

From Chairperson's Desk

Pre-packaged Insolvency Resolution Process

A market economy is all about choice. Provision of multiple competing options for resolution of stress makes an economy a great place to do business.

Insolvency and Bankruptcy Code, 2016 (Code) envisaged standard, plain vanilla processes to start with, but anticipated sophisticated options with the maturity of the ecosystem. With considerable learning and maturity of the ecosystem, and a reasonably fair debtor-creditor relationship in place, the ground seems ready to push the envelope a bit further.

The Code envisages corporate insolvency resolution process (CIRP) for resolution of stress of companies. The success of CIRP, however, critically depends on the availability of resolution applicants (RAs). When most companies, industries and economies continue to experience stress on account of the ensuing pandemic, the likelihood of finding an RA to rescue a failing company is less. This may remain a concern for some time, as there is no clarity as to when COVID-19 will subside fully and even after that the business and economy may take some time to return to normal. Further, CIRP is not available in respect of defaults below ₹ 1 crore and defaults that arose during the last one year. This has two consequences - either the company remains under stress for too long or the creditors use available means to recover their dues. In either case, the company may not survive long. This necessitates exploring novel options that attempt to resolve stress but do not yield liquidation for want of an RA.

CIRP has a set process and, therefore, some amount of inflexibility, which may limit its use in certain circumstances. It shifts control of the company to an interim resolution professional (IRP) and then to a resolution professional (RP) and finally to the successful RA, which may cause business disruptions. The displacement of the current management disincentivises the companies to initiate CIRP voluntarily in case of stress. This partly explains non-cooperation by the current promoters and management, leading to intense litigation in some cases. Determination of several issues, including avoidance transactions, has been a challenge to the limited capacity of the Adjudicating Authority leading to overstepping of timelines in some CIRPs.

Market prefers flexibility to work out a tailor-made resolution best suited to the unique circumstances. It, however, does not like complete flexibility; it appreciates a guided path and wishes to avail benefits and sanctity of a formal process. In other words, the market prefers a semi-formal process which side-steps the difficulties of a formal process but retains its benefits and sanctity. In a sense, the formal process and informal process are two ends of a spectrum and a variety of semi-formal processes, that blend elements from both, can exist to suit the convenience of the stakeholders. The most popular semi-formal option is pre-pack, which starts with an

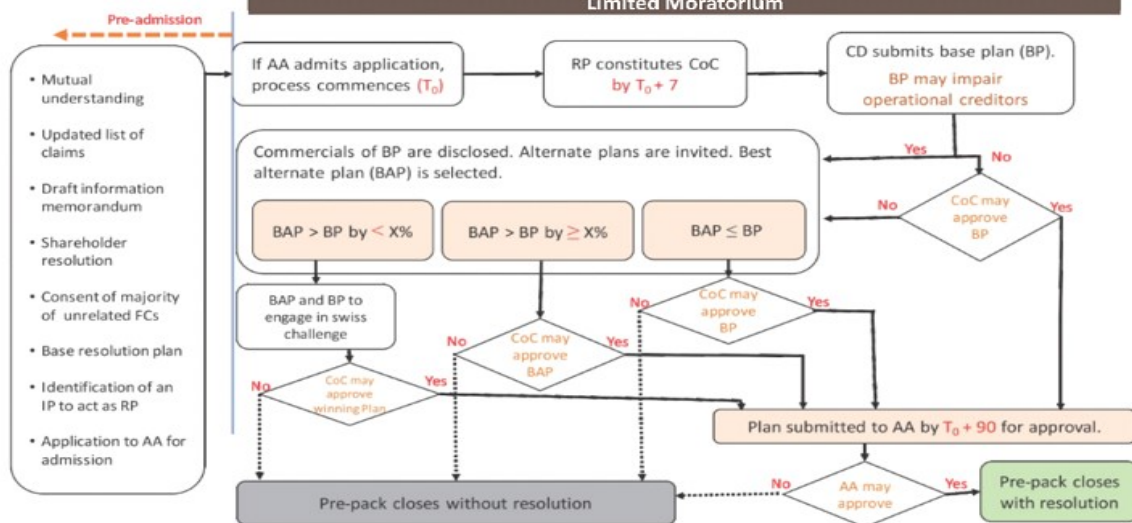
informal understanding among stakeholders, engages with them formally in between, and ends with a judicial blessing of the outcome. The insolvency laws around the world provide a variant of pre-pack, though the nuances differ across jurisdictions. The formal processes in India (withdrawal under CIRP, compromise or arrangement under the Companies Act, 2013 and the RBI's prudential framework) have some elements of pre-pack.

As compared to CIRP, prepack is typically more flexible, cost effective, time effective, less disruptive to business and devoid of stigma, and more conducive for group insolvency. It increases possibility of reorganisation and entails a limited role of the courts and IPs. It has, however, its share of concerns such as 'serial pre-packing' (controlling parties acquire the company successively to avoid debt rather than rescue the company). Private negotiation and understanding among a set of stakeholders prior to commencement of formal process, which contribute to its advantages, is often a source of concern. Though emanated from market practice, prepack is getting formal and regulated to address the concerns.

The market has been advocating and anticipating prepack resolution process for some time. In recognition of the need, the Government had set up a sub-committee of the Insolvency Law Committee to recommend an India-centric pre-pack. Within the basic structure of the Code, the sub-committee has designed a pre-pack process where the financial creditors have extensive control, company enjoys moratorium during the process, and the outcome is binding on all. The proposed pre-pack process has the features, which make a CIRP sacrosanct, and has the rigour and discipline of the CIRP. It is informal up to a point and formal thereafter. It blends debtor-in-possession with creditor-in-control. It is neither a fully private nor a fully public process - it allows the company, if eligible under section 29A, to submit the base resolution plan which is exposed to swiss challenge for value maximisation. It safeguards the rights of stakeholders as much as in CIRP and has adequate checks and balances to prevent any potential misuse. The recommendations of the sub-committee are presented later in this newsletter. A tentative process flow of proposed prepack insolvency resolution is presented in the Figure.

Now that the haze around moratorium has been cleared by the Supreme Court, the suspension of initiation of insolvency proceedings has expired, and the trajectory of COVID-19 is fairly understood, it is the most opportune time to introduce pre-packs, which is a natural step in the evolution of insolvency regimes, within the Code. It will enrich the menu of options for resolution of stress and take the Indian insolvency journey to the next level.

Figure: A tentative process flow of proposed Pre-packaged Insolvency Resolution Process
Limited Moratorium



(Dr. M. S. Sahoo)