TITLE: A Critical Analysis of India's Pre-pack Regime for MSMEs

Abstract: Hybrid restructuring procedures such as pre-packs have been encouraged to deal with expected increase in insolvent firms in the aftermath of the COVID-19 pandemic. Pre-packs have been gaining popularity as a restructuring mechanism across the world. India too introduced a pre-packaged insolvency resolution process for micro, small and medium enterprises in April, 2021. This paper first provides a brief overview of the pre-pack models employed in certain other jurisdictions such as the US, UK and Singapore with a view to understand the key features of pre-pack models and how they have been operationalised in these jurisdictions. It then briefly discusses other restructuring avenues which were available to a corporate debtor in India and the circumstance that led up to the introduction of pre-packs in India. Finally, it provides a detailed overview of the Indian pre-pack regime and evaluates its effectiveness for MSMEs, potential issues that may cause delays in the process and how the current pre-pack regime can be further streamlined. It argues that some of the procedural requirements and features of the Indian pre-pack regime may not be suitable for MSME insolvencies.

1. INTRODUCTION

Hybrid restructuring mechanisms such as pre-packs which incorporate elements of out-of-court workouts (i.e., negotiations between the debtor and its creditors) with limited judicial involvement (i.e., final approval of the negotiated plan)[1] serve as critical restructuring instruments, especially in jurisdictions with overburdened court systems[2] and ineffective reorganisation procedures.[3] By combining features of out-of-court workouts with formal reorganisation procedures, hybrid processes can enjoy benefits of informal workouts (such as confidentiality, cost-efficiency and speediness) along with benefits of formal reorganisation procedures (such as ability to bind dissenting creditors, binding effect of a reorganisation plan).[4] Establishing efficient hybrid workout regimes have especially been encouraged to deal with expected increase in insolvent firms in the aftermath of the COVID-19 pandemic.[5]

Pre-packs or pre-packaged reorganisations or insolvency processes are a popular hybrid restructuring mechanism that have been gaining popularity in various jurisdictions across the

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[1] W. A Bauer, R. S Craig, Jose M Garrido, Kenneth H Kang, Kenichiro Kashiwase, Sung Jin Kim, Yan Liu and Sohrab Rafiq, 'Flattening the Insolvency Curve: Promoting Corporate Restructuring in Asia and the Pacific in the Post-C19 Recovery' (2021) WP/21/16 IMF Working Paper, 20 <https://www.imf.org/en/Publications/WP/Issues/2021/01/29/Flattening-the-Insolvency-Curve-Promoting-Corporate-Restructuring-in-Asia-and-the-Pacific-in-49997> accessed 13 June 2023.

[2] ibid. These authors reported that use of pre-packs can result in five-fold increase in judicial capacity.

[3] Juliana Araujo, José Garrido, Emanuel Kopp, Richard Varghese, and Weijia Yao, 'Policy options for supporting and restructuring firms hit by the COVID-19 crisis' (2022) DP/2022/002 International Monetary Fund Legal Department (Series), 33 <https://www.imf.org/-/media/Files/Publications/DP/2022/English/POSRFEA.ashx> accessed 5 June 2023.

[4] Jose M. Garrido, 'Out-of-Court Debt Restructuring' (2012) World Bank Study, paras 14-19 <http://hdl.handle.net/10986/2230> accessed 13 June 2023.

[5] Antonia Menezes and Sergio Muro, 'COVID-19 Outbreak: Implications on Corporate and Individual Insolvency' (2022) World Bank Group COVID-19 Notes Finance Series, 2 <https://pubdocs.worldbank.org/en/912121588018942884/COVID-19-Outbreak-Implications-on-Corporate-and-Individual-Insolvency.pdf> accessed 6 June 2023.

world.[6] It is important to note that while the term 'pre-packs' is widely used across jurisdictions, it does not have a uniform meaning and the structure and features of 'pre-packs' are often very different in different countries.[7] Broadly, pre-packs can be understood to refer to a hybrid restructuring procedure which usually involves out-of-court negotiations leading to a pre-negotiated restructuring plan between the debtor and its creditors followed by opening of a formal reorganisation procedure under which the plan may be approved by the court.[8]

Reorganisation proceedings for firms in financial distress can result in direct costs (i.e., costs incurred in engaging lawyers, accountants etc.) and indirect costs (i.e., losses incurred on account of loss of customers, suppliers, employees etc.).[9] The indirect costs associated with pre-packs have been reported to be lower than formal reorganisation processes.[10] The advantages offered by pre-packs have made them an attractive avenue for reorganisation and they have been widely used in jurisdictions such as the United States of America (US)[11] and the United Kingdom (UK).[12] However, there have also been concerns relating to lack of transparency in pre-packs.[13]

India too introduced a pre-packaged insolvency resolution process[14] for micro, small and medium enterprises (MSMEs) in April, 2021.[15] In January 2023, the (Indian) Ministry of Corporate Affairs (MCA) sought public comments on certain proposed changes to the

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[6] For example, Belgium introduced a formal pre-packaged insolvency procedure in March 2021 (see Allen & Overy, 'Introduction of a pre-pack insolvency procedure in Belgium' <https://www.allenovery.com/en-gb/global/news-and-insights/publications/introduction-of-a-prepack-insolvency-procedure-in-belgium> accessed 13 June 2023); Singapore introduced a pre-packaged scheme of arrangement in 2017 (see Insolvency, Restructuring and Dissolution Act 2018, s 71). Also see Debby Lim, 'Singapore's First "Pre-Packaged" Scheme of Arrangement' (*Singapore Global Restructuring Initiative Blog*, 5 February 2021) <https://ccla.smu.edu.sg/sgri/blog/2021/02/05/singapores-first-pre-packaged-scheme-arrangement> accessed 13 June 2023.

[7] Aurelio Gurrea-Martinez, 'The Rise of Pre-Packs as a Restructuring Tool: Theory, Evidence and Policy' (2023) 24 European Business Organization Law Review 93, 95.

[8] John J. McConnell, Ronald C. Lease and Elizabeth Tashjian, 'Prepacks as a mechanism for resolving financial distress: The Evidence' (2023) 35 Journal of Applied Corporate Finance 31, 31.

[9] Brian L. Betker, 'An Empirical Examination of Prepackaged Bankruptcy' (1995) 24(1) Financial Management 3, 5-8.

[10] ibid 17.

[11] John Yozzo and Samuel Star, 'For better or worse, prepackaged and pre-negotiated filings now account for most reorganizations' (2018) 37(11) ABI J 64.

[12] See Adam Plainer, Kay Morley and Ola Majiyagbe, 'Legislative Developments: The New Pre-Pack Regulations' (Global Restructuring Review, 4 March 2022) <https://globalrestructuringreview.com/guide/the-art-of-the-pre-pack/edition-2/article/legislative-developments-the-new-pre-pack-regulations> accessed 13 June 2023. Pre-packs form around 29% of all UK administrations.

[13] Alexandra Kastrinou and Stef Vullings, ''No Evil is Without Good': A Comparative Analysis of Pre-pack Sales in the UK and the Netherlands' (2018) 27 Int. Insolv. Rev. 320, 320.

[14] The Insolvency and Bankruptcy Code 2016 (IBC 2016), chapter III-A.

[15] IBC 2016, s 54A. Section 7(1) of the Micro, Small and Medium Enterprises Development Act 2006 defines micro, small or medium enterprises as follows: (1) a 'micro enterprise' is one where the investment in plant and machinery or equipment does not exceed INR 10 million and the annual turnover does not exceed INR 50 million, (2) a 'small enterprise' is one where the investment in plant and machinery or equipment does not exceed INR 100 million and the annual turnover does not exceed INR 500 million, and (3) a 'medium enterprise' is one where the investment in plant and machinery or equipment does not exceed INR 500 million and the turnover does not exceed INR 2.5 billion.

insolvency regime under IBC 2016, one of which is to expand the applicability of the pre-pack regime to a wider category of debtors.[16] The Indian pre-pack regime is relatively new and still evolving. According to data available as on 30 June 2023, six pre-pack applications have been admitted under this regime, out of which one has been withdrawn and one has been resolved.[17] Given the proposal to expand this relatively nascent regime to other categories of debtors, it becomes important to analyse the existing pre-pack framework and evaluate potential issues that may be affecting its uptake.

This paper analyses the Indian pre-pack regime with the objective of evaluating its effectiveness for MSMEs, identifying potential issues and exploring ways of further streamlining the process. Part 2 provides a brief overview of the pre-pack models currently being employed in certain other jurisdictions such as the United States of America (US), United Kingdom (UK) and Singapore with a view to understanding the key features of leading pre-pack models and how they have been operationalised in these jurisdictions. Part 3 provides a detailed overview of the existing pre-pack regime in India along with a brief discussion of the existing reorganisation procedures in India and the circumstance that led up to the introduction of pre-packs in India. Part 4 analyses the Indian pre-pack regime and discusses its effectiveness for MSMEs, potential issues that may cause delays in the process and how the current pre-pack regime can be further streamlined. Part 5 evaluates MCA's recent proposals to amend the pre-pack regime as well as the fast-track insolvency resolution process in India. Part 6 concludes.

2. MODELS OF PRE-PACKS IN OTHER JURISDICTIONS

This part provides an overview of the pre-pack regimes in the US, UK and Singapore. As mentioned earlier, the key features and structure of pre-packs often differ across regime.[18] Understanding the features, benefits and challenges associated with different pre-pack models can provide guidance for the Indian pre-pack regime. The US and the UK pre-pack models have been selected for the comparative analysis as many pre-pack regimes across the world often adopt features from these two models (albeit with modifications).[19] On the other hand, Singapore's relatively nascent pre-pack regime provides an example of how an efficient pre-pack framework can be developed fairly quickly through modification of existing restructuring tools such as schemes of arrangement. The Singapore approach may provide especially useful lessons for the evolving Indian pre-pack regime.

2.1. US

A pre-packaged bankruptcy in the US involves negotiation of the reorganisation plan and formal solicitation of creditor votes on such plan prior to initiation of the formal reorganisation process

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[16] MCA, *Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016* (File No. 30/38/2021-Insolvency, 2023), para 7.

[17] The Insolvency and Bankruptcy Board of India, 'Insolvency and Bankruptcy News' (The Quarterly Newsletter of the Insolvency and Bankruptcy Board of India, April – June, 2023) vol 27, 16 <chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://ibbi.gov.in/uploads/publication/0d26415640ac24dab79ebdcbc11a64a8.pdf> accessed 13 June 2023.

[18] Gurrea-Martinez (n 7) 95.

[19] Examples of jurisdictions that follow the US model include: Singapore, Philippines and India. Jurisdictions that are modelled along the UK model include: Guernsey, Netherlands and Spain. See Gurrea-Martinez (n 7) 97, Carey Olsen, 'A Comparative Look at Pre-Packs in Selected Jurisdictions' – Guernsey' (*Briefings*, 27 June 2023) < https://www.careyolsen.com/briefings/comparative-look-pre-packs-selected-jurisdictions-guernsey> accessed 11 September 2023.

under Chapter 11 of the US Bankruptcy Code.[20] Once admitted into Chapter 11 proceedings, the court can then confirm the plan.

The debtor negotiates the reorganisation plan and shares it along with a disclosure statement with the creditors soliciting their vote on the plan.[21] Once it has received the requisite approval[22] from creditors, the debtor files a Chapter 11 petition where the court may approve the plan. In a pre-pack, the reorganisation plan is submitted along with the petition to initiate Chapter 11 proceedings.[23]

The US Bankruptcy Code 1978 (US Bankruptcy Code) contains provisions to enable pre-packaged plans. For example, Section 1126(b) of the US Bankruptcy Code allows votes cast before the commencement of the Chapter 11 proceeding to be considered for confirmation of the plan, provided the vote solicitation process complied with applicable bankruptcy and non-bankruptcy laws.[24]

By completing the negotiation and voting on the plan prior to initiation of the formal process, Chapter 11 proceedings can be completed relatively quickly and efficiently. Pre-packs in the US take an average of nearly 80 days to complete.[25] In fact, in certain cases, less than 24 hours passed between commencement and conclusion of the Chapter 11 process.[26] These "*super speed*" pre-packs may be best suited to a debtor which only requires a financial or balance-sheet restructuring and not an operational one which would require utilisation of tools available in a conventional restructuring (i.e., provisions relating to rejection of burdensome contracts, deal with trade creditors etc.).[27]

2.2. UK

Typically, pre-packaged administration in the UK entails a pre-agreed sale of the debtor's business to a purchaser (who is often a connected party of the debtor)[28], which is executed as soon as the debtor enters administration proceedings.[29] The Enterprise Act 2002, which permitted a debtor to enter administration without a court order provided an impetus to pre-pack

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[20] Dennis F Dunne, Dennis C O'Donnell and Nelly Almeida, 'Pre-packaged Chapter 11 in the United States: An Overview' (*Global Restructuring Review*, 11 December 2019). <https://globalrestructuringreview.com/guide/the-art-of-the-pre-pack/edition-1/article/pre-packaged-chapter-11-in-the-united-states-overview> accessed 12 June 2023; INSOL International, 'Special Report - A Comparative Look at Pre-Packs in Selected Jurisdictions' (2023) (INSOL Pre-pack Report 2023), 83.

[21] John D. Ayer, Michael L. Bernstein and Jonathan Friedland, 'Out-of-court Workouts, Prepacks and Pre-arranged Cases: A Primer' (2005) 24(3) ABI Journal <https://www.arnoldporter.com/en/perspectives/publications/2005/04/outofcourt-workouts-prepacks-and-prearranged-cas__> accessed 13 June 2023.

[22] See US Bankruptcy Code 1978, title 11 s 1126. A class of claims is said to accept a plan if it is accepted by creditors hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors.

[23] US Bankruptcy Code 1978, title 11 s 1121(a).

[24] US Bankruptcy Code 1978, title 11 s 1126(b).

[25] Yozzo and Star (n 11) 67; Rafiq (n 1) 20.

[26] Matthew B. Harvey and Paige N. Topper, 'One-Day Restructuring: The New Trend of "Super Speed" Prepacks' (*TOUCHPOINT - INSOL's Insolvency Practice Group Newsletter*, 15 April 2021). <https://www.morrisnichols.com/insights-one-day-restructuring-the-new-trend-of> accessed 13 June 2023.

[27] ibid.

[28] Report to The Rt Hon Vince Cable MP, Graham Review into Pre-pack Administration (2014) (Graham Report 2014), para 7.5. 'Connected persons' is defined under IA 1986 in para 60(A)(3) of Schedule B1.

[29] Peter Walton, 'Pre-packin' in the UK' (2009) 18 INSOL International Insolvency Review 85, 86.

administration processes in the UK.[30] UK's insolvency legislation does not expressly provide for a pre-pack regime. However, it developed as a commercial practice[31] within the broad scope of powers granted to an administrator in the provisions[32] dealing with administration.

The amendment introduced by the Enterprise Act 2002 permitted administrators to be appointed out-of-court by creditors (a floating-charge holder), the debtor company or its directors.[33] The administrator has the power to sell the debtor's assets usually without requiring a creditors' meeting.[34] The sale would require the consent of the debtor's secured creditors who have a charge or an encumbrance over the assets. On the other hand, unsecured creditors are usually not involved in the process.[35] Therefore, a pre-pack in the UK can be completed entirely without court involvement or a creditors' meeting.[36]

The main concerns or criticisms levelled at the UK pre-pack model are that it lacks transparency, gives rise to conflict of interest related issues, does not result in a fair price or consideration and is unfair to unsecured creditors who are not involved in the process.[37] The lack of transparency and conflict of interest is especially a concern in pre-packaged administrations where the administrator was appointed by the debtor company's directors and the business is sold to the same directors.[38] On the flipside, the advantages associated with pre-packs are that they are usually cost-efficient and result in preservation of employment.[39]

In 2015, the Statement of Insolvency Practice (SIP 16) (which has since been amended) was issued by the Joint Insolvency Committee to alleviate transparency concerns in pre-packaged sales in administration.[40] SIP 16 has since been revised a number of times in response to market concerns over pre-packs. Some of the key requirements for an administrator under the SIP 16 are to: (1) ensure clarity of nature and scope of the administrator's role in the pre-appointment period and to make it clear that their role is to advise the company and not its directors or the

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[30] ibid.

[31] See Adam Plainer, Kay Morley and Ola Majiyagbe, 'Legislative Developments: The New Pre-Pack Regulations' (Global Restructuring Review, 4 March 2022) <https://globalrestructuringreview.com/guide/the-art-of-the-pre-pack/edition-2/article/legislative-developments-the-new-pre-pack-regulations> accessed 13 June 2023.

[32] Insolvency Act 1986 (IA 1986), sch B1.

[33] IA 1986, sch B1 paras 14 and 22.

[34] IA 1986, sch B1 paras 60 and 52(1)(b). Also see *Re Transbus International Ltd* [2004] EWHC 932 (Ch).

[35] Kastrinou and Vullings (n 13) 325.

[36] See generally Mark Norman Wellard and Peter Walton, 'A comparative analysis of Anglo-Australian pre-packs: can the means be made to justify the ends? (2012) 21 INT'L INSOLVENCY REV. 143.

[37] Graham Report 2014, para 3.8-3.9; Jacqueline Ingram and Damilola Odetola, 'United Kingdom: Core Elements of a Pre-Pack Administration' (*Global Restructuring Review*, 4 March 2022) <https://globalrestructuringreview.com/guide/the-art-of-the-pre-pack/edition-2/article/united-kingdom-core-elements-of-pre-pack-administration> accessed 13 June 2023.

[38] Walton (n 29) 97.

[39] Graham Report 2014, para 3.4-3.5.

[40] Insolvency Practitioners Association, Statement of Insolvency Practice 16 - Pre-Packaged Sales In Administrations (SIP 16) <https://insolvency-practitioners.org.uk/mp-files/sip-16-all-uk.pdf/> accessed 13 June 2023.

purchaser's connected parties,[41] (2) provide creditors with an 'SIP 16 statement' with sufficient information such that "*a reasonable and informed third party would conclude that the pre-packaged sale was appropriate, and that the administrator has acted with due regard for the creditors' interests*"[42] (3) to advise the company to comply with the marketing essentials set out in SIP 16 to ensure that the best available price is obtained in the interest of the creditors,[43] and (4) to disclose information relating to valuation of the business and assets and in cases where no valuation is obtained, provide a reason for not obtaining valuation and how the administrator was satisfied regarding the value of the assets.[44]

In 2021, the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 were issued to further regulate pre-packaged sales to connected persons. According to these regulations, an administrator cannot complete a sale of all or substantially all of the debtor's business or assets to a connected person within first eight weeks of administration, unless creditors' approval has been obtained or a report from an independent evaluator is obtained on whether the consideration and reasons for such disposal are reasonable.[45] This report is required to be obtained by the connected person.[46]

2.3. SINGAPORE

In 2017, Singapore introduced pre-packs in its insolvency regime through the scheme of arrangement route by amendment to its Companies Act 1967 (CA 1967).[47] Later, the insolvency provisions under CA 1967 were consolidated under a new legislation – the Insolvency, Restructuring and Dissolution Act 2018 (IRDA 2018) which came into force on 30 July 2020. Section 71 of the IRDA 2018 lays down the framework for a pre-packaged scheme of arrangement. It does away with the requirement of a court order for convening of creditor meetings and the creditor meeting itself, provided certain conditions are met.[48] This includes provision of information related to the compromise or arrangement to the creditors, publication of a notice that a pre-pack application has been made, court being satisfied that had a meeting been conducted then the arrangement would have received approval of the majority in number representing at-least three-fourths in value of the creditors or class of creditors, among others.[49] It permits the debtor to directly approach the court for its approval of the scheme unlike a normal scheme of arrangement process, where the applicant has to approach the court twice – first, to get a court order convening the creditor meetings and second, to obtain the final court approval after reporting the outcome of the creditor meetings.[50] Therefore, a pre-packaged scheme of arrangement provides the advantage of being less time consuming, less expensive and of being less damaging to the reputation of the debtor.[51]

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[41] SIP 16, para 9.

[42] SIP 16, para 8.

[43] SIP 16, para 16.

[44] SIP, Appendix - Information disclosure requirements in the SIP 16 statement.

[45] Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021, reg 3(1).

[46] Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021, reg 6(1)(A)(i).

[47] Companies Act 1967, s 211l (which is now reintroduced as section 71 in Insolvency, Restructuring and Dissolution Act 2018).

[48] IRDA 2018, s 71.

[49] ibid.

[50] INSOL Pre-pack Report 2023, 75.

[51] Lim (n 6).

2.4. TAKEAWAYS

The pre-pack models discussed above are very different in various aspects such as the level of court involvement, creditor approval requirements, manner of regulation and role of insolvency professionals. A key difference in the UK and US pre-pack regime, is that a pre-pack in the US results in a reorganised debtor and the original debtor entity usually survives.[52] On the other hand, pre-packs in the UK involves a sale of the debtor's business or assets to the purchaser (i.e., a going concern sale).[53]

Some of the common themes and features in each of these procedures are pre-negotiated plans or arrangements, 'debtor-in-possession' model, reduced formalities and procedural requirements as compared to the traditional reorganisation procedure in the jurisdiction. Any jurisdiction looking to adopt a pre-pack would necessarily need to customise these features to its own local context. For example, institutional and cultural factors associated with the jurisdiction, such as lack of judicial capacity, efficiency of existing reorganisation procedures, stigma associated with insolvency should be taken into account while designing the pre-pack framework.

India is infamous for its judicial delays[54], therefore, minimizing court involvement to the extent possible may be a good solution for the jurisdiction. At the same time, the need for necessary safeguards cannot be overstated.

As discussed earlier, even though pre-packs have proved to be a useful restructuring tool in these jurisdictions, they have also fuelled concerns of lack of transparency.[55] The UK pre-pack regime, in particular, has been criticised for transparency concerns associated with pre-pack sales to connected persons (i.e., former management or directors), where unsecured creditors are often kept completely in the dark and not involved in the pre-pack negotiation.[56] Other key concerns with the UK pre-pack regime include absence of proper marketing and unreliable valuation of these deals.[57] According to the Graham Review, pre-packs often involve desk-top valuations and purchase price paid by 'connected persons' commonly matched the valuation price exactly.[58]

Therefore, while pre-packs do offer advantages of speed, efficiency and preservation of value, they also suffer from several shortcomings. Any jurisdiction looking to adopt pre-packs would also benefit from evaluating these shortcomings and including necessary safeguards to address these concerns.

As will be discussed in the following Part 3, India's pre-pack model does in fact include several safeguards against concerns relating to transparency, marketing and connected person sales. However, Part 4 argues that certain features of the Indian pre-pack regime may be too onerous and may not be appropriate for MSMEs.

3. INDIA'S PRE-PACKS REGIME: OVERVIEW AND KEY FEATURES

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[52] Ingram and Odetola (n 37)

[53] ibid.

[54] Ajit Ranade, 'Pending cases cross 5-crore: Justice delayed is justice denied' (Deccan Herald, 27 July 2023) <https://www.deccanherald.com/opinion/pending-cases-cross-5-crore-justice-delayed-is-justice-denied-1241077.html> accessed 11 September 2023.

[55] Corporate Report: Pre-pack sales in administration report, The Insolvency Services (2020), para 1.1.

[56] Bolanle Adebola, 'Transforming Perceptions: The Development of Pre-pack Regulations in England and Wales' (2023) 43(1) Oxford Journal of Legal Studies 150, 154.

[57] Kastrinou and Vullings (n 13) 326.

[58] Graham Report 2014, para 7.80.

This part of the paper provide a detailed overview of the Indian pre-pack regime and discusses its key features.

3.1. Background: Why were pre-packs introduced in India?

The pre-pack regime was introduced in India during the COVID-19 pandemic with a view to provide a speedy, efficient and cost-effective insolvency resolution mechanism for MSMEs.[59] By an order of the MCA dated 24 June 2020, the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process was constituted to study and recommend a regulatory framework for pre-packs in India.[60] The report of the sub-committee proposing a pre-pack framework was published on 8 January 2021. Based on the sub-committee's recommendations, India introduced a pre-pack regime (currently applicable only to corporate MSMEs) in April 2021.[61]

To understand the rationale and the context in which the pre-pack regime was introduced in India, it is important to briefly discuss other restructuring avenues which were available to a corporate debtor in India.

3.2. Existing reorganisation avenues

3.2.1. Corporate insolvency resolution process (CIRP) under IBC 2016

The primary reorganisation procedure under India's insolvency regime is known as the corporate insolvency resolution process (CIRP) under IBC 2016.[62] IBC 2016 prescribes a cash-flow test wherein a CIRP may be initiated by the debtor itself or its creditors provided there is a payment default for an amount of INR 10 million.[63] Once admitted, a moratorium comes into place which stays creditor actions, legal proceedings and enforcement of security interest against the debtor.[64]

Upon commencement of CIRP, a licensed insolvency professional is appointed as the resolution professional to manage the CIRP.[65] The existing board of directors is suspended and the management and control of the debtor is vested with the resolution professional who is required to run the company as a going concern.[66] Once admitted into insolvency, the resolution professional invites the creditors to submit claims and a committee of creditors is formed after verification of their claims. IBC 2016 classifies creditors into two categories – financial and operational creditors. Financial creditors (usually banks or financial institutions) are creditors who have lent against the consideration for the time value of money.[67] Operational creditors are creditors who are owed debt in relation to provision of goods and services.[68] Government dues

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[59] *Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process* (2020) (ILC Pre-pack Report) paras 1.35-1.36.

[60] MCA, Order No. 30/20/2020 dated 24 June 2020.

[61] The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021.

[62] IBC 2016, Part II ch II.

[63] MCA, Notification S.O. 1205(E) dated 24 March 2020.

[64] IBC 2016, s 14.

[65] IBC 2016, s 13(1)(c), 16 and 17.

[66] IBC 2016, ss 17(b) and 20.

[67] IBC 2016, s 5(8).

[68] IBC 2016, s 5(21).

are also classified as operational debt.[69] The committee of creditors which is tasked with important decision-making powers during a CIRP is constituted only from financial creditors who are not related parties[70] of the debtor.[71]

Moreover, while the management of the debtor is transferred to the resolution professional, critical decisions (such as undertaking of related-party transactions, change in debtor's constitutional documents, change in capital structure, creation of security interest, among others) require approval by a 66% vote of the committee of creditors.[72] Therefore, unlike Chapter 11 proceedings under the US Bankruptcy Code, the CIRP does not follow a 'debtor-in-possession' but a 'creditor-in-control' model.

The resolution professional invites bids for the debtor. However, there are eligibility restrictions on who is allowed to bid in a CIRP. Section 29A of IBC 2016 bars certain entities such as an undischarged insolvent, wilful defaulters, certain convicted offenders, entities holding accounts classified as non-performing for a period of one year prior to commencement of the CIRP, individuals disqualified to act as a director under India's Companies Act 2013 (CA 2013), person who is prohibited from trading in securities or accessing the securities market, among others from bidding in a CIRP.[73] This provision was inserted into IBC 2016 to alleviate market concerns that unscrupulous and dishonest promoters who were responsible for the financial distress at the company, were gaining a back-door entry and regaining control of the company through the IBC process.[74] While section 29A does not expressly bar promoters from bidding for their insolvent company in a CIRP, the bar on entities holding NPA accounts may effectively result in restriction of promoter bids. The committee of creditors votes on the submitted resolution plans which needs to be approved by a 66% vote of the committee.[75] Once the plan receives the committee of creditor's approval, it is submitted to India's insolvency tribunal – the National Company Law Tribunal (NCLT) which may approve the plan, provided that the NCLT is satisfied that the plan meets certain minimum conditions set out under IBC 2016.[76]

Introduction of CIRPs under IBC 2016 has been credited with causing a behavioural change in debtors who are now posed with the threat of losing their company if it enters insolvency proceedings.[77] For example, as on 31 May 2023, 25,565 applications for initiation of CIRP with an underlying default of around INR 8 trillion were resolved before admission.[78] On the other hand, one of the main criticisms levelled against CIRPs is inordinate delays in completion of the

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[69] ibid.

[70] A 'related party' is defined under sections 5(24) and 5(24A) of IBC 2016.

[71] IBC 2016, s 21(2).

[72] IBC 2016, s 28.

[73] IBC 2016, s29A.

[74] Insolvency and Bankruptcy Board of India and International Finance Corporation, 'Understanding the IBC: Key Jurisprudence And Practical Considerations: A Handbook' (2020), 143 <https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf> accessed 13 June 2023.

[75] IBC 2016, s 30(4).

[76] IBC 2016, ss 31 and 30(2). The resolution plan must meet certain minimum conditions such as it must provide for: (1) payment of the insolvency resolution process costs in priority to other debts, (2) payment of liquidation value to the operational creditors, (3) management of the affairs of the debtor after approval of the plan, (4) implementation and supervision of the plan.

[77] (n 17) 16.

[78] ibid.

procedure.[79] The prescribed timeline for completion of a CIRP is 180 days (which can be extended by 90 days).[80] Moreover, an outer time limit of 330 days has been prescribed for completion of a CIRP, including any time spent in legal proceedings related to the CIRP.[81] According to data available as on 31 March 2023, the average time taken by a CIRP to conclude is over 600 days.[82] While this offers an improvement over the past regimes which took an average time of 4.3 years to complete[83], the failure to meet the prescribed timelines continues to be a key challenge in CIRPs. According to a report of the Standing Committee of Finance, the delay in admission of the insolvency application and approval of the resolution plan by the NCLT are the primary reasons for the delay in insolvency resolution.[84]

Chapter IV of IBC 2016 also provides a fast-track insolvency resolution process. This procedure is currently available only to small companies[85], a start-up[86] and an unlisted company whose total assets do not exceed INR 10 million.[87] The fast-track insolvency resolution process largely mimics a typical CIRP but with shorter prescribed timelines for different steps.

3.2.2. SCHEME OF ARRANGEMENT

A company may undergo a scheme of arrangement under CA 2013 to restructure its liabilities and undergo a debt restructuring.[88] A scheme of arrangement may be proposed by the debtor, its creditor, shareholders or liquidator before the NCLT. The NCLT may then convene a meeting of creditors, or class of creditors, members or class of members. The scheme needs to be approved by a majority in number and three-fourths in value of the each class of creditors and shareholders.[89] After receiving the requisite approval, the scheme is submitted to the NCLT for its approval. Once the scheme is approved by the NCLT and green lighted by other regulatory

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[79] Standing Committee on Finance, 'Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' (2021) (Standing Committee Report 2021), 20-21.

[80] IBC 2016, s 12.

[81] ibid.

[82] (n 17) 16.

[83] Ministry of Commerce & Industry, 'Press Release - India ranks 63 in World Bank's Doing Business Report' (2019) <https://pib.gov.in/PressReleseDetailm.aspx?PRID=1589055#:~:text=The%20World%20Bank%20has%20recognized,4.3%20years%20to%201.6%20years.> accessed 13 June 2023.

[84] Standing Committee Report 2021, 24.

[85] A 'small company' is defined under s 2(85) of Companies Act 2013 as:

> "*a company, other than a public company,— (i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or (ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees: Provided that nothing in this clause shall apply to— (A) a holding company or a subsidiary company; (B) a company registered under section 8; or (C) a company or body corporate governed by any special Act;*"

[86] A 'start-up' is defined under MCA, Notification G.S.R. 364(E) dated 11 April 2018.

[87] MCA, Notification S.O.1911(E) dated 14 June 2017.

[88] Companies Act 2013 (CA 2013), s 230.

[89] CA 2013, s 230(5) and (6).

bodies (such as the Securities and Exchange Board of India, Competition Commission of India, income-tax authorities, among others), it becomes binding on the creditors and shareholders.[90]

However, schemes of arrangement have not gained much popularity as debt restructuring tool possibly because of the significant costs and delays associated with the process.[91] Onerous procedural requirements, potential litigation over classification of creditors and multiple court hearings have contributed to schemes' dormant status as a debt restructuring tool in India.[92] Moreover, it lacks the benefit of providing a moratorium or binding all stakeholders which can be achieved in a CIRP.

3.2.3. OUT-OF-COURT PROCEDURES

In 2019, India's central bank – the Reserve Bank of India (RBI) issued a 'Prudential Framework for Resolution of Stressed Assets' (RBI's Prudential Framework) for early identification, reporting, and resolution of stressed debt accounts that applies to specific creditors regulated by the RBI.[93] The framework is applicable to scheduled commercial banks, certain designated financial institutions, small finance banks, asset reconstruction companies and systemically important non-banking financial companies.[94] These regulated creditors are required to undertake a *prima facie* review of the borrower account within thirty days of a payment default, and then decide on a resolution strategy.[95] The resolution strategy may include implementation of a resolution plan. If the resolution plan route is selected then the creditors need to enter into an inter-creditor agreement and any decision by the creditors is required to be approved by lenders representing 75% of the total outstanding debt by value and 60% of lenders by number.[96] The creditors may also opt to initiate recovery or insolvency proceedings against the borrower.[97] However, this framework has faced its own challenges. For example, it may not be suitable for debtors with non-RBI regulated creditors, does not bind creditors who are not signatories to the ICA[98] and does not offer a statutory moratorium giving rogue creditors the ability to initiate legal proceedings against the debtor.[99]

Additionally, the debtor and it creditors always have the ability to agree to a debt restructuring under a contract outside of any formal regime.

3.2.4. NEED FOR PRE-PACKS IN THE INDIAN RESTRUCTURING REGIME

Despite its challenges, introduction of CIRP offered a considerable improvement over the erstwhile restructuring regime and provided an effective restructuring tool for distressed

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[90] ibid.

[91] The Bankruptcy Law Reform Committee, *Interim Report* (2015), 78.

[92] See generally Umakanth Varottil, 'The Scheme of Arrangement as a Debt Restructuring Tool in India: Problems and Prospects' (2017) NUS Centre for Law & Business Working Paper 17/02.

[93] The Reserve Bank of India (RBI), Prudential Framework for Resolution of Stressed Assets (2019) (RBI Prudential Framework 2019).

[94] RBI Prudential Framework 2019, para 3.

[95] RBI Prudential Framework 2019, para 9.

[96] RBI Prudential Framework 2019, para 10.

[97] RBI Prudential Framework 2019, para 9.

[98] ILC Pre-pack Report, para 1.27.

[99] Ganesh Gopalakrishnan and Urmika Tripathi, 'Debt Restructuring in India (1/2): Recent Challenges' (*Singapore Global Restructuring Initiative Blog*, 17 December 2020) <https://ccla.smu.edu.sg/sgri/blog/2020/12/17/debt-restructuring-india-12-recent-challenges> accessed 13 June 2023.

companies in India. However, as discussed, CIRP follows a creditor-control model (i.e., the existing management of the corporate debtor is replaced). Moreover, if the existing management or promoter of the debtor is ineligible under section 29A of IBC 2016, then the risk of being completely ousted from the company may disincentivize promoters from initiating voluntary CIRPs.[100]

The two other key restructuring tools outside of the IBC 2016 framework (i.e., scheme of arrangement and RBI's Prudential Framework) also suffer from several challenges. Lack of a moratorium, delays, inability to get all creditors to the drawing board (under RBI's Prudential Framework) make these tools rather unattractive for restructurings. Therefore, there was an urgent need to introduce an efficient debtor-in-possession based restructuring mechanism. This would also incentivize promoters to take prompt and timely steps to restructure at early stages of default leading to a beneficial outcome for all stakeholders. Introduction of pre-packs was especially prompted on account of the COVID-19 pandemic, when several businesses suffered due to circumstance out of their control.[101]

3.3. Key Features of the Indian Pre-pack Regime

The Indian pre-pack regime is primarily governed by chapter III-A of IBC 2016, IBBI (Pre-packaged Insolvency Resolution Process) Regulations, 2021 (Pre-pack Regulations 2021) and the Insolvency and Bankruptcy (Pre-packaged Insolvency Resolution Process) Rules, 2021.

The key features of the pre-packaged insolvency resolution process under IBC 2016 are described below.

3.3.1. Applicability and initiation

Currently, the pre-pack regime is only available to corporate debtors which are classified as a micro, small or medium enterprise (MSMEs).[102]Moreover, the pre-pack regime does not extend to sole proprietorships. A pre-pack application can be filed by the debtor[103] if the following conditions are met:[104] (1) there is a payment default of INR 1 million by the debtor[105], (2) the

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[100] That is not to say that CIRP is unattractive for promoters or existing management of stressed companies in all scenarios. If the promoter of a distressed company is not yet ineligible under section 29A of the IBC, then initiation of voluntary CIRP against their company can offer several benefits too (such as moratorium against creditor actions, ability to bind creditors to a cross-class cramdown, wipe out past liabilities, amongst others). Once CIRP is initiated, the promoter can submit a bid for the company. However, the promoter will still face the risk of losing the company to a more competitive bid.

[101] (n 59).

[102] IBC 2016, s 54A; See (n 15).

[103] The application can be made by (1) the corporate debtor, (2) an authorised member or partner of the corporate debtor, (3) an individual who is in charge of managing the operations and resources of the corporate debtor, (4) a person who has control and supervision over the financial affairs of the corporate debtor. See IBC 2016, s5(5).

[104] IBC 2016, s54A.

[105] MCA, Notification SO-1543(E) dated 9 April 2021.

debtor meets the eligibility criteria for a bidder set out under section 29A of IBC 2016[106], (3) financial creditors of the debtor (who are not its related parties) holding at least 10% of the debtor's financial debt have proposed the name of an insolvency professional to be appointed as the resolution professional to conduct the pre-pack and such proposal has been approved by financial creditors holding at least 66% of the total financial debt (in value)[107], (4) majority of directors or partners of the debtor (as the case may be) make a declaration that (i) the debtor will file a pre-pack application within 90 days, (ii) the pre-pack process has not been initiated to defraud any person, and (iii) the name of the resolution professional who has been approved to be appointed, (5) three-fourths of the shareholders of the debtor or the total number of partners of the debtor (as the case may be) have passed a resolution approving the filing of the pre-pack application, (6) financial creditors of the debtor holding at least 66% of the total financial debt have approved the filing of the pre-pack application.

Prior to seeking the approval of the financial creditors to initiate the pre-pack process, the debtor needs to provide them with a 'base resolution plan' which should not impair any operational creditor claims owed by the debtor.[108] Moreover, while filing the pre-pack application, the applicant also needs to provide a declaration regarding the existence of any transactions that may fall within the scope of provisions relating to avoidance transactions[109] such as preferential transactions, undervalued transactions, transactions defrauding creditors, extortionate credit transactions or fraudulent or wrongful trading.

The debtor may be ineligible to apply for a pre-pack if: (1) it has undergone a pre-pack or completed a CIRP during a period of three years prior to the date of application for the pre-pack, (2) it is undergoing a CIRP, (3) a liquidation order has been passed against the debtor.[110] Once the pre-pack application is admitted, the NCLT will declare a moratorium which stays creditor actions, legal proceedings and enforcement of security interest against the debtor.[111]

3.3.2. MANAGEMENT OF THE DEBTOR

Unlike a CIRP under the IBC, where the management and control of the debtor shifts from the erstwhile board of directors to the resolution professional upon admission, during a pre-pack, the management of the debtor continues to vest with the existing board of directors.[112] The resolution professional is tasked with monitoring the management of the affairs of the debtor. The resolution professional is also required to constitute a committee of creditors consisting of

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[106] Section 29A of IBC 2016 bars certain entities such as an undischarged insolvent, wilful defaulters, certain convicted offenders, entities holding accounts classified as non-performing for a period of one year prior to commencement of the CIRP, entities who have issues a guarantee in respect of a debtor who is undergoing CIRP (where such guarantee has been invoked and remains unpaid), individuals disqualified to act as a director under India's Companies Act 2013, person who is prohibited from trading in securities or accessing the securities market, among others from bidding in a CIRP. Importantly, MSMEs are exempted from the disqualification relating to holding non-performing assets and issuance of guarantee for a debtor undergoing CIRP under this provision (see IBC 2016, s240A).

[107] In case the debtor does not have any financial creditors or if all the financial creditors are its related parties, then the approval must be obtained from its operational creditors. See Insolvency And Bankruptcy Board Of India (Pre-Packaged Insolvency Resolution Process) Regulations 2021 (Pre-pack Regulations 2021), reg 14(8).

[108] IBC 2016, s54A(4)(c).

[109] IBC 2016, ss 43-51 and 66.

[110] IBC 2016, s 54A(2).

[111] IBC 2016, s54E.

[112] IBC 2016, s 54H(a).

the debtor's financial creditors (who are not related parties of the debtor).[113] However, the committee of creditors may resolve by at least 66% votes, that the management of the debtor should vest in the resolution professional. The NCLT may then pass an order vesting the management of the debtor with the resolution professional, if it is of the opinion that that the debtor's affairs have been conducted in a fraudulent manner or if there has been gross mismanagement of affairs of the debtor.[114]

The 'base resolution plan' submitted by the debtor is put up before the committee of creditors for their approval. At this stage, if the committee of creditors does not approve the base resolution plan or if the plan impairs operational creditor claims, then the resolution professional may invite third parties to bid and compete with the debtor's plan.[115] If the plan submitted by a third party is significantly better than the base resolution plan then it may be put up for approval of the committee of creditors. Otherwise, it will compete with the base resolution plan in accordance with regulation 42 of the Pre-pack Regulations 2021. The plan must be approved by the committee of creditors by at least 66% votes. The creditor-approved plan is then submitted by the resolution professional to the NCLT for its approval. If the plan meets the minimum requirements[116] set out under IBC 2016, then the NCLT must approve the plan within 30 days of receipt of the plan. Once approved, the resolution plan becomes binding on the debtor, its employees, shareholders, creditors, guarantors and other stakeholders involved in the plan.[117] A pre-pack needs to be completed within 120 days from the date of admission of the pre-pack application.[118] The creditor-approved resolution plan needs to be submitted to NCLT within 90 days from admission of the pre-pack application otherwise the resolution professional must file an application to terminate the pre-pack.[119]

In case the NCLT has transferred control to the resolution professional then the plan must result in a change in the management and control of the debtor otherwise the NCLT is required to reject the resolution plan, terminate the pre-pack process and pass a liquidation order against the debtor.[120]

3.3.3. TERMINATION OF THE PRE-PACK

The pre-pack may be terminated in the following instances[121]: (1) if at any time between the commencement of the pre-pack and approval of a resolution plan under the pre-pack process, the committee of creditors votes by at least 66% to terminate the pre-pack process, (2) if no resolution plan is approved by the committee of creditors, (3) if no resolution plan is approved by the committee of creditors within 90 days from commencement of the pre-pack and (4) if at any time between the commencement of the pre-pack and approval of a resolution plan under the pre-pack process, the creditor of committee votes by at least 66% to instead initiate a CIRP against the debtor.

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[113] In the event that the debtor does not have any financial creditors who are not related parties of the debtor, then the committee of creditors is constituted from operational creditors in accordance with regulation 25 of Pre-pack Regulations 2021.

[114] IBC 2016, s 54J.

[115] IBC 2016, s 54K(5).

[116] (n 76).

[117] IBC 2016, ss 31(1) and 54L(2).

[118] IBC 2016, s 54D(1).

[119] IBC 2016, s 54D(2) and (3).

[120] IBC 2016, s 54L(4).

[121] IBC 2016, s 54N.

3.3.4. SUMMARY AND OBSERVATIONS

The Indian pre-pack regime is relatively unique in its design. Arguably, the regime is more similar to the US model as compared to the UK model of pre-packs. For example, court and creditor involvement requirements are more similar to the US unlike the UK where the pre-pack can usually be pursued entirely without court involvement. There are also a few notable differences between the US and Indian pre-pack regime. For example, the US Bankruptcy Code permits votes cast before the commencement of the reorganisation procedure to be considered in the formal process for confirmation of the plan.[122] IBC 2016 does not contain a similar provision and the only votes cast by financial creditors prior to the initiation of the process is on whether they approve the 'initiation' of the pre-pack.

Importantly, the Indian pre-regime also includes several safeguards against concerns such as lack of transparency and inadequate marketing that are associated with pre-packs. These include (1) bar against impairment of operational dues under the plan, (2) requirement to obtain approval of the committee of creditors both at the pre-initiation stage and for approval of the plan, (3) creditors' ability to effect a change in management in case of gross mismanagement, (4) creditors' ability to invite third party bids if they reject the base resolution plan.

The next Part 4 looks at the safeguards and procedural requirements under the Indian pre-pack regime to discuss if these are too onerous for MSMEs.

4. ANALYSIS OF THE INDIAN PRE-PACK REGIME

This part evaluates India's pre-pack regime and its effectiveness for MSMEs and discusses potential issues that may affect timelines and efficiency of the procedure.

4.1. IS THE CURRENT PRE-PACK REGIME SUITED FOR MSMES?

An evaluation of India's pre-pack regime for MSMEs first requires an understanding of the unique issues that arise in the insolvency of MSMEs. Some of the key issues to be considered in MSME insolvencies are: (1) MSMEs do not usually have sufficient assets to cover the costs of a formal insolvency procedure, (2) MSMEs may lack the sophistication required to access complex reorganisation procedures which disincentivizes them from taking timely action to address financial distress, (3) MSMEs may not be subject to the general corporate law requirements that apply to large corporates and could have inefficient or weak information systems which leads to difficulties in gathering information during insolvency. [123] Traditional reorganisation or insolvency procedures can be too rigid and not suitable for MSMEs.[124]

Some of the key recommendations of existing legislative proposals for dealing with MSME insolvency which may be especially relevant to evaluation of the current Indian pre-pack regime are: (1) developing a simplified restructuring procedure and primarily out-of-court model for

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[122] US Bankruptcy Code 1978, title 11 s 1126(b).

[123] World Bank Group Insolvency and Creditor/Debtor Regimes Task Force: Working Group On The Treatment Of MSME Insolvency, 'Report on the Treatment of MSME Insolvency' (2017) (World Bank Report 2017), V. <http://documents.worldbank.org/curated/en/973331494264489956/Report-on-the-treatment-of-MSME-insolvency> accessed 13 June 2023.

[124] Aurelio Gurrea-Martínez, 'Implementing an insolvency framework for micro and small firms' (2021) 30(1) International Insolvency Review S46, S49; Edward R. Morrison and Andrea C. Saavedra, 'Bankruptcy's Role in the COVID-19 Crisis' (2020) Columbia Law and Economics Working Paper No. 624, 8 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3567127> accessed 13 June 2023.

restructuring MSMEs[125], (2) reducing formalities for procedural steps involved in the insolvency proceedings compared to the typical reorganisation procedure[126] (3) reducing disclosure requirements at the stage of application for commencement of the reorganisation procedure to a minimum.[127]

Arguably, some of the requirements and features of the Indian pre-pack regime may not be suitable for an MSME insolvency. For example, one of the documents required to be filed at the time of making the pre-pack application includes a declaration regarding any transactions that fall under the avoidance transactions provisions. The World Bank's report on MSME insolvency notes that reorganisation regimes that involve submission of extensive documentation to start the process, uncertain costs of the participants involved in the process or separate the management from administration of the debtor's business may disincentivize MSMEs from utilizing these regimes.[128] Requirement to submit extensive documentation such as a declaration regarding avoidance transaction at the stage of filing the pre-pack application may be burdensome for an MSME and may disincentivize them from using the pre-pack process.

Formalities should be kept to a minimum in MSME insolvencies. For example, jurisdictions covered by the Organization for the Harmonization of Business Laws in Africa have simplified filing requirements for small businesses applying for insolvency procedures.[129] While documents providing information regarding the financial situation of the small business do need to be filed, these documents need not be audited or include comprehensive financial statements.[130] As discussed earlier, in the UK, the process of entering administration was streamlined by allowing appointment of an administrator out-of-court through amendments under the Enterprise Act 2002. Interestingly, one of the drivers behind this amendment was to reduce the cost of entry into administration.[131] The fixed costs related to documents required for a court applications deterred SMEs served as a barrier to accessing this reorganisation procedure forcing them into liquidation.[132] After the amendment, the number of administrations increased from 643 in 2002 to 1,602 in 2004 and 2,512 in 2007.[133] On the other hand, liquidations went from 16,306 in 2002 to 12,507 in 2007.[134]

Another feature of MSMEs that should be considered while devising insolvency procedures for MSMEs is that typically, MSMEs do not have complicated debt structures[135] and usually have a

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[125] World Bank Group Insolvency and Creditor/Debtor Regimes Task Force: Working Group On The Treatment Of MSME Insolvency, 'Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency' (2018) (World Bank Report 2018), X <http://documents1.worldbank.org/curated/en/989581537265261393/pdf/Saving-Entrepreneurs-Saving-Enterprises-Proposals-on-the-Treatment-of-MSME-Insolvency.pdf> accessed 13 June 2023.

[126] UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises, para 13.

[127] UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises, para 25.

[128] World Bank Report 2017, 11.

[129] World Bank Report 2017, 27.

[130] World Bank Report 2018, 27.

[131] Graham Report 2014, para 5.13.

[132] ibid.

[133] Graham Report 2014, para 5.14.

[134] ibid.

[135] World Bank, 'Small and Medium Enterprises (SMEs) Finance' <https://www.worldbank.org/en/topic/smefinance> accessed 13 June 2023.

small number of creditors.[136] Therefore, creditor committees may not be necessary in MSME insolvencies, and the expense involved in organising these committees may not be economically viable.[137] The requirement for formation of a creditor committee under the Indian pre-pack regime may not always be practical. The costs incurred in formation of the committee of creditors and holding its meetings may not be feasible in an MSME insolvency.[138]

The existing pre-pack regime also involves the NCLT at two stages, first, at the time of admission of the pre-pack application and second, at the time of approval of the resolution plan. Increased court involvement is likely to lead to higher costs. Moreover, as discussed earlier, significant delays occur at both stages of admission as well as approval of plan before the NCLT.[139] Potential costs associated with delays at NCLTs may deter MSMEs from employing this regime. Devising a solution along the lines of Singapore's pre-packaged scheme of arrangement could be explored for MSMEs, provided that necessary protections are built-in to ensure that creditors are treated fairly. For example, if the debtor provides proof of requisite creditor support for its plan along with evidence that sufficient information regarding the plan was provided to the creditors and that the plan meets the minimum requirements set out in IBC 2016, then the NCLT could fast-track the process and provide its approval for the application and the plan in one step.

Other requirements which may be too rigid or complex for an MSME insolvency are: (1) the applicant is required to furnish a 'preliminary information memorandum'[140] containing details of the debtors' assets and liabilities, audited financial statements, details of material litigation or investigations against the debtor, among others[141]; the promoter, director or partner may be liable to pay compensation in case any person suffers a loss or damage due to omission of any material information or inclusion of any misleading information[142], (2) possibility of losing control over the management and affairs of the debtor. The debtor may lose control over the management and affairs of the debtor if the creditors decide to invite and approve third-party bids[143] for the debtor or if the committee of creditors vote to vest the management of the debtor in the resolution professional and the NCLT finds that there has been gross mismanagement of affairs of the debtor or its affairs have been conducted in a fraudulent manner.[144]

As discussed above, MSMEs may often have inefficient record-keeping systems.[145] Therefore, the requirement to provide the information memorandum with potential liability associated with it may not be feasible for MSMEs.

The threat of losing control over the debtor in a pre-pack process could also disincentivize MSME debtors from employing this regime. In fact, omission of certain provisions relating to transfer of management during a pre-pack has been proposed under MCA's recent proposals for

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[136] Gurrea-Martínez (n 124) S47.

[137] World Bank Report 2018, 6.

[138] Gurrea-Martinez (n 7) 109.

[139] (n 84).

[140] IBC 2016, s 54G(1)(b).

[141] Pre-pack Regulations 2021, reg 40(2).

[142] IBC 2016, s 54G(2).

[143] See IBC 2016, s 54K.

[144] IBC 2016, s 54J.

[145] World Bank Report 2017, 13.

changes to IBC 2016.[146] This has been further discussed in the next part. Arguably, the ability to displace existing management could be restricted to cases involving gross mismanagement and fraud. Moreover, in any case, the committee of creditors retains the right to terminate a pre-pack by 66% vote at any time between commencement of the pre-pack and approval of a plan by the creditors.[147]

4.2. Potential to further streamline the pre-pack process?

With the recent proposal to expand the applicability of the pre-pack regime to other categories of debtor, it also becomes important to consider its effectiveness for non-MSME debtors. Some of the protections built into the pre-pack regime such as formation of creditor committees, provision of preliminary information memorandum which may be too burdensome for MSMEs may be more suited and relevant to pre-packs for larger or non-MSME debtors.

However, it is still important to evaluate whether the procedures and processes involved in the Indian pre-pack regime can be completed in the prescribed timelines or will it face similar challenges as a CIRP. As described above, one of the key criticisms of CIRP is the long delays involved in it. One of the primary causes of delay in a CIRP is the time taken in admission of a CIRP application and approval of the resolution plan.[148] The pre-pack regime also takes a similar approach to a CIRP where first, the NCLT has to be approached for initiation of the process and then later for approval of the plan. Therefore, it may also be subject to similar delays and it becomes important to identify ways in which the pre-pack process can be further streamlined to ensure that it does not suffer from delays and higher costs.

One potential way of further streamlining the process is by adopting the US approach where votes on the plan which were formally solicited prior to initiation of the Chapter 11 process can be considered in the Chapter 11 proceedings.[149] Votes solicited for the plan, prior to admission into pre-pack, provided certain minimum safeguards were adhered to ensure that creditors were treated fairly, could also be considered for the purposes of approval of the plan in the Indian pre-pack process. Waiting several weeks for holding a creditors' meeting and obtaining their approval may result in a situation where the very advantages offered by pre-packs of being quick and discreet are undone.[150] Including an enabling provision that permits votes cast prior to admission into the pre-pack process to be counted for approval of the plan may help reduce the time taken to conclude the process post admission.

As discussed earlier, the two-stage involvement of the NCLT may also be avoided by seeking its approval for the plan at the application stage itself. This may also help reduce congestion at an already overburdened NCLT. Moreover, if the debtor fails to garner the necessary votes and the creditors are not on board with the debtor's plan then they would have the right to initiate a CIRP, provided conditions for initiation of CIRP are met.

Provisions relating to transfer of management and affairs from the debtor to the resolution professional or invitation of third party bids may also warrant further consideration even in pre-packs for non-MSMEs.[151] As discussed earlier, the possibility of ousting the current management during a pre-pack could be limited to cases involving fraudulent or gross mismanagement of affairs. An attractive 'debtor-in-possession' pre-pack regime with necessary

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[146] (n 16) para 7.

[147] IBC 2016, s 54N.

[148] (n 84).

[149] US Bankruptcy Code 1978, title 11 s 1126(b).

[150] Wellard and Walton (n 36) 158.

[151] IBC 2016, s 54J.

safeguards built-in to prevent abuse may encourage promoters to take timely action to address financial distress.

5. Evaluation of Recent Developments and Recommendations

5.1. MCA's proposals for changes in the pre-pack and fast-track insolvency regime

On 18 January 2023, the MCA invited public comments on certain changes being proposed in the insolvency regime under IBC 2016.[152] One of the key changes proposed by them was to expand the applicability of the pre-pack regime to larger corporate debtors. The MCA has also proposed the following additional changes to the existing pre-pack regime: (1) lowering the threshold for approval by financial creditors for confirming a proposed insolvency professional to conduct the pre-pack, from 66% to 51%, (2) lowering the threshold for approval by financial creditors for initiation of the pre-pack process from the current requirement of 66%, (3) omit the requirement to provide a declaration regarding avoidance transactions, at the time of filing an application before the NCLT to initiate the pre-pack process, (4) omitting the provisions permitting a change in management if the management is involved in fraudulent activities or conversion to a CIRP or liquidation process.[153]

The proposal notes that given the committee of creditors' ability to terminate the pre-pack process at any time, the additional safeguard provided under the provisions to cause a change in management[154], convert the pre-pack process to a CIRP or liquidation process may not be required.

In a separate proposal, the MCA has also suggested changes to the fast-track insolvency resolution process under IBC 2016. The MCA has now proposed that the fast-track process be redesigned to allow financial creditors of the debtor to approve a resolution plan through an informal out-of-court process. The NCLT can then get involved at the final stage to provide a final approval to the plan or order a moratorium, if required.[155]

The filing of the application to seek NCLT's approval for the resolution plan (agreed to in the informal out-of-court process) should be backed by 66% vote of financial creditors. Moreover, the financial creditors will be responsible for overseeing and appointed an insolvency professional to conduct the out-of-court process. A moratorium can also be sought from the NCLT with the approval of the financial creditors. The resolution plan submitted for approval of the NCLT must comply with the minimum requirements set out for a plan during a CIRP.

5.2. Evaluation of recent proposals

The proposal to expand the applicability of the pre-pack regime, remove the requirement to provide a declaration regarding avoidance transactions and omitting provisions relating to change in management during a pre-pack are positive steps towards streamlining and simplifying the pre-pack procedure. As mentioned in the MCA's proposals, even if the provision which expressly permit transfer of management in certain cases were omitted, the committee of creditors could always vote to terminate the pre-pack.[156] Moreover, creditors would also have a right to initiate a CIRP if the minimum conditions for initiation of a CIRP were met.

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[152] (n 16).

[153] (n 16) para 7.

[154] IBC 2016, ss 54J, 54O and 54N(4).

[155] (n 16) para 6.

[156] (n 16) para 7.2(c).

However, the proposal is silent on the provisions related to third-party bids in pre-packs, which may also result in change in management. The proposal suggests omission of change in management related provisions on the grounds that bona fide debtors who are using the pre-pack process should not be concerned with possibility of change in management.[157] The possibility of losing the company would remain even in case the creditors choose to invite third-party bids and approve a bid which results in a change in management. The pros and cons of having provisions for third party bids need to be studied and policy-makers need to consider whether the provisions for third-party bids may be limited to CIRPs.

Another interesting proposal is the change suggested to the fast-track process. As mentioned earlier, currently this process is applicable to limited categories of debtors, and is largely the same as a CIRP with shorter prescribed timelines. The proposal to conduct the negotiation and voting on the plan out-of-court and then submit the plan to the NCLT for its final approval resembles Singapore's pre-packaged scheme of arrangement. In this context, it may be important for policy makers to consider whether the Indian insolvency regime needs a separate pre-pack and fast-track insolvency process or whether the objective of speedier resolutions under a simplified insolvency procedure can be achieved by relying on one of the two.

6. CONCLUSION

The introduction of the pre-pack regime in the Indian insolvency regime and its possible expansion to wider category of debtors is a welcome step. The current pre-pack framework ties in many of the benefits of a CIRP into the pre-pack regime. However, some of its features and requirements may be over-prescriptive, rigid or burdensome, especially for MSMEs. Therefore, consideration may be given to further streamlining and simplifying the pre-pack regime to ensure that it becomes an attractive route for reorganisation and incentivizes promoters to take timely action to resolve stress with an efficient tool at their behest. While recent proposals for changes in the pre-pack regime appear to address some of these concerns, overcoming institutional challenges such as delays before insolvency tribunals and meeting prescribed timelines is likely to be challenging. Ideally, this should be achieved by undertaking institutional reforms and increasing institutional capacity but these may take time to materialise.[158] Therefore, customising and designing efficient solution to fit the current market taking these limitations into account may be necessary.[159] For example, reducing intensive documentation and procedural requirements may make the pre-pack process more suitable for MSMEs. Permitting votes cast prior to the pre-pack to be considered for confirmation of plan and seeking NCLT's approval of the plan at the initial stage itself will help move some of the time-consuming processes out-of-court, reduce the case load at NCLT and expedite timelines.

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[157] ibid

[158] Aurelio Gurrea-Martínez, 'Insolvency Law in Emerging Markets' (2020) Ibero-American Institute for Law and Finance - Working Paper 3/2020, 14 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606395> accessed 13 June 2023.

[159] ibid.