

Pre-packaged Insolvency Resolution Process for MSMEs - An Analysis



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Introduction

The Insolvency and Bankruptcy Code (Amendment) Bill, 2021 (the Bill) was introduced in the Lok Sabha in July 2021, replacing the IBC Amendment Ordinance of April 2021. The Bill introduces the concept of a “pre-packaged” resolution process for stressed micro, small and medium enterprises (MSMEs) (“MSME Pre-pack”).

While the term “pre-packaged” or “pre-pack” has not been defined in the Bill, the Government of India seems to have taken a page out of American and European insolvency processes where the concept is prevalent. A pre-packaged insolvency process essentially means that the resolution plan has been negotiated and agreed upon by the main stakeholders, i.e., the creditors, the corporate debtor, and its shareholders, *before* approaching the adjudicating authority (in this case, the NCLT). Once a corporate debtor approaches NCLT with a pre-packaged resolution plan, then the roadmap thereafter for the insolvency resolution process to be approved and completed stands considerably reduced (when compared to the timelines and process involved in traditional IBC proceedings). This is because the resolution plan would have already been agreed upon between the principal stakeholders ahead of presentation to NCLT.

Analysis

The outbreak of Covid-19 brought many small and local businesses to a standstill, precipitating financial defaults in the process. The MSME Pre-pack offers an efficient alternative insolvency resolution process for MSMEs by providing a cost-effective mechanism that is both speedy and value accretive, with minimum disruption to business operations of the affected company. The threshold to invoke the Pre-packaged Insolvency Resolution Process (PIRP) is lower (Rs.1 lakh-Rs.1 crore) than for non-MSMEs and the thrust of MSME Pre-pack is that the management of the MSME continues to be retained by the directors or partners till the resolution plan is implemented, while the creditors remain in ‘overall control’ through oversight and supervision of the resolution plan that has been agreed upon. Thus, the PIRP is largely aimed at providing MSMEs with an opportunity to restructure their

liabilities in such fraught times, without having to cede operational control of their businesses to the resolution professional appointed, as in the case of the corporate insolvency resolution process (“CIRP”) that is applicable to non-MSMEs.

Further, the PIRP can only be instituted by the debtor. If the debtor has defaulted amount in the range of Rs. 1 lakh to Rs. 1 crore, it can formulate a base resolution plan for initiating an insolvency resolution process and approach the board of creditors (or the creditor, if only a single creditor is involved). The PIRP can be initiated, and the resolution plan can be taken to the NCLT only if the proposed base resolution plan formulated by the debtors is approved by 66% of the creditors. Such base resolution plan will also contain the name(s) of prospective resolution professionals suggested by the debtor. The creditors, while approving the base PIRP would also agree upon a suitable resolution professional to carry out the PIRP.

Once the application for PIRP is submitted to the NCLT, the resolution process moves at a good pace, given the stringent timelines laid down in the Bill. The timelines stipulated by the Bill are as follows:

- Once the PIRP application is filed with the NCLT, it has to approve or reject the application within 14 days of receipt. Any corrections required in the application should be intimated to the debtor within 7 days of receiving the application.
- Once the application has been accepted by the NCLT, the PIRP (as approved by at least 66% of the creditors) must be submitted within 90 days by the Resolution Professional to NCLT.
- If no plan has been agreed upon by the board of creditors, within the 90-day period, the Resolution Professional must file an application with NCLT for termination of PIRP. This ensures that the application does not drag on beyond 90 days without a resolution plan in place.
- If the Resolution Plan has been submitted to the NCLT within 90 days, then the NCLT must approve the plan within 30 days.

Speaking of the PIRP's advantages over the CIRP, the first stark difference is the timelines for resolution of insolvency proceedings. One of the key criticisms of the CIRP has been the time it takes for resolution. At the end of March 2021, 79 per cent of the 1,723 ongoing insolvency resolution proceedings had crossed the 270-day threshold. A major reason for the delays is the prolonged litigation by erstwhile promoters and potential bidders. The pre-pack in contrast, is limited to a maximum of 120 days with only 90 days available to stakeholders to bring a resolution plan for approval before the NCLT¹. Secondly, unlike the CIRP, where the responsibility of the management of the company is transferred to the resolution professional, the PIRP allows the board of directors or partners of the debtor to continue managing the affairs of the company. The transfer of management under the PIRP to the resolution professional happens only after the approval by the creditors and the adjudicating authority (NCLT).

The Bill also seems to take into account the concern that a low default threshold may incite the debtor to initiate PIRP as a means to avoid repayment of dues to its creditors. To address this concern, the Bill provides for penalty for instituting fraudulent and malicious PIRP and also for fraudulent management of the debtor during the PIRP.

The Bill also lays down a formal procedure to be followed by the debtor to file for an application before the adjudicating authority. These are as follows:

- Under Section 54A(2)(f) of the amended IBC, the debtor shall execute a declaration stating that:
 - i. The corporate debtor shall file application for PIRP within 90 days of the declaration;
 - ii. The PIRP is not being initiated to defraud any person; and

- iii. The name of the insolvency resolution professional proposed by the debtor and approved (by the creditors) to be appointed for the PIRP.
- Under Section 54A(2)(g) of the amended IBC, the corporate debtor shall pass a special resolution, approving the application for initiating PIRP. In case the debtor is a partnership firm, such resolution will have to be passed by at least 3/4 partners.
 - While making an application to the NCLT for initiating the PIRP, the debtor shall, along with the aforementioned special resolution and the declaration, submit the name and written consent of the proposed and approved resolution professional and a declaration regarding the existence of any transactions under chapter III of the IBC (*avoidance of transactions*) and chapter IV of the IBC (*fraudulent or wrongful trading*).

Conclusion

To summarize, in essence, the PIRP for MSMEs provides a timebound resolution process with a lower threshold to aid the MSMEs in restructuring their debts while retaining control of their enterprise. While the PIRP is an opportunity for MSMEs to restructure their debts and liabilities, it is yet to be seen if the timelines provided in the Bill are practically possible to adhere to or if further amendments are rolled out to provide for extended timelines under certain conditions.

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