Pre-Packaged Insolvency Resolution Process for MSMEs

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The Government introduced a Pre-Packaged insolvency process through an Ordinance dated April 4, 2021[1]. The Ordinance inserts Chapter IIIA in the Insolvency and Bankruptcy Code, 2016 (“IBC”) to provide a “pre-packaged insolvency resolution process for corporate persons classified as micro, small and medium enterprises (“MSMEs”).”[2] The Preamble asserts the necessity and immediacy of such an action due to the unique economic challenges that have been created by COVID-19. In the following paper, we attempt to analyze whether the changes so brought about by the Ordinance will result in a quicker resolution of distressed assets of MSMEs.

The introduction of the Pre-Packaged insolvency resolution process does not change the existing corporate insolvency resolution process but instead offers an alternative route that can be undertaken by the corporate debtor to provide a faster and more debtor-friendly solution. The newly introduced model allows for a solution wherein the management and the promoters of the corporate debtor are allowed a second chance to run the company. Instead of the resolution professional taking over the board and managing the affairs of the corporate debtor, the extant management of the corporate debtor retains control over its affairs throughout the resolution process. The new model also provides for expedited timelines wherein the entire pre-packaged insolvency resolution process shall be completed within 120 days of the Adjudicating Authority admitting the application filed by the corporate debtor. However, the Ordinance only introduced this alternate process for MSMEs. MSMEs represent a range of enterprises that are involved in manufacturing different goods and services but are limited by maximum profit and turnover thresholds. By introducing the Pre-Packaged route only for MSMEs, a fair assessment can be made with respect to how the Pre-Packaged route would impact all other corporate structures.

1. Eligibility for Promoters to Submit Resolution Plans

Section 29A of the IBC prescribes certain conditions for eligibility of resolution applicants. While applying for Pre-Packaged insolvency, a corporate debtor is required to satisfy the conditions under Section 29A of the IBC. However, Section 240A of the IBC prescribes an exception for MSMEs wherein they are exempted from the requirements of clauses (c) and (h) of Section 29A. Section 29A(c) prohibits a person from submitting a resolution plan who has an account declared as a Non-Performing Asset (“NPA”) by the RBI for 1 year preceding the submission of the plan or is a promoter of, or in the management or control of, a corporate debtor whose account has been classified as an NPA for 1 year before submission of the resolution plan. Further, Section 29A(h) prohibits a person
from submitting a plan if they have executed an enforceable guarantee in favor of a creditor of a corporate debtor against which the application for insolvency resolution made by such creditor has been admitted under the IBC. The regulatory leniency was provided for MSMEs keeping in mind their business size, the insolvency costs and chances of their revival through the resolution process. Therefore, promoters of MSMEs can submit resolution plans under the CIRP process if they satisfy the eligibility criteria prescribed under Section 29A of the IBC, except the conditions under clauses (c) and (h) of the IBC.

The Ordinance now extends the benefit of these exemptions to MSMEs applying under the Pre-Packaged insolvency resolution process as well. This is in stark contrast to the stance taken by the majority of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process[3] wherein it was recommended that the exemption under Section 29A to promoters with NPAs should not be provided. The majority’s rationale was that the purpose of Section 29A would be defeated if the promoters were provided such an exemption. Section 29A is enacted to prevent the promoters and the management from taking advantage of their own wrongs. It is a means to prevent back-door entry of promoters who caused the distress to the corporate debtor in the first place. Therefore, allowing promoters with accounts classified as NPAs to submit resolution plans would defeat the purpose of revival of the corporate debtor.

However, the Ordinance still went ahead and provided this exemption to MSMEs applying for Pre-Packaged resolution process, thereby allowing promoters with NPAs to also participate in the resolution process. This, in the authors’ view, is a step forward in realizing the objective of introducing Pre-Packaged insolvency. The idea is to allow the corporate debtors to retain control of the management and to ensure its revival, without having to undergo the lengthy insolvency process under the IBC. By allowing the promoters to remain in control of the resolution process by adopting the Pre-Packaged route, the Ordinance prevents a huge drain in the already limited resources of the corporate debtor, therefore incentivizing the promoters to act in the best interest of the debtor. Considering that most MSME defaults do not meet the current threshold prescribed under the Code, and most resolution applicants are not interested in revival of distressed MSMEs, allowing the promoters of the MSMEs to submit resolution plans would maximize the survival rate of the MSMEs. The MSMEs can submit resolution plans either individually or jointly, and more often than not, it will be the promoters of the corporate debtor who will submit a plan with the debtor. By reducing the eligibility criteria for the promoters, the Ordinance prevents MSMEs from succumbing to the draconian effects of COVID-19, allowing MSMEs to continue contributing to the GDP of the economy. Therefore, exempting promoters of MSMEs from the ineligibility under Section 29A(c) of the IBC is a practical step forward in realizing the aim of the Ordinance. It will ensure that the theoretical underpinnings of the IBC that mainly apply to larger corporates, do not hinder the quicker resolution of distressed assets of MSMEs.

2. Approval of the base resolution plan by the Committee of Creditors ("COC")

The Ordinance prescribes that every corporate debtor shall submit a base resolution plan within 2
days of the application being admitted by the Adjudicating Authority, and the plan so submitted shall conform to the requirements set out under sub-section 2 of Section 30 of the IBC. The resolution professional shall then present the plan to the COC for its review, to determine the viability and feasibility of the plan. The Ordinance contemplates that in the event the plan does not impair any claims of the operational creditors, the COC “may” approve the base resolution plan. However, if the COC disapproves of the plan, then fresh bids from eligible resolution applicants shall be invited to compete with the base resolution plan, thereby initiating the same resolution process envisaged under the IBC except under expedited timelines.

By conferring the COC with the discretionary power to reject a resolution plan based on viability and feasibility, the Ordinance defeats the purpose of the Pre-Packaged resolution process. The debtor-in-possession model envisaged by the Ordinance loses its meaning when the power still vests with the creditors in rejecting the base plan submitted by the corporate debtor although it satisfies all the criteria laid down under Section 30(2) of the IBC. Instead, by prescribing a list of criteria, which if complied with, requires the COC to approve the base resolution plan, would make the Pre-Packaged route a more lucrative and feasible option for corporate debtors.

The commercial wisdom of the CoC has been recognized in several judgments by the Supreme Court and that the Adjudicating Authority should not interfere with the same. The proposed Pre-Packaged route does not diminish or undermine the importance and necessity of the standard CIRP process and instead is an alternative that can be pursued by the debtor. All creditors and the debtor are allowed to pursue an insolvency proceeding under Sections 7, 8 and 9 of the IBC, irrespective of when the Pre-Packaged route is undertaken. Further, the preamble of the Ordinance also states that the primary purpose for the introduction of the pre-packs is to ensure “quicker, cost-effective and value-maximizing outcomes for all the stakeholders, in a manner which is least disruptive to the continuity of their businesses and which preserves jobs.” The intention behind the inclusion of such a mechanism was to create a resolution process that is faster and more efficient than the existing resolution process while ensuring that the existing process is not undermined. Thus, a mechanism should be introduced wherein a base resolution plan which meets all the prescribed criteria should be accepted by the COC, and not left to their further discretion.

3. Conclusion

The introduction of the Pre-Packaged route is a step further in strengthening the Indian insolvency resolution framework. By creating an alternative mechanism that is not as time-consuming or costly, it serves to promote the objectives of the IBC in achieving a quicker and smoother resolution of distressed assets. While it is only limited to MSMEs at the moment, in the event the IBBI plans to roll out Pre-Packaged insolvency for other corporates as well, it should be kept in mind that the success/failure of the same with MSMEs should be not treated as an indicator of how the same will play out with all corporates. MSMEs serve as a distinct group of enterprises and have provisions such as Section 240A protecting them. Further, the current deliberations on the introduction of a Special Insolvency Resolution Process (SIRP) indicate that the legislature intends to create a very
tailored approach to MSMEs due to the special nature of the industry and its importance to the Indian economy.

Reference

