

April 2021

## Pre-Packaged Insolvency Resolution Process

On April 5, 2021, the President of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 (the “**Ordinance**”) amending the Insolvency and Bankruptcy Code, 2016 (“**IBC**”). The Ordinance has brought in several amendments including a new chapter on pre-packaged insolvency resolution process (“**Pre-Pack Process**”). To streamline and deal with the operational aspects of the Pre-Pack Process, the Insolvency and Bankruptcy Board of India (“**IBBI**”) notified the Insolvency and Bankruptcy Board of India (Pre-Packaged Insolvency Resolution Process) Regulations, 2021 (the “**Pre-Pack Regulations**”) on April 9, 2021.

Section 10A of the IBC had suspended the initiation of corporate insolvency resolution process (“**CIRP**”) in respect of defaults during the period of 1 (one) year beginning from March 25, 2020 under Sections 7, 9 and 10 of the IBC (“**Suspension Period**”)¹.

With the end of the Suspension Period, the concept of the Pre-Pack Process has been introduced with the key objective of providing an efficient alternative insolvency resolution process for certain corporate persons. The aim of the Pre-Pack Process is to ensure cost-effective and value maximising outcomes for all the stakeholders, in a time bound manner which is least disruptive to the continuity of the businesses of the corporate debtor, and which will preserve jobs.

### What is a Pre-Pack?

A Pre-Pack Process may be considered as a process pursuant to which a pre-arranged restructuring plan between a corporate debtor and its creditors is sanctioned by an adjudicating authority on an expedited basis. It is a hybrid procedure between an informal or out of court restructuring and a court driven CIRP. During the Pre-Pack Process, the management and promoters of the corporate debtor are permitted, in normal circumstances, to continue with the operations and management of the corporate debtor.

### Scope of the Pre-Pack Process under the Ordinance

**Applicable to MSMEs:** Under the Ordinance, the Pre-Pack Process is currently only applicable to a corporate debtor which is classified as a micro, small or medium enterprise (“**MSME**”)².

¹ Section 7 of the IBC deals with initiation of insolvency proceedings against the corporate debtor by a financial creditor, whereas Section 9 of the IBC deals with initiation of insolvency proceedings against the corporate debtor by an operational creditor and further, Section 10 of the IBC deals with initiation of insolvency proceedings by the corporate debtor against itself.

² As per the Notification dated June 26, 2020, issued by the Government of India in the Ministry of Micro, Small and Medium

**Default Amount:** In order to commence a Pre-Pack Process against an MSME, it should have committed a payment default of an amount of atleast INR 1,000,000.

**Disqualifications:** The Pre-Pack Process cannot be initiated against an MSME corporate debtor:

- (i) that has undergone the Pre-Pack Process or completed a CIRP, as the case may be, during the period of three years preceding the initiation date;
- (ii) that is undergoing a CIRP; and
- (iii) against which order for liquidation has been passed.

## **Important Conditions for the Pre-Pack Process**

An application for initiating the Pre-Pack Process may be made in respect of a MSME corporate debtor, who commits a default as mentioned above, subject to the following conditions:

- (i) **Eligibility:** The corporate debtor should be eligible to submit a resolution plan under section 29A<sup>3</sup> of the IBC.
- (ii) **Approval of Creditors:** The proposal for the Pre-Pack Process should be approved by the financial creditors of the corporate debtor (not being its related parties) representing atleast 66% in value of the financial debt due to such creditors.
- (iii) **Identification of RP:** Financial creditors (not being its related parties) and having not less than 10% of the value of the financial debt of such creditors should have proposed the name of an insolvency professional to be appointed as a resolution professional (“**RP**”) for conducting the Pre-Pack Process. The terms of approval of appointment of RP have to be in a form prescribed under the Pre-Pack Regulations.
- (iv) **Declaration of Directors / Partners:** Majority of the directors or partners of the corporate debtor should have made declarations, in the prescribed form, *inter alia*, specifying that (a) the corporate debtor will make an application for the Pre-Pack Process within 90 days, (b) the Pre-Pack Process is not being initiated to defraud any person, and (c) the name of the insolvency professional approved by the financial creditors as mentioned above; and (d) either the corporate debtor has not been subject to any transactions Sections 43 (*preferential transaction*), 45 (*avoidance of undervalued transaction*), 50 (*extortionate credit transactions*) or 66 (*Fraudulent trading or wrongful trading*) of the IBC (“**Avoidance Transactions**”) or listing out the Avoidance Transactions, in a form prescribed under the Pre-Pack Regulations.
- (v) **Shareholder / partner approval:** The members of the corporate debtor should have passed a special resolution or atleast 75% of the partners of a corporate debtor have passed a resolution, as the case may be, approving the filing of an application for initiating the Pre-Pack Process; and

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Enterprises number S.O.2119(E), an enterprise shall be classified as a micro, small or medium enterprise on the basis of the following criteria, namely:-

- (i) a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;
- (ii) a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and
- (iii) a medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees.

<sup>3</sup> Section 29A lays down a list of disqualifications or ineligibility criteria for resolution applicants.

- (vi) **Creditor Approval to initiate the Pre-Pack Process:** The corporate debtor should have obtained the approval of financial creditors representing atleast 66% in value of the financial debt due to such creditors for filing the application to initiate the Pre-Pack Process.

Where the corporate debtor does not have financial creditors (who are not related parties of the corporate debtor), then the applicant has to convene a meeting of operational creditors (who are not related parties of the corporate debtor) and seek their approval where the approval of the financial creditors is required as mentioned above.

## **Process to be followed for Pre-Pack Process**

- (i) **Base Resolution Plan:** Upon the occurrence of a default, the MSME corporate debtor must formulate a base resolution plan. The base resolution plan must meet certain conditions set out in the IBC and the Pre-Pack Regulations. Amongst others, it must include a statement on how it has dealt with the interests of all stakeholders, including the financial creditors and the operational creditors.
- (ii) **Approvals of Creditors:** The corporate debtor has to obtain the approval of the creditors as mentioned above after it has submitted the base resolution plan, directors' / partners' declarations and the shareholders' / partners' resolution to such creditors.
- (iii) **Report of the RP:** Once the creditors have proposed and confirmed the name of an RP, the RP is required to prepare a report a form prescribed under the Pre-Pack Regulations, confirming if the corporate debtor meets the conditions mentioned above and if the base resolution plan meets the conditions set out in the IBC.
- (iv) **Application by the Corporate Debtor to NCLT:** After fulfilling the criteria and conditions mentioned herein above and obtaining the approval of the creditors as mentioned above, a corporate debtor may file an application in a prescribed form with the National Law Company Tribunal of the relevant jurisdiction ("NCLT"), along with the necessary supporting documents as mentioned in the IBC, the Pre-Pack Regulations and Insolvency and Bankruptcy (Pre-Packaged Insolvency Resolution Process) Rules, 2021.
- (v) **Commencement of Pre-Pack Process:** The NCLT may either admit or reject such application within 14 days. If the application is admitted, the Pre-Pack Process has to be completed within 120 days from the date of admission ("**Pre-Pack Commencement Date**").
- (vi) **Steps on Pre-Pack Process Commencement:** On the Pre-Pack Commencement Date, the NCLT will (a) appoint a RP; (b) declare a moratorium on, *inter alia*, legal proceedings, transfer of assets and enforcement of security; and (c) cause the RP to make a public announcement of initiation of the Pre-Pack Process in a prescribed form under the Pre-Pack Regulations, within 2 days of the Pre-Pack Commencement Date.
- (vii) **Submission of Information to the RP:** Within 2 days from the Pre-Pack Commencement Date, the corporate debtor must submit a list of claims (along with security interest and guarantees, if any) in a prescribed under the Pre-Pack Regulations, a preliminary information memorandum and the base resolution plan to the RP. The preliminary information memorandum must contain certain prescribed information, including details of assets and liabilities of the corporate debtor, certain financial statements, list of claims, details of debts due, details of guarantees provided for debts of the corporate debtor, material litigation and ongoing investigations and proceeds, and details of liabilities towards employees and workmen.

- (viii) **Appointment of Valuers and Liquidation Value:** The RP shall within 3 days of its appointment, appoint two registered valuers to determine the fair value and the liquidation value of the corporate debtor, in the manner laid down in the Pre-Pack Regulations. The valuations are to be provided to the CoC once the resolution plans are received.
- (ix) **Constitution of CoC:** The RP has to constitute a committee of creditors (“CoC”) within 7 days from the Pre-Pack Commencement Date, and the CoC shall convene a meeting within 7 days of its constitution.
- (x) **Submission of Information Memorandum:** The RP has to finalize the information memorandum with all such information as prescribed in the Pre-Pack Regulations and submit the same to the CoC within 14 days of the Pre-Pack Commencement Date after receiving an undertaking from a member of the CoC to the effect that such member or resolution applicant shall maintain confidentiality of the information and shall not use such information to cause an undue gain or undue loss to itself or any other person.
- (xi) **Preferential & Other Transactions:** Within 30 days of the Pre-Pack Commencement Date, the RP has to form an opinion whether the corporate debtor has been subjected to any Avoidance Transaction. If the RP believes that the corporate debtor has been so subjected, then RP shall determine the same within 45 days of the Pre-Pack Commencement Date under intimation to the IBBI. The RP shall then apply to NCLT for appropriate relief within 60 days of the Pre-Pack Commencement Date.
- (xii) **Approval of the Base Resolution Plan by the CoC:** The RP has to present the base resolution plan to the CoC. The CoC may either approve (with at least 66% majority) the base resolution plan submitted by the MSME corporate debtor or reject the same. However, it cannot approve the base resolution plan if it impairs<sup>4</sup> any claims of operational creditors of the corporate debtor.
- (xiii) **Invitation for new Resolution Plans:** In case the CoC rejects the base resolution plan or if the base resolution plan impairs any claims of operational creditors, then the RP must invite prospective resolution applicants to submit resolution plan by publishing brief particulars of the invitation in a prescribed form under the Pre-Pack Regulations within 21 days of the Pre-Pack Commencement Date, in the manner set out in the Pre-Pack Regulations. Amongst other things, the invitation must include the basis for evaluation<sup>5</sup>, basis for considering how a new resolution plan would be considered as significantly better<sup>6</sup> than the base resolution plan, the manner of improving the resolution plan and the minimum amount of improvement required (i.e., the tick size).
- (xiv) **Evaluation of the Plans:** After evaluating the plans, the CoC will select one resolution plan (“**Selected Plan**”). The CoC may accept such Selected Plan if it is significantly better than the base resolution plan. If it is not significantly better, then it will decide to compete this Selected Plan with the base resolution plan and one of these plans will be selected for approval. The Pre-Pack Regulations prescribe that the RP has to disclose the scores of the base resolution plan and Selected Plan to the submitters of the plans. Thereafter, a process to improve the scores will be followed for a period of 48 hours where each submitter will get the opportunity to improve the scores of their plan over the last

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<sup>4</sup> The claims will be considered to be impaired where the resolution plan does not provide for the full payment of the confirmed claims as per the updated list of claims maintained by the RP.

<sup>5</sup> Under the Pre-Pack Regulations, “basis for evaluation” includes the parameters to be applied and the manner of applying such parameters, as approved by the CoC, for evaluating a resolution plan to assign a score to the plan, and disclosed in the invitation for resolution plans.

<sup>6</sup> Under the Pre-Pack Regulations, “significantly better” in relation to resolution plan, means that the score of the resolution plan is higher than that of another resolution plan by a certain number or percentage, as approved by the committee and disclosed in the invitation for resolution plans.

score of the other plan. The plan with the highest score will be considered for approval by the CoC. The resolution plan has to be approved by the CoC (with at least 66% of the voting shares).

- (xv) **Performance Security:** Upon the approval of the resolution plan, the resolution applicant will be required to provide a performance security within the time specified therein.
- (xvi) **NCLT Approval of the Resolution Plan:** Once the CoC approves the plan, RP has to make an application to the NCLT in a form prescribed under the Pre-Pack Regulations. If the NCLT is of the opinion that the resolution plan confirms to the requirements of the IBC and the Pre-Pack Regulations, then within 30 days of the application, it will approve the resolution plan.
- (xvii) **Termination of Pre-Pack:** The NCLT may terminate the Pre-Pack Process if: (a) no resolution plan is approved by the CoC, (b) the resolution plan approved by the CoC does not meet the criteria specified in the IBC, or (c) if the RP makes an application at any time before approval of a plan based on a decision of the CoC (by 66% vote) to terminate the Pre-Pack Process.
- (xviii) **Liquidation of the Corporate Debtor:** Further, where the management of the corporate debtor has been vested in the RP as mentioned below, and the resolution plan approved by the CoC does not provide for a change in management or control of the corporate debtor to a person who was not the promoter or in management or control of the corporate debtor, then the NCLT will reject the resolution plan, terminate the Pre-Pack Process, and order liquidation of the corporate debtor.

## Role of RP

**Supervisory and administrative role:** The role of an RP under a Pre-Pack Process is primarily supervisory and administrative in nature. Unlike in a CIRP where an RP is required to manage the operations and management of the corporate debtor, in a Pre-Pack Process, the management of the affairs of the corporate debtor continues to vest in the board of directors or the partners of the corporate debtor in normal circumstances.

**Primary Roles and Duties of the RP:** The primary roles and duties of an RP under a Pre-Pack Process include (i) confirming and maintaining list of claims shared by the corporate debtor; (ii) informing creditors of their claims; (iii) constituting the CoC; (iv) monitoring the management of the corporate debtor; (v) preparation of information memorandum; and (vi) assisting the CoC in the manner prescribed in the Ordinance and the Pre-Pack Regulations. The RP also has the right to, *inter alia*, call for information regarding the operations of the corporate debtor, visit the offices and inspect assets of the corporate debtor, and seek information regarding any legal proceedings initiated by or against the corporate debtor.

**Responsibility of the corporate debtor and its directors/partners:** The directors / partners of the corporate debtor have to take all endeavours to protect and preserve the value of the property of the corporate debtor and manage its operations as a going concern. Further, the promoters, members, personnel and partners, as the case may be, of the corporate debtor, have to exercise and discharge their contractual or statutory rights and obligations in relation to the corporate debtor. The CoC may also require that transactions above a certain monetary threshold should only be undertaken by the corporate debtor with the CoC consent. The corporate debtor has to provide the CoC with monthly reports with details of any legal proceedings that have a material impact on the business of the corporate debtor, details of key contracts executed and any other matters that can materially impact the business of the corporate debtor.

**Vesting of management in the RP:** However, the Ordinance provides that during the Pre-Pack Process, the CoC may, by a 66% vote, resolve to vest the management of the corporate debtor with the RP. If they do so,

the RP must make an application to the NCLT in a format prescribed under the Pre-Pack Regulations. The NCLT may pass an order vesting the management with the RP if it is of the opinion that the affairs of the corporate debtor have been conducted in a fraudulent manner or there has been gross mismanagement in the affairs of the corporate debtor. If this happens, then the powers and duties of the RP will stand expanded to include several powers and duties that an insolvency professional has during a CIRP.

## **Role of the NCLT**

While one of the benefits of Pre-Pack Process is that most of the restructuring discussions are completed without any involvement of the NCLT, the final sanction of the resolution plan is with the NCLT. This provides the resolution plan judicial sanctity and makes the Pre-Pack Process unique compared to out of court debt restructuring processes.

Further, other than the final implementation of the plan, any interim decision which would have an impact on the plan is also sanctioned by the NCLT. Under the Ordinance and Pre-Pack Regulations, *suo moto* actions by NCLT are not stipulated and all actions are to be undertaken upon an application of the CoC.

## **Conclusion**

The amendments proposed in the Ordinance along with the supporting measures in the Pre-Pack Regulations, are timely and much needed to prevent an onslaught of CIRPs against the MSME sector which has been adversely impacted by the pandemic. The Ordinance also includes provisions to protect the interests of creditors who were not involved at the time of formulating the base resolution plan. However, the provision that requires the base resolution plan should not “impair” the claims of operational creditors may be unworkable in many cases (especially where financial creditors have agreed to a reduction in their debt). Consequently, in several instances, new plans will probably be invited after a base resolution plan has been proposed by the corporate debtor. As the CIRP has shown, processes involving multiple bidders have a propensity to be dragged into protracted litigation.

Further, while the Pre-Pack Regulations provide much needed clarity on various aspects, they are also prescriptive in various places and appear to mimic a CIRP in several aspects. It is essential for CoC members and the courts and tribunals to acknowledge and understand that the Pre-Pack Process is not intended to be a CIRP and therefore, it will need a change in the way they approach the same. In order to make the Pre-Pack Process effective and meaningful, it is essential that the timelines set out in the IBC and Pre-Pack Regulations are strictly adhered to. The Government must ensure that the NCLTs have sufficient manpower and additional benches to navigate the ongoing CIRPs as well as deal with the possible deluge of applications for commencing the Pre-Pack Process and new CIRPs post the suspension period.

Lastly, it would be useful if the Government extends the Pre-Pack Process to non-MSME entities as soon as possible so that they may benefit from a quicker debt restructuring process.

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