Pre-packaged Insolvency Resolution Process:
A tailored mechanism but an effective one?

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Introduction

The Insolvency and Bankruptcy Code, 2016 (**Code**) was introduced with an objective to consolidate and amend the laws relating to reorganization and insolvency resolution in a 'time bound' manner. Prior to the enactment thereof, the resolution and revival of a sick, distressed corporate body in India was governed by multiple legislations, due to the multiplicity of which there was considerable lack of coherence in the insolvency regime. As a result, it was imperative to have a comprehensive, consolidated and streamlined legal framework to deal with the revival of corporate body, which did away with the implementation deficits even as the symbolic existence of laws remained in place. Accordingly and repeatedly so, both the Ministry of Corporate Affairs (**MCA**) and the Insolvency and Bankruptcy Board of India (**IBBI**) have emphasized the importance of enacting the Code as an effective mechanism by the stakeholders, of the stakeholders and for the stakeholders.

Conceptualizing PIRP

One of the key amendments to address the hardships faced by the Micro, Small and Medium Enterprises (**MSMEs**) during Covid-19, was the Pre-packaged Insolvency Resolution Process (**PIRP**), which was introduced in 2021. It was considered as the mechanism to counter increasing risk of insolvencies, post the lockdown. PIRP distinguishes itself as an out-of-court quick resolution, by way of an agreement between the secured creditor and corporate debtor, and not conducted through usual public bidding process.

PIRP is, in essence, a hybrid model of insolvency resolution process, which is frequently followed in overseas jurisdictions. The cost-effectiveness, timely resolutions and interest of the stakeholders results in value maximization of assets of the corporate debtor. It is pertinent to mention that the out-of-court nature allows the management of the corporate debtor and the creditors to work out an arrangement for debt resolution among themselves with minimal court intervention, while still maintaining the sanctity of the judicial system. Additionally, the time limit of ninety (90) days for approval of resolution plan promotes speedy resolution, allowing the corporate debtor to revive itself as soon as possible.

In the aforesaid context, PIRP gives the impression of being next natural step in the evolution of the insolvency regime in India.

Current Position

In August 2021, PIRP was inserted in Chapter III-A (*Section 54-A to Section 54-P*) of the Code. However, only those companies/ corporate debtors who qualify as an MSME according to the definition provided in section 7(1) of the MSME Development Act, 2006 were made eligible to file for a pre-packaged resolution.

It is noteworthy that PIRP is triggered for the default amount ranging between INR 10,00,000 (Ten Lacs) and INR 1,00,00,000 (One Crore). Insolvency resolution for any amount higher than the upper ceiling would be dealt under previously existing Corporate Insolvency Resolution Process ("**CIRP**") in the manner prescribed under the Code. Few pre-requisites for PIRP include that the corporate debtor must not have

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include: any ongoing or completed CIRP or PIRP in the last three years, approved PIRP resolution plan in the last 12 months and liquidation order under section 33 of the Code.

Key Differences between PIRP and CIRP

In the former an Insolvency Practitioner/ Resolution Professional ("**RP**") is in control, while in the latter the incumbent management remains in control of the company under supervision of the RP. CIRP may be initiated by the financial creditors, operational creditors, or the corporate debtor whereas PIRP may only be initiated by the corporate debtor with the consent of majority of the financial creditors. The role of RP is limited to conducting the resolution process and they do not have the responsibility of managing the affairs of the Corporate Debtor as under CIRP. The timeline of resolution period is considerably reduced - CIRP has a timeline of 180 days for deciding on the resolution plan, then 90 days for approval of resolution plan by the Adjudicating Authority whereas in PIRP there are 90 days for deciding on the resolution plan and then 30 days for approval by Adjudicating Authority. CIRP is terminated either when the application is withdrawn or when the company goes into liquidation post expiry of the resolution period, whereas in PIRP it can additionally be terminated by the company going into CIRP with majority creditor's approval.

Recommendations

In order to make the PIRP process more effective and efficient in terms of practical implementation, set forth below are certain recommendations that should be considered by the MCA and IBBI in respect of the PIRP mechanism:

1. *Inclusion of other corporates other than MSME*

At present, India has an upper limit on the debt owed for an undergoing PIRP. The process is restricted strictly to those corporations that fall into the category of MSME. This restriction is absent in many mature jurisdictions, allowing corporates including limited companies, partnerships, limited liability partnerships and sole traders, to undergo a pre-pack insolvency. It is imperative to note that, the United States (US) pre-packaged insolvency regime does not provide any upper limit to file a claim against the corporate debtor. Further, the United Kingdom insolvency regime also does not provide any lower/upper limited of debt owed to proceed into insolvency resolution process. Thereby making all corporate structures eligible under the PIRP.

2. *Revised Thresholds*

The current PIRP framework requires approval from a number of financial creditors at the pre-commencement stage pertaining to the confirmation of the proposed Resolution Professional, thereby causing undue delays. To expedite the process, the thresholds mentioned under Section 54 A (2) (e) of the Code, may be revised from a minimum sixty-six percent to fifty-one percent for unrelated financial creditors. Similarly, thresholds under Section 54 A (3), pertaining to approval of filing of an application, may be revised from sixty-six percent to fifty-one percent for unrelated financial creditors.

3. *Justified haircuts*

Haircuts are considered last resort while resolving debts, however, under PIRP, creditors are encouraged to take voluntarily haircuts. It is noted that the creditors become reluctant in terms of taking voluntary haircuts as the debt owned is not that large which requires haircut. Moreover, a lot of creditor's time and money is devoted, justifying in court the reason behind agreeing on such haircuts. For this reason, creditor's process even the probable cases of PIRP, by way of normal CIRP, thereby increasing the burden on the businesses of MSMEs.

4. *Increase representation for Operational Creditors*

In India, operational creditors form a large part of MSME sector, however the PIRP fails to resolve the issues of the operational creditors. PIRP enables the corporator debtor to submit its own plan and control the management during the whole process, converting the creditor-in-control approach to debtor-in-control approach. It is to be noted that Section 54k read in consonance with Section 21(2) of the Code, only recognizes financial creditors for approving the resolution plan, thereby causing inequality to the operational creditors. In common parlance, the financial creditors tries to maximize the recovery of their dues, despite it being inimical to the operational creditor's real interests.

5. *Fair value instead of liquidation value*

The liquidation value is calculated based on the assumption that the corporate debtors is liquidated/ dissolved on the date of commencement of insolvency, however this does not fit in the concept of PIRP as the corporate debtors continues to work as a going concern, without being liquidated. The control stays with the management and the corporate debtor is expected to generate revenue and operate in such manner so as to increase the value of the assets. For that reason, liquidation value should be replaced with the fair value while calculating the minimum amount payable to the operational creditors. Fair value is calculated based on estimated value of the corporate debtor's assets that may be realized on the date of commencement of the insolvency process, between a willing seller and buyer, post marketing. As such, fair value approach may be added to the current laws relating to PIRP in India.

Conclusion

In theory, PIRP is a method of debt resolution that combines the features of a court proceedings conducted with an established legal framework, with those of informal out-of-courts settlements and provides MSMEs the opportunity to restructure their debts and resolve them in a timely and efficient manner that causes minimal disruption to their everyday business. However, it inevitably has certain shortcomings that have resulted in only two companies being admitted under PIRP in the years post implementation. Hopefully, the recommendations provided, would assist in remedying the same and afford a practical solution to the market landscape in India.