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PRE PACK INSOLVENCY VIS- A-VIS INSOLVENCY AND BANKRUPTCY CODE (INSOLVENCY LAW)

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ABSTRACT

The Insolvency and Bankruptcy code,2016 has been one the major structural reform in India pertaining to the Indian Insolvency and Bankruptcy laws but the law has , since its enforcement been subjected to various amendments to fill in the gaps it creates in the practical application of its provisions. The Current insolvency law does not incorporate any resolution that could be unanimously agreed by the creditors and the corporate debtors before filing any resolution application by them under section 7,9,10, post default. Pre Pack insolvency is one such evolving procedure through which a resolution mechanism could be set up prior to the occurrence of any default and has already gained success in countries like USA and UK whereas it is not established in India and a committee is being set up by the Ministry of Corporate affairs to look into the possibility of inculcating it in the current regime. The paper will be dealing with contrasting differences between the two and the possibility of its coexistence.

KEY WORDS: Pre pack Insolvency, Insolvency and Bankruptcy Code, CIRP.

INTRODUCTION

In India, The Insolvency and Bankruptcy Code, 2016 is a code which came into force to provide a comprehensive and consolidated framework of the insolvency and bankruptcy regime. The preamble itself provides the objectives of the Act which is value maximization, promote entrepreneurship , and the availability of credit and balance the interests of all the stakeholders involved in the resolution process. One of the major objectives of the Act is to provide for an insolvency resolution process in a time bound manner, which actually is achieved to what extent will be discussed later in the paper. Pre pack Insolvency is one such mechanism which can help in providing a speedy menthod for the

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implementation of the administrative process. If a pre-pack is introduced efficiently it can definitely maximize value by "combining the efficiency, speed, cost, and flexibility of workouts with the binding effect and structure of formal insolvency proceedings".[1] The pre packaged insolvency has already been very successful in the Countries like USA and UK and the countries who have adapted it into their Insolvency regime. However there are many hurdles which might come in way of the implementation of pre packs.

WHAT IS A PRE PACK INSOLVENCY?

There are two popular methods of rescuing a financially distressed company, first being the formal insolvency proceeding and the other being the pre pack insolvency proceeding which involves a private/informal arrangement between the corporate debtor and creditors and a restructuring plan agreed by all are then executed via judicial process. It is a hybrid mechanism and a blend of private and judicial processes. This process can be initiated either before the default or after the default or potential event of default has occurred.

THERE ARE SOME ADVANTAGES OF PRE PACKS DISCUSSED BELOW (IN RELATION TO IBC)

- Speed is undoubtedly the most attractive feature of a pre pack insolvency . Under the current regime of insolvency law which involves a stressed company to go through a 330 days long procedure of corporate insolvency resolution process , is usually longer than the period due to some exceptions which are as follows:

1. The period of 68 days of lockdown, due to the COVID- 19 outbreak has been exempted from the calculation of the total number of days for any task that was hampered owing to the lockdown.
2. In the case of Quinn Logistics India Pvt Ltd, Vs. Mark Soft Tech Pvt. Ltd[2], the NCLAT laid down a principle stating that the period of stay shall be excluded while reckoning the 330 days if the CIRP is set aside by the Appellate Tribunal or order of the Appellate Tribunal is reversed by the Hon'ble Supreme Court, and corporate insolvency resolution process is restored.

[1] Designing Framework for Pre Packaged Insolvency Resolution in India, Some Ideas for Reform, Vidhi Centre for Legal Policy, Feb 2020 https://vidhilegalpolicy.in/wp-content/uploads/2020/02/Report-on-Pre-Packaged-Insolvency-Resolution.pdf

[2]Quinn Logistics India Pvt Ltd, Vs. Mark Soft Tech Pvt. Ltd (2018) 208 CompCas 0432

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3. In another case of In Committee of Creditors of Essar Steel India Limited Vs. Satish Kumar Gupta & Ors,[3], the Hon'ble Supreme Court noted that if the Appellate Authority is of the opinion that that only a short period is needed beyond the 330 days to complete the CIRP and that it would be in the interest of all stakeholders for the corporate debtor to be put back on its feet instead of being liquidated; and further that the time taken in legal proceedings was largely due to factors that could not be ascribed to the litigants and the delay or a large part thereof being attributable to the tardy process of the AA and/or the NCLAT itself, there could be given an extension beyond 330 days.

According to the data produced by the Insolvency and bankruptcy board of India , there are around 277 CIRPs which have yielded resolution plans by the end of September, 2020 took an average of 433 days (384, after excluding the time excluded by the Adjudicating Authority) for the conclusion of the whole process.[4] On the other hand under the pre pack the resolution plan is supposed to be submitted to the adjudicating authority within 90 days of the pre pack commencement date.[5]

- The pre pack is indeed a comparatively cheaper process than the current Corporate Insolvency Resolution Process. Under the pre pack , since the corporate debtor is in the possession of the existing management of the company, it avoids the cost related to the disruption of business as the management is not shifted to the IPR and due the confidentiality of the process until the commencement of formal procedure, it reduces the indirect costs in terms of the loss of reputation of the business. On the other hand the total cost involved under the current insolvency process includes the fee payable to the insolvency resolution professional, to the valuers, fee payable to the legal, audit, accounting and finance and any other professional, expenses related to public announcement, expenses pertaining to litigation, other related expenses etc. Even the government recognizes that a pre pack insolvency may help in cost reduction (litigation costs and delays) and may decongest the

[3]Committee of Creditors of Essar Steel India Limited Vs. Satish Kumar Gupta & Ors, 2019 SCC OnLine SC 1478

[4] The quarterly news letter of Insolvency and Bankruptcy Board of India, Vol. 16 (July-september), https://www.ibbi.gov.in/uploads/publication/411436dab58c1265aacb015b6b43a215.pdf

[5] Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process, Ministry of Corporate Affairs, (October,2020) https://ibbi.gov.in/uploads/whatsnew/34f5c5b6fb00a97dc4ab752a798d9ce3.pdf

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overburdened tribunals/courts.[6]

- The pre packs are considered confidential in comparison to open bids and therefore the depreciation of the value on account of CIRP which decreases the returns for the creditor does not happen in the pre pack insolvency procedure.
- It is notable that there are certain exemptions like that of securities law requirements which is provided in statutory schemes like Insolvency and Bankruptcy Code,2016 which obviously increases the certainty regarding the implementation of the plan but for these exemptions to be provided in a private restructuring it is important for the process to be approved by the adjudicating authority. The perfect practical example to explain this is the failure of the Jet Airway's out of court resolution process, where it initiated the negotiations with the Ethiad airways prior to the default but due to the non acceptance of the waiver claimed by the airlines, the deal could not materialize. This hadn't been the scenario if the same waiver was claimed in the resolution plan under the code. It is therefore necessary to give the private restructuring, some properties of formal procedure for being able to get the fruits of certainty in the implementation. Pre pack is that hybrid framework which if given a statutory status could be perfect mix of both.[7]

CONNECTED PARTY PARTY/ PROMOTERS

The biggest hurdle which comes in way of pre packs is the bar which Section 29A, IBC ,2016[8] creates for the promoters, managers (connected parties) who have non performing assets from being the resolution applicants and thereby preventing to open gates for phoenixing. The bar was not a part of the statute *ab initio*, it rather was introduced via the Amendment Act of 2017 when it was realised that the promoters/connected party could not be allowed to buy back the company at notably discounted rates and have a second bite to the cherry. This has the potential of hampering the implementation of a pre pack as the negotiating process necessarily involves the presence of directors and promoters being the representative of the corporate debtor. The bar within the section is twofold, firstly, as has been already discussed above and secondly, that the management's participation in the insolvency proceedings (even when they do not intend to take part in the bidding

[6] Monthly Newsletter, Ministry of Corporate Affairs, Government of India (Vol. 13Z, November 2018); the Ministry of Corporate Affairs has also sought public comments on, inter alia, pre-packaged insolvency resolution process under the Code.

[7] Supra note 1 at 2

[8] The Insolvency and Bankruptcy Code, 2016, No. 31 , Act of Parliament,2016 (India)

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process). The Supreme Court in the case of Chitra Sharma v Union of India[9] has categorically said that section 29A prohibits the promoter of the corporate debtor from submitting any resolution plan and also disallowed the corporate debtor from entering into a master restructuring plan which was accepted by all the creditors. Under the IBC, the current management of the company which is going into a resolution process is substituted with that of the committee of creditors by the IRP whereas this is not the case with a pre pack however there are suggestions for the voluntary involvement of IRP to ensure a fair price deal to the creditors.

A blanket ban on the promoters/connected party as a class can lead to hampering of entrepreneurship, especially in times of covid when the economy is sluggish, even the prospective resolution applicants (other than Asset Restructuring Companies) would first like to secure themselves before they bid for others.[10] This could in turn reduce the bidding amounts and further affect the creditors. According to a data released by the Insolvency and Bankruptcy Board of India since the commencement of the Act from on December 1, 2016 around a total of 4008 CIRPs have commenced by the end of September, 2020 , out of which 291 have been withdrawn;, 473 have been closed on appeal or review or settled; 1025 have ended in orders for liquidation and 277 have ended in approval of resolution plans, more than 60% of the CIRPs have resulted into liquidation.[11] The experts attribute the comparatively high number of liquidation cases with the lack of investor interest in stressed assets. Considering this, eliminating the connected party can actually be counter-productive, as in some cases specially those where the inability of the company to repay its debts can be attributed to external factors, such as sluggish growth in a particular sector of the economy, temporary cash flow mismatch, extraordinary situations like pandemic etc. In UK, after the recommendation of the graham committee, pre pack pool was adopted where a pool of independent people with expertise in business are set up in order to assess and give an opinion upon a proposed pre-pack sale to a "connected person", however a purchaser may also provide a voluntary viability review statement. This can ensure the regulation of the sphere of connected parties. With the strong stance taken by the legislature and the judiciary, regarding the connected party involvement in the resolution of the corporate debtor , it can be said that the position is going to be the same in case of pre packs.

[9]Chitra Sharma v Union of India*, W.P. (C) 744 of 2017*

[10]Samrat Sharma, why are liquidation cases under IBC rising?, Financial Express, (Sep 8,2020, 6;11 PM) https://www.financialexpress.com/industry/why-are-liquidation-cases-under-ibc-rising-haircut-becomes-new-fear-for-creditors-interview/2078027/

[11]Supra note 4 at 3

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CREDITOR's ROLE

The creditors of the corporate debtor play a very crucial role under the corporate rescue mechanism. The code provides ample protection to the creditors, wide range of protection is given to the creditors ranging from- to form committee of creditors who take part in the negotiation (financial creditors) to given priority under the payment waterfall mechanism. The resolution professional makes sure that the interest of all the stakeholders of the corporate debtor is protected. On the other hand the pre pack is a debtor run process, where the debtor is in the control of the existing management therefore the benefits given under the IBC to the creditors is more attractive than a typical pre pack and thus the legislature needs to take special care in preventing the harassment of the creditors at the hands of the debtor.

In the Indian context, if the moratorium is not implemented under the pre pack then it would lead to the possibility of the creditors enforcing their remedies outside of the pre pack negotiation. Also if the creditors are highly dissatisfied then they may also go to the NCLT for the initiation of CIRP under the Code which would hold the whole process of pre pack as a futile exercise. The heterogeneity of creditors would make it difficult to achieve the desired goal. Therefore in India, a moratorium period applicable to the pre pack would help in dealing with such issues. In view of the same the Sub-Committee of the Insolvency Law Committee has recommended that, a moratorium should be made applicable from the pre pack commencement date till the closure or termination of the process. If the government accepts the recommendation, then it would be a bane for the creditors who fears the actions of the other creditors.

CO EXISTENCE OF BOTH THE PROCESSES

In India it is feasible to blend the aspects of the IBC with corporate rescue tools like pre pack, prior to initiating a CIRP. It has been recommended by the sub-committee that formal procedure of the pre pack should be carried out under the legislative umbrella and the informal part be left to the best practices. It also said that , for an effective pre pack to take place, it is important to get it introduced under the code with necessary checks and balances.[12] It is to be noted that the current insolvency regime of the country is not fully unaware and devoid of the features of pre pack , in fact under section 12A of the IBC , the withdrawal of the application can be sought after the application admitted under section 7,9 or 10 , when an applicant makes an application which has an approval of

[12] Supra Note 5 at 3

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ninety percent voting share of the committee of creditors. The Supreme Court and the NCLT/NCLAT has also given its approval to such a withdrawal where the other settlement seems to be a better alternative in relation to the resolution plan. The validity of pre pack has been an extensively debated by the Bankruptcy Law Reforms Committee and the committee insisted on the intervention by the NCLT which is mandatory as the Indian market is not developed enough to allow out of court restructuring. [13] In 2018 the approval given by NCLT, to the out of court settlement in case of Binani Cements Insolvency added fuel to the pre pack debate. However the same was struck down by the Supreme Court. In the infamous case of Standard Chartered Bank v Essar Steel Ltd[14], essar raised an issue that the CIRP application should not be entertained by the AA, as there was an ongoing discussion regarding the restructuring with its lenders. The NCLT rejected the contention and noted that that the CIRP does not require the ongoing discussion to be withdrawn as it could later form the basis of the resolution plan under the Code. Therefore the code seems wide enough to include within its boundary, the possibility of negotiating a resolution plan as a pre pack. It is worth considering "project sashakt" , which was an initiative introduced by the central government. The project suggests for an approach of bringing the financial institutions and banks together which are dealing with the stressed assets , by way of an inter creditor agreement. The resolution approach to be adopted in respect of the asset depends on the size of the stressed assets, enabling a better price discovery and a comparatively quicker turnaround of assets. If the resolution cannot be completed in 180 days, the stressed assets would be subjected to the CIRP process under the Code. A pre pack in some ways is similar with this scheme, as the recommendation of the sub Committee also points out that if the pre pack fails then it would be subjected to the CIRP. Therefore it can be said that the terms of a pre pack can be promptly implemented as a resolution plan under the Code and hence it could work along the lines of the basic structure of CIRP.

CONCLUSION

There are few challenges in way of pre pack implementation in India , however the same can be worked out with a proper legislative arrangement. The sub-committee in its report has negated the scope of a complete legislation on the subject due to many reasons such as limited human foresight, ambiguities of the language and higher cost associated with the entire birth cycle of law.[15] It has to

[13] Bankruptcy Law Reform Committee, The Interim Report of the Bankruptcy Law Reform Committee, Ministry of Finance 79 (Feb. 2015), https://www.finmin.nic.in/sites/default/files/Interim_Report_BLRC_0.pdf
[14] Standard Chartered Bank v Essar Steel Ltd,IB No. 39/7/NCLT/AHM/2017
[15] Supra Note 5 at 3

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be noted that excessive regulation might lead to a mini CIRP before an actual one, therefore a balance has be maintained. In view if the same the sub-committee has advised for a skeletal provision that would enable pre pack and the code may be amended by ordinance. Currently the world is under the grip of the coronavirus pandemic and there is a possibility in the rise of corporate and individual insolvencies. The IMF and World Bank has come up with key challenges and the three phase implementation of the responses for the same. In the first phase the , copious interim measures has to be taken to halt insolvency and debt enforcement activities, in the second phase special out of court workouts are suggested to flatten the curve of huge wave of insolvency and the third phase calls out for a regular debt resolution tools. In view of addressing it India has also made some changes like the suspension of the process, this however took the effective option for the resolution of debt in Covid. At this time CIRP may not yield the desired outcome for the want of resolution applicants. Pre pack would be an effective tool to fill the existing loopholes during the pandemic period and even post this period.