
PRE-PACKAGE INSOLVENCY RESOLUTION PROCESS: A LIFELINE FOR MSMEs AMIDST COVID 19 TURMOIL

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ABSTRACT

The Pre-packaged Insolvency Resolution Process (Pre-pack) has become a crucial instrument for Micro, Small, and Medium Enterprises (MSMEs) as they navigate the economic consequences of the COVID-19 epidemic. This abstract examines the underlying reasoning behind Pre-pack procedures designed to tackle the distinct difficulties encountered by Micro, Small, and Medium Enterprises (MSMEs) in the context of the pandemic. It emphasizes the need of prompt and debtor-friendly solutions in view of the unparalleled disruption to business activities and financial equilibrium. It highlights the significance of implementing efficient and effective insolvency frameworks to support the revival and sustainability of distressed MSMEs during and after the COVID-19 crisis. It does so by examining the key features, regulatory considerations, operational challenges, and potential benefits of Pre-pack processes for MSMEs. Pre-packs provide a potential opportunity for conserving value, saving employment, and promoting economic resilience in the MSME sector by offering a timely and consensus-driven procedure for debt restructuring and resolution.

Keywords: Insolvency, MSMEs, Corporate Debtor and Financial Creditor

Introduction

The Pre-packaged bankruptcy Resolution Process (PPIRP) has become a prominent instrument within the range of bankruptcy procedures, specifically designed for Micro, Small, and Medium Enterprises (MSMEs) who are facing economic difficulties that have been intensified by the COVID-19 epidemic. In response to the distinct vulnerabilities and significance of Micro, Small, and Medium Enterprises (MSMEs) within the economic context, certain countries, such as India, have implemented or examined the notion of Pre-packs designed to cater to the special requirements of these businesses during the ongoing pandemic. In the midst of the unparalleled disruption brought about by the COVID-19 pandemic, micro, small, and medium enterprises (MSMEs) have encountered a diverse array of obstacles. These issues include limitations in cash, interruptions in the supply chain, a decrease in demand, and operational difficulties. The financial well-being of several MSMEs has been greatly impacted by these difficulties, leaving them vulnerable to bankruptcy procedures.

Policymakers, regulators, and stakeholders have increasingly focused on Pre-pack processes as a feasible strategy for MSMEs to achieve quicker, more cost-effective, and more debtor-friendly settlements in response to these difficulties. A Pre-pack refers to the process of developing and negotiating a restructuring plan between the debtor and its creditors outside of the official insolvency procedure. This plan is then submitted for approval to the appropriate adjudicating body. Pre-packs provide MSMEs with the chance to quickly reorganize their debts, maintain value, and sustain operations as a going concern by enabling a pre-negotiated and consensus driven.

It is crucial to analyze the essential characteristics, regulatory structure, operational obstacles, and possible advantages of Pre-packaged Insolvency Resolution Processes that are especially tailored for Micro, Small, and Medium Enterprises (MSMEs) amidst the COVID-19 epidemic. Pre-packs has the capacity to alleviate the detrimental effects of the pandemic on the MSME sector and foster its enduring resilience and expansion by offering a prompt and effective procedure for debt restructuring and settlement.

Rationale to implement PPIRP

On 4-4-2021, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021¹ was issued

¹ Chapter IIIA inserted by Act 26 of 2021, section 8 (w.e.f. 04.04.2021)

by the President of India with the purpose of implementing a pre-packaged insolvency resolution process within the framework of the Insolvency and Bankruptcy Code, 2016. The purpose of the Ordinance, as stated in its Statement of Objects and Reasons, was to provide micro, small, and medium-sized enterprises (MSMEs) with a "effective alternative insolvency resolution process." Its objective is to provide a mechanism for resolving insolvency that is efficient, value-adding, and expeditious, with minimal disruption to business operations.

During Covid-19 pandemic, there was substantial surge of insolvencies were observed. As a consequence, governmental entities have been advised by organizations such as the World Bank and the International Monetary Fund to safeguard minor enterprises against insolvency. As a reaction, governments have implemented various strategies such as sector-specific forbearances, moratoriums on loan repayments, liquidity infusions into the banking system to assist financially distressed firms in obtaining credit, relaxation of asset classification banking standards, flexibility in the obligations of directors to initiate insolvency proceedings, and suspensions on creditors' ability to file insolvency proceedings.

However, Formal insolvency procedures, such as the corporate insolvency resolution process (CIRP), are especially protracted and time-consuming when implemented in the context of small enterprises. Hence, Chapter III-A was introduced in Insolvency and Bankruptcy Code, 2016 by issuing an ordinance which came into force on 04.04.2021.

Pre-packaged process offers a feasible compromise through the implementation of a unique mechanism that seeks to combine the benefits of informal exercise with legal recognition. Hybrid mechanisms, pre-packs facilitate the acknowledgment of out-of-court resolutions as recognized under insolvency law, while simultaneously affording sufficient safeguards for all parties concerned. Pre-pack is an alternative method of resolving corporate debts owed to medium-sized, small, and micro-sized enterprises (MSMEs). The process functions according to the "debtor-in-possession with creditor-in-control" structure and strives to attain a resolution in short duration.

Procedure to be followed in PPIRP

A. Eligibility and Conditions to apply for PPIRP

An Application for initiating pre-packaged An application for initiating pre-packaged

insolvency resolution process (PPIRP) may be under section 7(1) of the Micro, Small and Medium Enterprises Development Act, 2006.²

Thus, application can be made for PPIRP in respect of MSME which is incorporated as company or LLP. There is no specific provision that the corporate debtor must be registered as MSME, but obviously highly advisable.

The minimum should be INR 10 Lakhs for the matters relating to the PPIRP of corporate debtor under Chapter III-A of the IBC, 2016.³ The procedure for initiation of PPIRP is quite different from the existing CIRP processes. In PPIRP, a corporate debtor who is in default and intends to have resolution plan, approaches an Insolvency Professional (or IP may approach prospective corporate debtor). The corporate debtor, with assistance and guidance of Insolvency Professional, will informally have discussions with major financial creditors and explore possibility of initiating PPIRP. Once, majority of unrelated financial creditors (at least 66%) indicate their willingness, corporate debtor can take further steps to make application for PPIRP. This process is informal or semi formal as till the application is made, the Adjudicating Authority doesn't come into picture at all.

B. Procedure Prior To Application to AA For Approval to initiate PPIRP

Appointment of Resolution professional with first informal and then formal consent of financial creditors is the first step in initiating PPIRP. Then, approval of unrelated financial creditor with at least 66% value is taken. For such purpose, the Applicant shall convene meetings of the financial creditors, who are not related parties of the corporate debtor.⁴ However, PPIRP regulations do not specify very strict procedures at such meetings as such meetings are expected to be exploratory and only semi-formal.

C. Procedure to file application for initiating PPIRP

Where a Corporate Debtor meets the requirements of section 54A, a corporate applicant thereof may file an application with the Adjudicating Authority for initiating PPIRP.⁵ The

² The Insolvency and Bankruptcy Code 2016, S.s.54A(1)

³ Notification S.O. 154(3) dated 09.04.2021.

⁴ Regulation 14(1) of The IBBI (PPIRP) Regulations, 2021.

⁵ The Insolvency and Bankruptcy Code 2016, Section 54C(1).

Corporate Applicant shall file an application alongwith the following documents:

- i. The declaration made by the majority of the partners or directors, as the case may be, for initiating PPIRP.
- ii. The approval of the Financial creditors for initiating PPIRP.
- iii. The name and the written consent of the insolvency professional to be appointed as resolution professional.

The Adjudicating Authority (NCLT) shall, within a period of 14 days of the receipt of the application, by an order: admit the application, if it is complete or reject the application, if it is incomplete. However, before rejecting an application, the Adjudicating Authority shall give notice to rectify the defect in the application within 7 days of receipt such notice. In the case of **Pioneer Urban Land & Infrastructure Ltd. v. UOI**⁶, the Hon'ble Supreme Court held that the time limit of 14 days prescribed is not *mandatory* but *directory*.

D. Commencement of PPIRP

The pre-packaged insolvency resolution process (PPIRP) shall commence from the date of admission of the application u/s 54C(4)(a), now along with the order of admission of application under the said section, the Adjudicating Authority shall –

- i. Declare a moratorium for the purpose referred to in section 14(1) r/w section 14(3) of the Code 2016 which shall be applicable to the proceedings under Chapter III-A.
- ii. Appoint a resolution professional.
- iii. Cause a public announcement of the initiation of the pre-packaged insolvency resolution process to be made by the resolution professional.

E. Managing the affairs of corporate debtor

Within the context of the PPRIP, a hybrid method that combines the debtor-in-possession

⁶ (2019) 8 SCC 416

model with the creditors-in-control model has been implemented. Under the PPIRP framework, the powers of the board of directors, as well as the management and control of the corporate debtor, are vested in the resolution professional upon the beginning of the PPIRP. In contrast, the CIRP framework allows the management of the corporate debtor to continue to run the business during the PPIRP from the moment it begins. However, it should be noted that some critical issues that need approval from the committee of creditors under a CIRP, as provided in Section 28 of the Code, are also relevant to PPIRP.

In some circumstances, the resolution professional may be trusted with the responsibility of managing the corporate debtor. This is done in order to guarantee that the PPIRP operates well. In the event that the CoC decides to entrust the administration of the corporate debtor to the resolution professional by a vote of not less than 66% of the voting share, the resolution professional is required to submit an application to the Adjudicating Authority. Upon receiving such an application, the Adjudicating Authority will, if it is satisfied that the affairs of the corporate debtor are being conducted in a fraudulent manner or if there has been gross mismanagement of the affairs of the corporate debtor, issue an order that will vest the management of the corporate debtor with the resolution professional.

The entire process is required to be completed within 120 days after the admission of application for PPIRP as MSMEs doesn't have the capacity to survive the prolonged insolvency processes as in CIRP which was observed by the sub-committee in its report.⁷

The Committee of Creditors (CoC) has the authority to adopt the basic resolution plan, provided that it does not compromise any outstanding claims owing by the corporate debtor to the operational creditors. In cases where the Committee of Creditors (CoC) does not grant approval to the base resolution plan or if the base resolution plan hinders the ability of the corporate debtor to meet its obligations to operational creditors, it becomes necessary for the resolution professional to extend invitations to potential resolution applicants. These applicants are then expected to submit resolution plans that can effectively compete with the base resolution plan. The criteria for evaluating these

⁷ Ministry of Corporate Affairs, *Report of Sub-Committee of the Insolvency Law Committee on Prepackaged Insolvency Resolution Process* (2020) para 3.16 available at <https://www.ibbi.gov.in/uploads/resources/24c7fc03cdfff69960ce374416fa646.pdf>

proposals are established by the resolution professional and subject to approval by the CoC.

The resolution professional must offer compliant resolution plans to the committee of creditors for consideration, based on the evaluation of the received plans against the criteria set by the resolution professional and conformity with the rules of the Code. The Committee of Creditors (CoC) will choose a resolution plan from the resolution plans that have been submitted, based on the review.

The resolution plan that is deemed to be considerably superior to the basic resolution plan will be chosen for approval and thereafter submitted to the Adjudicating Authority. In the event that the chosen resolution plan fails to meet the aforementioned requirements, it will be compared against the basic resolution plan, and one of them will be chosen for approval and submission to the Adjudicating Authority. The resolution plan must be approved by the CoC by a vote of not less than 66% of the voting shares in order for it to be submitted to the Adjudicating Authority. Within thirty days of receiving the resolution plan, the Adjudicating Authority is required to either accept or reject the resolution plan and terminate the PPIRP. This decision is made after the Adjudicating Authority has reached a conclusion on whether or not the resolution plan complies with the requirements of the Code.⁸

The resolution professional shall submit the resolution plan, as approved by the Committee of Creditors (CoCs) to the Adjudicating Authority u/s 54K(4) or section 54K(12) of the Code of 2016, within 90 days from the date of commencement of PPIRP.

F. Submission of Resolution Plan

Prior to commencing the PPIRP, a corporate debtor must submit the basic resolution plan to the financial creditors. This plan must be presented to the resolution professional within 2 days of the PPIRP beginning date. It is essential that the basic resolution plan adheres to the stipulations outlined in Sections 30 (1), (2), and (5) of the Code.⁹

⁸ Insolvency and Bankruptcy Code, 2016, Section 54L (1) and (3).

⁹ Insolvency and Bankruptcy Code, 2016, Section 54K (1), (2) and (3).

G. Termination of PPIRP

In the event that the resolution professional submits an application to the Adjudicating Authority in accordance with Section 54N, the proviso of Section 54K (12), or Section 54D (3) of the Code, the Adjudicating Authority has the ability to terminate the PPIRP.

Challenges to PPIRP

A. Pre-Packaged Insolvency resolution Process misled as based on Debtor-in-possession (DIP) Model

The DIP strategy, which gives the board of directors of the defaulting firm the ability to run the operations of the company, is a fundamental development that has come about as a result of its implementation. Despite the fact that it would seem that the Code has embraced the DIP model, a brief examination of the clauses that are pertinent reveals that creditors retain authority over the resolution process. In addition, the CoC has exercised its power to commence the CIRP against the debtor by commencing resolution of the matter after receiving a vote share of sixty-six percent. The PPIRP would be terminated in advance as a result of this. As a result, it is now a part of the Code, namely Section 54-O. With this clause, the misnomer of the DIP model, which the amendment intends to implement, is brought into even greater perspective.

B. Exclusion of Operational Creditors

It is not possible for the operational creditors to participate in the PPIRP. Throughout its history, the Code has, among other things, precluded operational creditors from any involvement inside the CoC. Nevertheless, it has granted them the authority to launch the CIRP against the debtor. Due to the fact that only the debtor has the ability to begin PPIRP, the amendment does not provide such rights for the operational creditors. The CoC that is established for this purpose is similar to the one that is established for CIRP, and it does not allow any involvement from the operational creditors. In addition, this is in contrast to the methods that are followed in other jurisdictions, such as the United States, where a committee of unsecured creditors is established in order to safeguard the interests of creditors who would not be given enough attention. In a similar vein, in the United Kingdom, every firm that is in the process of being resolved must

have the permission of such creditors, who must account for seventy-five percent of the value of each category of creditors. Because micro, small, and medium-sized enterprises (MSMEs) are regarded to be operational creditors, the exclusion is also detrimental to the interests of these businesses. Due to the fact that micro, small, and medium-sized enterprises (MSMEs) would not be able to vote or express their view on the topic, any future structure of PPIRP for larger corporations would undoubtedly become detrimental to the MSMEs themselves.

C. Absence of Calm period

There is a "calm period" that is included in the terms of the current CIRP procedure. During this period, the resolution expert works to revitalize the operational prospects of the firm without involving the CoC in an excessive manner. In this way, the professional is given the opportunity to seek approval for a resolution plan that has the potential to provide a viable alternative to the bankruptcy of the firm. The examination of the framework reveals that the PPIRP does not provide the advantage of a tranquil time. This is due to the fact that the CoC has the ability to interfere with the management and resolution processes by imposing their judgments on the Board. In the event that compliance is not maintained, the CoC may initiate the termination of the PPIRP. It would seem that the difficulty occurs due to the fact that the corporate debtor, rather than the interim expert, is the one who comes up with the resolution plan.

Conclusion

In spite of the fact that the advantages of the pre-pack exceed the challenges that are encountered in its successful implementation, it is nevertheless necessary to observe how it turns out to be starting from the very beginning. If this testing proves to be effective, the government may seek to carry out this procedure for other types of firms as well. Micro, small, and medium-sized enterprises (MSMEs) make up a significant portion of the business sector in India. This is a significant step toward the goal of attracting further investments in Indian firms and promoting ease of doing business in addition to that. Due to the COVID-19 epidemic, several firms have been rendered inoperable since they were unable to participate in the CIRP program during its suspension for over a year. Now, the pre-pack procedure makes it possible for these companies to detoxify themselves in a relaxed way, with the least amount of disturbance possible and without any loss of employment

opportunities. It requires honesty on the part of both the creditors and the debtors in order to resolve the issues that have been raised throughout the process without making the procedure take an excessive amount of time. However, they must take precautions to ensure that the sluggishness of CIRP does not spread to PIRP. It is a path that leads to a conclusion that is agreeable and should not get involved in debates over technical matters.