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Pre-Pack Insolvency Resolution Process

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Why in News

Recently, a **sub-committee of the Insolvency Law Committee (ILC)** has recommended a **pre-pack framework** within the basic structure of the **Insolvency and Bankruptcy Code (IBC), 2016**.

The Government had constituted a sub-committee of Insolvency Law Committee (ILC) in June, 2020 under the **chairmanship of Dr. M. S. Sahoo**, Chairperson, Insolvency and Bankruptcy Board of India (IBBI) to make recommendation on **Pre-Pack Insolvency Resolution Process (PPIRP)**.

Key Points

- **Pre-Packs:**

- A pre-pack is an **agreement for the resolution of the debt of a distressed company** through an agreement **between secured creditors and investors instead of a public bidding process**.

This system of insolvency proceedings has become an increasingly **popular mechanism for insolvency resolution in the UK and Europe** over the past decade.

- In India's case, such a system would likely require that financial creditors agree on terms with potential investors and seek approval of the resolution plan from the **National Company Law Tribunal (NCLT)**.

- **Need for Pre-Packs:**

Slow progress in the resolution of distressed companies has been one of the key issues raised by creditors regarding the **Corporate Insolvency Resolution Process (CIRP)** under the IBC.

- CIRP is the process of resolving the corporate insolvency of a corporate debtor in accordance with the provisions of the Code.
- Under the IBC, stakeholders are required to complete the CIRP within 330 days of the initiation of insolvency proceedings.

- **Key Features of Pre-Packs:**

- Pre-Pack usually **requires services of an insolvency practitioner** to assist the stakeholders in the conduct of the process.

The extent of authority of the practitioner varies across jurisdictions.

- **Pre-pack envisages a consensual process** - prior understanding among or approval by stakeholders about the course of action to address stress of a **Corporate Debtor (CD)**, before invoking the formal part of the process.
- **No requirement of Court Approval:** It does not always require approval of a court. Wherever it requires approval, the courts often get guided by commercial wisdom of the parties.

Outcome of the pre-pack process, where approved by the court, is binding on all stakeholders.

- **Advantages of Pre-pack Offer:**

- **Quick Resolution:** Pre-pack, which enables a faster resolution, preserves and maximises value (of a company in a stressful state) and increases the possibility of resolution.
- **Minimises Disruptions to the Business:** Since the CD continues with the existing management during pre-pack, it avoids the cost of disruption of business as it does not shift management to Interim Resolution Professional (i.e. unlike that in the CIRP process) and continues to retain employees, suppliers, customers, and investors.
- **Group Resolution:** Given that resolution of a group of companies can be value-adding as compared to a separate insolvency proceeding for each company in distress, many jurisdictions are contemplating to make available an enabling framework for the same.

In the absence of any mechanism to effectively deal with insolvency of a group of companies in most jurisdictions, pre-packs have proved to be very helpful.

- **Lighter on Courts:** The courts usually have limited infrastructural capacity and can perform its obligations within its limits.
 - A pre-pack has the potential to reduce litigation, due to its informal and consensual nature. It does not require involvement of the court during the informal part of the process and requires a minimum role of courts during formal process.
 - It is necessary to have a functional out of court restructuring process, so that the vast majority of cases are restructured out of bankruptcy, with the NCLT acting as a court of last resort if no agreement is possible.

- **Drawbacks of Pre-Packs:**
 - **Lack Transparency:**
 - The key drawback of a pre-packaged insolvency resolution is the **reduced transparency compared to the CIRP** as financial creditors would reach an agreement with a potential investor privately and not through an open bidding process.
 - This could lead to stakeholders such as **operational creditors raising issues of fair treatment** when financial creditors reach agreements to reduce the liabilities of the distressed company.
 - **Insufficient Marketing:** The research shows that where no marketing is carried out pre-packs return less money to creditors.
 - **No consideration is given to the future viability of the new company:** The **insolvency practitioner has no legal requirement** to look at the future viability of the new business emerging from a pre-pack sale.
His/her only legal responsibility is to the creditors of the old business.

Way Forward

- Under the present regime of the IBC, insolvency professionals are still evolving the necessary expertise required over time. Like the law under the UK regime has evolved over time rather than simply promulgated, application of pre-pack insolvency in India will require a much higher degree of expertise of insolvency professionals, as under such resolution methods, they have a much higher degree of control.
- However, with the increase in the trend of out of court settlements, pre-pack insolvency could very well be the next alternative to regular CIRP proceedings.

Source: PIB