors to propose and approve the appointment of a Resolution Professional (“**RP**”) for PPIRP.

Second, the CD must obtain internal approvals for starting PPIRP, including declarations to be made by majority of partners or directors regarding the timeline of filing of application and the proposed RP. The members of the CD must pass a special resolution to approve PPIRP

Third, unrelated financial creditors must approve the initiation of PPIRP with a 66% majority vote. At this stage, the CD is required to provide sufficient information to enable creditors to make an informed decision, including the declarations from directors or partners and members. The CD shall also share the base resolution plan with the financial creditors proposing its resolution as a going concern.

4. PROCEDURE

Once the pre-commencement requirements are satisfied, the CD may proceed to file an application to initiate PPIRP with the Adjudicating Authority (“**AA**”). The application must be submitted by the corporate applicant within the above mentioned timeframe, accompanied by a report from the proposed RP confirming eligibility and compliance with the requirements, especially confirming conformity of the base resolution plan with the stipulated require-

ments. Additionally, the application must also accompany declarations as regards existence of any antecedent transactions as per provisions under Chapter III or VI of Part II of IBC.

Within 14 days of receiving the application, the AA reviews its eligibility and, if satisfactory, admits the application which marks the formal commencement. The AA then declares a moratorium as per Section 14(1) and (3) of IBC and appoints the RP along with a public announcement to be made by the RP in the manner as stipulated under IBC.

Once the application is admitted, it is mandatory to complete PPRIP within a brief timeline of 120 days from date of admission, which is divided into 90 days for approval of the resolution plan by the Committee of Creditors (“CoC”) and 30 days for adjudication by AA.

The approval of resolution plans follow a three-stage process. The CD first submits the base resolution plan to the RP, which, if approved by CoC, is submitted to the AA for final approval. If not approved, a public invitation is issued and prospective resolution applicants are invited to submit competing resolution plans.

The CoC evaluates the plans received via public invitation and selects one for approval, which may be submitted to AA. If the selected plan is not significantly better than the base plan, it competes with the base plan in the third stage, wherein the competing resolution plans are continually improved until one outperforms the other, and the winning plan is considered for final approval. The stipulated time period for the third stage is 48 hours.

The closure of PPRIP can occur through various avenues. First, it concludes when the CoC's approved resolution plan receives approval by AA. Second, the AA can issue a termination order under specific conditions, such as CoC resolution seeking termination, non-submission of a plan within 90 days, or CoC rejection of the selected resolution plan. Third, based on resolution by CoC, the AA can initiate CIRP.

5. CHARACTERISTICS

Pertinently, the CD retains control over its operations during this period, however, subject to specific obligations. The CD must manage its affairs in a manner which safeguards the interests of creditors and preserves the value of its assets, while also adhering to any regulations imposed by the Central Government.

The RP oversees and facilitates PPRIP which entails, inter alia, collection of information, filing relevant applications, monitoring the management of CD entity.

The CoC, composed of financial creditors, exerts significant command during PPRIP as it enjoys the power to approve certain key actions of the CD, if approved by 66% majority vote, including entering into transactions, creating security interests, and deciding the outcome of PPRIP.

The CoC can approve or reject resolution plans, terminate PPRIP, as well as request AA to vest management in the RP if misconduct or mismanagement is detected. Additionally, the CoC may at any state seek replacement of the RP by a 66% majority vote.

6. CONCLUSION

PPRIP offers a structured and time bound approach to corporate debt resolution of MSME entities, emphasizing the preservation of business value. This process involves distinct stages, roles for key stakeholders, and strict timelines to ensure efficiency and transparency in resolving distressed CDs. Through a combination of eligibility criteria, regulatory oversight, and creditor participation, PPRIP aims to strike a balance between the interests of the various stakeholders.

7. ANALYSIS

While other modes of corporate debt resolution involve court interference and significant control by RPs or liquidators, PPRIP is recommended due to its costeffectiveness by allowing existing management to continue running the company, reducing the need for external RP management. The foregoing preserves the value of stressed assets, expedites the resolution process, and minimizes the burden on courts due to its informal and consensual nature. PPRIP also ensures confidentiality and flexibility in negotiations, giving creditors a say in management decisions.

PPRIP follows a debtor-in-possession approach, thereby allowing the CD to retain control of the company while implementing safeguards for creditors' interests. The CoC plays a crucial role in overseeing PPRIP and can shut the entire process if the CD engages in activities detrimental to creditors' interests, whereby the RP's role is to ensure fairness and transparency throughout PPRIP.