

## Pre-Packaged Insolvency Resolution Process For MSMEs

*The Micro, Small and Medium Enterprises (MSMEs) are susceptible to distress and failures on account of variety of factors such of undiversified business portfolio, supply chain issues, overdependence on key markets and limited availability of fresh credit. Pre-Packaged insolvency resolution process is a hybrid framework that empowers stakeholders to resolve the stress in MSMEs. It is quick and discreet way of completing the insolvency resolution process with a blend of formal and informal framework. In the process promoters remain in possession of assets and the business is run by them, however creditors decide commercial matters. Read on...*



CA. Reshma Mittal

The author is a member of the Institute. She can be reached at [careshmamittal@gmail.com](mailto:careshmamittal@gmail.com) and [eboard@icai.in](mailto:eboard@icai.in)

Pre-Packaged insolvency resolution process (PPIRP) or Pre-pack, as known globally, has emerged as an innovative method to revive the stressed enterprises that blends the benefits of both informal (out-of-court) and formal (judicial) insolvency processes. It is quick and economical method to resolve the stress before the enterprise value deteriorates. Business continues as a going concern by the existing promoters, hence there is no business disruption unlike other insolvency resolution process. The process is initiated with an informal understanding between the promoters and stakeholders and concludes with a judicial blessing. Many

countries, including the United Kingdom (UK) and the United States of America (USA), permit pre-packaged insolvencies. According to a report “majority of pre-packs in the U.K. have been successful in preserving jobs”. Research in USA credits pre-packs for reducing the time taken by courts and confirming a reorganization plan to half. Pre-Packaged Insolvency Resolution Process as introduced in India works within the basic structure of the Insolvency and Bankruptcy Code, 2016. The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 was promulgated on 4<sup>th</sup> April, 2021 which introduced Pre-Packaged Insolvency Resolution Process



for MSMEs in the country. The Ordinance is now repealed by The Insolvency and Bankruptcy Code (Amendment) Act, 2021 and it shall be deemed to have come into force on the 4<sup>th</sup> day of April, 2021.

It is expected that the incorporation of Pre-Packaged insolvency resolution process in the Insolvency and Bankruptcy Code 2016 will alleviate the distress faced by MSMEs due to the impact of the COVID-19 pandemic. Pre-packaged process duly recognize the contribution of MSMEs in the economic development of the country.

The benefit of pre-pack resolution process is that a significant part of the resolution process is done informally, including preparation of the base resolution plan. PPIRP is an alternative resolution framework for MSMEs. The objective of PPIRP is cost-effective, timely, efficient resolution of distress thereby ensuring positive signal to debt market, ease of doing business, job preservation, and preservation of enterprise value. Other objectives of this amendment in IBC is lesser burden on Adjudicating Authority which are already overburdened with Corporate Insolvency Resolution Process (CIRP) cases, assured continuity of business operations of MSME without any interruption, less insolvency process costs and maximization of value for financial creditors and rights protection for operational creditors.

## Pre Packaged Insolvency process in other countries

Pre-packaged Insolvency process finds its roots in United States of America (USA) and United Kingdom (UK). Both in UK and in USA, the bankruptcy code allows initiation of Pre-pack process by any stakeholder of the corporate debtor and the corporate debtor negotiates the reorganization plan with all the classes of creditors. The substantial insolvency laws of the UK and the US are contained in the Insolvency Act, 1986 and in the Chapter 11 of the United States Bankruptcy Code respectively. Corporate reorganization is governed by Chapter 11 of US Bankruptcy Code and it is the counter part of the corporate insolvency resolution process (CIRP) under the IBC. One of the two pre-pack routes in the US is contained in Chapter 11 and the other is contained in section 363 of the US Bankruptcy Code. The UK Insolvency Act provides for three routes to formal rescue which include administrative receivership, Company Voluntary Agreements (CVAs), and administration. Schedule B1 of the Insolvency Act 1986 governs administration through which most pre-packs in the UK are affected.

A review from Wolverhampton University identified the several criticisms of pre-pack sales in UK. According to their review report "There is a general concern that the pre-pack administrator favours the interests of the management and secured creditors ahead



The benefit of pre-pack resolution process is that a significant part of the resolution process is done informally, including preparation of the base resolution plan.

of those of the unsecured creditors. The speed and secrecy of the transaction often lead to a deal being executed, about which the unsecured creditors know nothing and offers them little or no return. There is often a suspicion that the consideration paid for the business may not have been maximized due to the absence of open marketing. Credit may have been incurred inappropriately prior to the pre-pack and this may not be fully investigated".

Pre-pack can be completed without creditors' approval in UK. This makes unsecured creditors a vulnerable stakeholder in the insolvency resolution process. In the US, pre-packs can be implemented through two routes, one requires creditors' approval and the other does not. Globally it is considered that Pre-pack sales were a valuable tool for revival of business enterprises and can often help to preserve the jobs. However, for unsecured creditors it highlighted the lack of transparency around pre-pack sales therefore leaving them feeling aggrieved and evicted from the process.

# Insolvency

## Amendment made in Insolvency and Bankruptcy Code (IBC), 2016

A new Chapter namely **Chapter III A (Pre-Packaged Insolvency Resolution Process)** has been inserted in the Insolvency and Bankruptcy Code, 2016 providing sixteen sections – 54A to 54P. Further, three new sections have been inserted – 11A in Chapter II (Corporate Insolvency Resolution Process), 67A in Chapter VI (Adjudicating Authority For Corporate Persons) and 77A in Chapter VII (Offenses and penalties) of IBC 2016 under Part II of IBC.

## Definition of Micro Small & Medium Enterprises (MSME)

The definition of MSME that was given in MSME Development Act in the year 2006 was revised after 14 years in the Atmanirbhar Bharat package on 13<sup>th</sup> May, 2020 as the economy has undergone significant changes. Also, a new composite formula of classification for manufacturing and service units has been notified. Now, there will be no difference between manufacturing and service sectors. Also, a new criterion of turnover is added.

| Classification Of Enterprise | Investment in Plant & Machinery or Equipment | Turnover (Rs.)            |
|------------------------------|--|---------------------------|
| Micro Enterprises            | Not exceeding Rs. 1 crore                    | Not exceeding Rs. 5 crore |

|                    |                            |                             |
|--------------------|----------------------------|-----------------------------|
| Small Enterprises  | Not exceeding Rs. 10 crore | Not exceeding Rs. 50 crore  |
| Medium Enterprises | Not exceeding Rs. 50 crore | Not exceeding Rs. 250 crore |

For classification of an enterprise as micro, small or medium, a composite criteria of investment in plant & machinery and turnover is applied.

## Calculation of investment in plant and machinery or equipment. —

- Investment in Plant & Machinery or equipment as reported in previous year Income Tax Return (ITR).
- The Invoice value of a plant and machinery or equipment, whether purchased first hand or second hand excluding Goods and Services Tax (GST).

## Calculation of turnover

- Exports of goods and/or services are excluded.
- Turnover as reported in ITR or GST returns.

## Filing of application for Initiating PPIRP

Application for initiating pre-packaged insolvency resolution process is filed in Form1 (as prescribed in Insolvency and Bankruptcy (prepackaged insolvency resolution process) Rules, 2021 accompanied with affidavit, documents or records

as referred in Annexures therein, in electronic form, along with a fee of Rs. 15000/-.

Copy of Application is also submitted to Insolvency & Bankruptcy Board of India (IBBI) before filing it with the Adjudicating Authority (AA).

## Documents to be attached with the Application

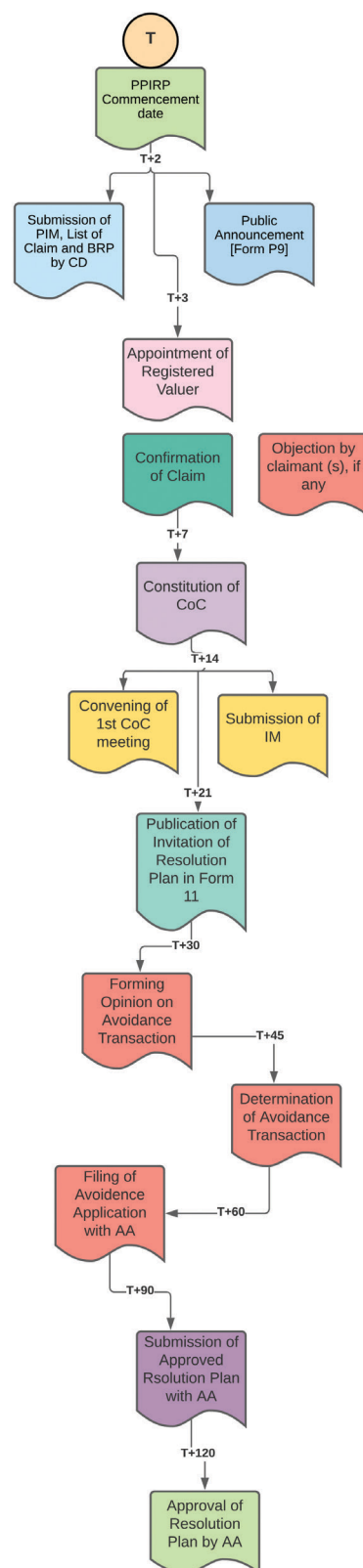
- In case of financial debt, record of default obtained through the Information Utility (IU) or documents to prove existence of Financial debt.
- In case of operational debt, (i) copy of invoice / demand notice served by an operational creditor on the corporate debtor and (ii) record of default obtained through the Information Utility or documents to prove existence of Financial debt.
- Approval of creditors for appointment of the proposed resolution professional (RP) [Form P3].
- Written consent by the proposed RP [Form P1].
- Latest & Updated Udyam Registration Certificate, or proof of MSME classification
- Declaration of the majority of the directors/partners [Form P6].

- Copy of Special resolution.
- Approval of creditors [Form P4].
- Report of the proposed RP [Form P8].
- Declaration from directors/partners regarding the existence of any avoidance transactions (Preferential, Undervalued, Extortionate, Fraudulent) of the corporate debtor (Form P7).
- Affidavit stating eligibility of the corporate debtor (CD) under section 29A of IBC.
- Copy of the relevant books of account evidencing the default to creditors.
- Copies of audited financial statements of the CD for the last two financial years.
- Provisional financial statements for the current financial year made up to a date not earlier than 14 days from the date of the application.
- A statement of affairs of CD made up to a date not earlier than 14 days from the date of application to initiate PPIRP including the following document, namely:—

- (a) A list of assets and liabilities with estimated values.
  - (b) Particulars of the claim mentioning amount, detail of security, date of security creation.
  - (c) Detail of Financial creditors and operational creditors mentioning their name, address and claim amount.
  - (d) Particulars of debts owed by or to the CD.
  - (e) Particulars of guarantees given in relation to the debts of CD specifying which guarantors is a related party to the CD.
  - (f) Detail of shareholders/partners mentioning their name, address and shareholding.
- A copy of Memorandum of Association and Articles of Association of CD or LLP Agreement.
  - A Copy of Board resolution or resolution passed by the partners.

## Pre Packaged Insolvency Resolution process (PPIRP) Timeline

The timeline is the essence of IBC. PPIRP should be completed within 120 days from its commencement date. Unlike CIRP, there is no provision for extension of time period. AA shall approve the resolution plan within 30 days. However, like CIRP, there is no compulsion on AA to pass an order within 30 days. See Chart



The timeline is the essence of IBC. PPIRP should be completed within 120 days from its commencement date.



# Insolvency

## Corporate Insolvency Resolution Process (CIRP) Vs. Pre Packaged Insolvency Resolution Process (PPIRP)

| Parameter                   | CIRP  | PPIRP   |
|-----------------------------|---|---|
| Initiation by               | Financial Creditor, operational creditor or CD                | CD, with consent of 66% of unrelated FCs                      |
| Default Amount              | Default above Rs. 1 crore                                     | Minimum Default Rs. 10 lakh                                   |
| Appointment of IP           | IRP proposed by the applicant, thereafter CoC approved RP     | RP approved with the consent of 66% Unrelated FCs             |
| Role of IP and AA           | Relatively More   | Relatively Less   |
| Claim Collation             | IRP to Invite and collate                                     | CD to invite and RP to confirm the claims                     |
| Moratorium                  | Yes   | Yes   |
| Management of CD            | IRP/RP in possession of CD with Creditors in Control          | CD in possession with Creditors in control                    |
| Valuation of Assets         | Yes   | Yes , but no concept of third valuation                       |
| Avoidance Transaction       | Yes   | Yes   |
| Information Memorandum      | Prepared by RP  | Draft prepared by CD and finalised by RP                      |
| Approval of Resolution Plan | With 66% of Voting Share                                      | With 66% of Voting Share                                      |
| Regulatory Benefits         | All Regulatory benefits are available to Resolution Applicant | All Regulatory benefits are available to Resolution Applicant |
| Clean Slate                 | Yes   | Yes   |
| Timeline                    | 180 days  | 90 days + 30 days for AA to approve it                        |

### Pre-requisites for initiation of PPIRP

Existence of debt and default

Approval of Shareholders with Special Resolution

Declaration and disclosures by board of directors

Consent of unrelated FCs having 66% of value of debt for approving the terms of appointment of IP and initiation of PPIRP

Unrelated FCs having at least 10% of the value of debt may propose the name(s) of RP

- No PPIRP or CIRP conducted during 3 years preceding the initiation date.
- MSME Company should be eligible under section 29A of IBC 2016 to submit the Base Resolution Plan

#### No Parallel Proceedings

|               |   |          |
|---------------|---|----------|
| CIRP ongoing  | X | No PPIRP |
| PPIRP Ongoing | X | No CIRP  |

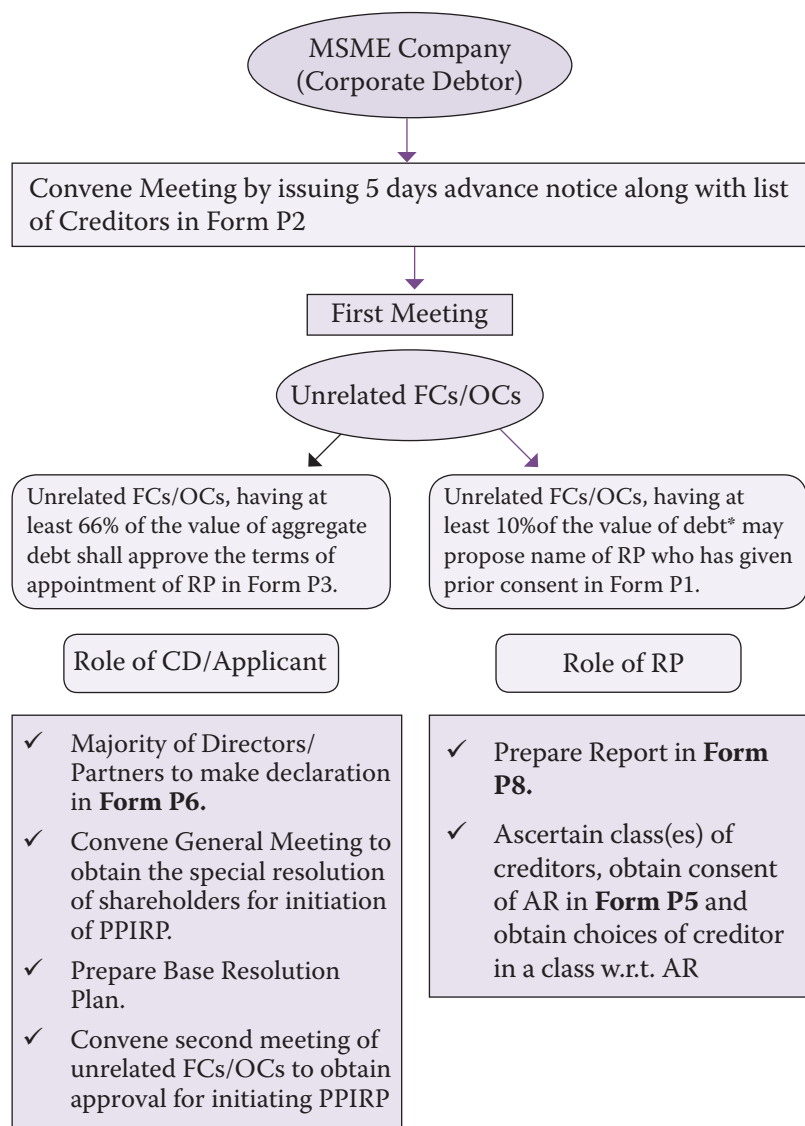
#### Pre-Initiation Process

Pre-initiation process of Pre Packaged Insolvency Resolution Process is not entirely codified. It is an informal process and Resolution Professional has to ensure pre-initiation due diligence. There is limited time for initiation after creditors' consent.

Pre Packaged Insolvency Resolution process (PPIRP) commences from the date of admission order passed by the Adjudicating Authority.

#### Eligibility & Conditions for initiation of PPIRP

- Classified as MSME under MSME Development Act, 2006.
- Minimum Default of Rs.10 Lakhs.
- Not Undergoing under CIRP.
- No Order of Liquidation passed.



## Post Initiation Pre-Packaged Insolvency Resolution process

### (i) Moratorium

A Moratorium comes into the effect on the pre-packaged insolvency commencement date by the order of Adjudicating Authority prohibiting Institution of suits or continuation of pending suits or proceedings against the corporate debtor

Moratorium shall not be applied to a personal guarantor to the CD. Unlike CIRP, Moratorium does not cover the supply of essential goods

or services to the corporate debtor.

### (ii) Management of affairs of corporate debtor

Unlike CIRP, the management of the affairs of the CD shall continue to vest in the Board of Directors or the partners.

However the CD shall not undertake any of the following actions without obtaining prior approval of the Committee of Creditors (CoC):-

- transaction above a threshold limit as decided by the CoC

- any other matter as decided by the CoC

### (iii) Public announcement

The RP shall make a public announcement within 2 days of the commencement of PPIRP. The public announcement is sent to every creditor, as listed in the list of claims provided by the CD, Information Utility and published on the website of the CD, if any, and the IBBI.

### (iv) Collation of claims

The CD shall submit a list of claims in Form P10 to the RP. Thereafter RP shall confirm the claim from the records of the CD and other relevant material available on record.

### (v) Committee of Creditors (CoC)

RP shall constitute committee of creditors. CoC shall consist of unrelated FCs.

- Where the CD has no financial debt or all financial creditors are related parties, the committee shall consist of unrelated operational creditors (OCs) as under:
  - (a) ten largest OC by value, and if the number of OC is less than ten, the committee shall include all such OCs;
  - (b) one representative elected by all workmen other than those workmen included under clause (a); and
  - (c) one representative elected by all employees other than those employees included under clause (a).
- Authorized representatives of each class of creditors
- CoC members shall have the voting share in proportion to the value of total debt.

### (vi) Valuation of Assets of Corporate Debtor

The RP shall within 3 days of

his appointment, appoint two registered valuers to determine the fair value and the liquidation value of the CD.

## (vii) Preparation of Information Memorandum

The preliminary information memorandum (IM) shall be prepared by CD. The RP shall finalize the IM submit to CoC within 14 days of the pre-packaged insolvency commencement date.

## (viii) Preferential and other transactions.

The RP shall form an opinion on whether the CD has been subjected to any preferential, undervalued, extortionate or fraudulent transaction by 30<sup>th</sup> day of Pre Packaged insolvency commencement date and where the RP is of the opinion that the CD has been subjected to any such transactions covered he shall make a determination and apply to the AA for appropriate relief.

Since the time frame given under the regulation for determining the preferential and other transaction is very tight, it is advisable to make an estimate of such transactions during the informal stage of Pre-Packaged Insolvency Resolution process.

## (ix) Resolution Plan

The CD shall submit the **Base Resolution Plan** (BRP) to the RP within 2 days of the commencement of PPIRP, and the RP shall present it to the CoC. CD may submit the base resolution plan either individually or jointly with any other person. The CoC may provide the CD an opportunity to revise the BRP prior to its approval or invitation of prospective resolution applicants. The CoC may approve the BRP for submission to the AA if it does not impair any claims owed by the CD to the operational creditors.

The RP shall present the resolution plan which confirm to the requirements referred to in section 30 (2) before the CoC. If such resolution plan is significantly better than the BRP, such resolution plan may be selected as **Base Alternative Plan** by the CoC. CoC shall decide in advance about the tick size to shortlist the Resolution plan which may be considered significantly better than the BRP. Thereafter Base Resolution plan shall compete with Base Alternative Plan.

RP shall disclose the scores of Base Resolution Plan and Base Alternative Plan to the submitters of these plans, who have an option to improve their resolution plan at least tick size. The process of improvement shall be continuous process until either of the applicant fails to use the option within the time frame specified in the invitation of the resolution plan. The process of improvement shall be completed within 48 hours. The resolution plan with highest score shall be selected by the CoC for its approval.

The resolution plan shall be approved by CoC by a vote of at least 66% of the voting shares after considering its feasibility and viability. Where the resolution plan does not provide for the full payment of the confirmed claims, the CoC may require the promoters of the CD to dilute their shareholding or voting rights in the CD. Where the resolution plan does not provide for such dilution, the CoC shall record reasons for its approval. The resolution plan approved by the committee of creditors shall be submitted to the Adjudicating Authority (AA) by the RP along with Compliance Certificate in Form P12. Resolution plan approved by AA shall be binding on all the stakeholders.

## Conclusion

Much of the preparatory work needs to be done by Insolvency Professionals along with the Corporate Debtor and creditors before submitting pre-pack insolvency resolution application to Adjudicating Authority. Corporate Debtor has to bring a lot to the table of creditors to get their prior approval. The speed and confidentiality offered by pre-packs have made them prevalent in UK and the USA, however, these advantages come with trade-offs. It is also pertinent to mention that pre-packs have been successful in UK and USA for corporate debtors with concentrated debt and a small group of creditors. In India, pre-packs have not evolved through the present regime as it does not allow for the assets of a debtor to be sold without its creditors' approval. Formats of most of the documents needed in PPIRP are formally prescribed in PPIRP Regulations. The new mechanism provides an opportunity to MSMEs to restructure and start with a clean slate. Over time, the process should turn out to be an effective mechanism to arrive at a quick resolution for distressed MSMEs.

## References:

1. US Bankruptcy Code.
2. Insolvency Act 1986 (US Court-Chapter 11).
3. Vanessa Finch & David Milman, Corporate Insolvency Law: Perspectives and Principles.
4. Mark Wellard & Peter Walton, A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be Made to Justify the Ends?
5. <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>.
6. Ministry of Corporate Affairs - Report of the Sub-Committee of the Insolvency Law Committee on Pre packaged Insolvency Resolution Process.
7. Bo Xie (2016), Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue, Edward Elgar Publishing. ■■■