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## Pre-Pack: The Future of IBC

### Introduction

Insolvency and Bankruptcy Code, 2016 (IBC) is regarded as one of the major structural reform in the history of Indian Insolvency & Bankruptcy Regime. The Code aims to provide a time-bound resolution and value maximisation of assets of the Corporate Debtor. Another objective of the Code is to protect and promote the financial and other assistance provided by the creditors, which includes both Operational and Financial Creditors. The Corporate Insolvency Resolution Process (CIRP) can be initiated upon satisfying the existence of default which is due and payable by the creditors to the Adjudicating Authority (NCLT). Post which the business of the defaulting company is taken over by Interim Resolution Professional (IRP) or Resolution Professional (RP), as the case may be. The Resolution Professional directs the operations of the defaulting company upon the directions given by the duly constituted Committee of Creditors (COC) as per the resolution plan submitted by the successful resolution applicant, receiving 66% of the voting share of the Financial Creditors.

While IBC only provides for insolvency resolution after the creditors make the application under Section 7 or 9 or by the Corporate Debtor himself under Section 10 of the Code. It limits itself in providing a framework where there is a resolution of insolvency before the occurrence of a default or where the debtors and the creditors engage themselves with the resolution of the distressed assets at an earlier stage before any default occurs or before any application is made to NCLT. Hence, the Code doesn't recognise the concept of out of court resolution of the Corporate Debtor.

Pre-Pack is an emerging concept which can reduce the above-said problem. This concept is prevalent in major economies like the USA & UK and is successfully playing its role there. In this, the advantages of private restructuring (outside Court) is coupled with the essentials of the formal procedures. It means that the resolution for insolvency of the company is pre-determined and is agreed before the Corporate Debtor formally goes into the process of insolvency or liquidation. The pre-pack allows *"a troubled company and its creditors conclude an agreement in advance of statutory administration procedures"* which *"allows statutory procedures to be implemented at maximum speed."*<sup>[1]</sup>

The concept provides for the resolution and reorganisation plan to be submitted along with the application for insolvency or bankruptcy. The restitution or the restoration plan is circulated to all the creditors before the filing of the insolvency application, which is negotiated by the parties and

finally, a settlement is reached by way of voting. This is called pre-packed insolvency resolution process. There are some cases wherein all the essentials take place before, but voting is held after the bankruptcy application. This method is called the pre-arranged resolution process. Both the process as mentioned above includes the formation of a resolution plan which requires prior approval of at least two-third creditor and later approval from the Court (in Indian scenario: NCLT). Lastly, there is the concept of pre-arranged sales wherein the debtor sells all or the substantial portion of its assets before the formation of the reorganisation plan. This method takes lesser time than the above two methods and also than the insolvency and bankruptcy cases.

## Advantages

There are numerous advantages of pre-pack, some of which are as follows:

1. **Retaining business in the hands of existing management:** a crucial role is played by the existing management of the company as the negotiations and bargaining take place before the commencement of insolvency proceedings. It can incentivise the existing management and promoters of the company to initiate the pre-pack proceedings before the occurrence of a default or at an earlier stage of default. It can help the business to retain its current management and would be agreed by the creditors as they generally agree to hold on to the existing management.
2. **Speedy & Cheaper Resolution:** pre-packs are usually a cheaper and less time-consuming method than the proper insolvency and bankruptcy proceedings as all the essentials of the CIRP are done beforehand like the negotiation and acceptance of resolution plan and also voting on the same. It reduces the legal cost involved in the formal procedure and also the insolvency professional cost. Further, there is no or minimal intervention by the courts (in the Indian scenario, if implemented then, NCLT).
3. **Certainty:** creditors are certain about repayment of the amount given as loans to the debtor which is not in the case where CIRP is initiated, and the share to each creditor depends upon the resolution plan submitted by the successful resolution applicant. Confidentiality: pre-pack transactions are so confidential that it doesn't harm or reduces the value of the business of the Corporate Debtor, and thus, it remains a going-concern.
4. **The business remains a going-concern:** under this process, the business of the corporate debtor remains as a going under the control of the existing management, which is not the case when the resolution takes place after the filing of the application as there exists a likelihood of the company been sent for the liquidation if there is no successful resolution plan for restructuring or reorganisation of the business of the corporate debtor. Further, no moratorium is imposed on the corporate debtor as in the case of an application under section 7,9 or 10.
5. **The ultimate authority to proceed remains with the Court:** For a pre-packed plan (be it for pre-pack insolvency resolution or pre-arranged sales) to be binding, it requires the approval of the appropriate authority (in Indian scenario, if implemented then, NCLT). Hence, only that resolution plan will get approval and will be binding which satisfies the essentials of the resolution plan given under the law. In the Indian scenario, if implemented, only those plans will get approval from the NCLT which satisfies the requirements given under Section 30 of the Code.
6. **Reduction of the burden on the courts (NCLT):** if implemented in India, the pre-pack schemes will reduce the already burdened NCLT's as already there will exist a resolution

plan.

## Disadvantages

Despite the pros of pre-packs, there are various cons attached to it, which are as follows:

1. **A loss to the unsecured creditors:** due to the confidentiality of the process, the process receives approval only from the secured creditors and duly ignores the interest of the unsecured creditors. Due to the lack of transparency, the unsecured creditors become aware of the transaction once it has been executed. It means that the value which initially belongs to unsecured creditors will not be assigned or captured by the other stakeholders. This fear increases in the cases where the sale is executed to the parties related to the corporate debtor.
2. **Lack of good corporate governance:** if the connected parties execute the sales then there might arise the issue of bad corporate governance, and a bogus restructuring or resolution plan as the existing management will retain the business of the company without bearing the liability to repay the debts.
3. **Increase in undervalued or preferential transactions:** this can also go against the fundamental objective of any insolvency law, which is to maximise the assets of the corporate debtor. There may arise some situations wherein the assets have been sold to the third party or related party at an undervalued price or while executing preferential transactions.
4. **Circumvention of Insolvency laws:** there can also arise a situation wherein the directors or the promoters to regain their lost control over the company might go in a roundabout manner through pre-pack. And since, it is a debtor initiated process before the initiation of the CIRP, the applicability of Section 29A of the Code will not be made into effect.
5. **No advantage of the moratorium:** under the pre-pack scheme there will be no shield of the moratorium, unlike the case where an application is filed under section 7,9 or 10. It will make the company vulnerable as the creditors can enforce their rights and remedies anytime while the corporate debtor is negotiating a pre-pack resolution.

## Conclusion

While every reform brings a profusion of hurdles and challenges, so does the concept of pre-pack will. Considering the present scenario, the lack of existing laws on this concept will act as an obstacle in achieving the result of the pre-pack resolution. Thus, there will arise a need for successful formulation and implementation of a set of laws on this subject matter.

Once implemented, it will be testing the expertise of the insolvency practitioners to work more precisely, conscientiously and thoroughly. Though the concept has a lot of disadvantages, as mentioned above, and it will surely surpass all of it once implemented after taking into consideration all its disadvantages. Applicability of Section 29A of the IBC in the matters of pre-pack resolution will have a long way to travel for determining its success in India. Also, for a pre-pack resolution to be successful there needs to be extensive marketing of the assets of the corporate debtor so that the interested or parties concerned can take over the business or assets of the corporate debtor.

Further, mandatory approval from the NCLT of the resolution plan will reduce the fear of the stakeholders regarding their rights of recovery as the same will depict the binding nature of the resolution plan. It would also ensure that there is no bogus resolution plan to circumvent the

existing laws and provide additional benefits to the current management. It can also reduce the problem of preferential or undervalued transactions as given under Section 43 of the Code. The concept of pre-pack will promote the objective of the Code, which is to maximise the value of the assets of the corporate debtor and safeguarding the interest of all the stakeholders (inclusive of creditors). Lastly, the operational creditors can also feel secure in this process as they'll be particular about the payment of the goods and services provided.

Hence, it can be expected from the legislature that they'll strike a balance between the existing laws and the new system. Once implemented, it will pave the way for smoother implementation of resolution plans and will keep the company as a going concern. It also ensures that the creditor receives the payment due for the funds or goods or services given by them. Thus, it can be concluded that the new system would ensure and produce a better result and would have more advantages over disadvantages.

### **Reference**

[1] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles* (2nd edition, Cambridge University Press 2009) 453.

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