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Pre-Packaged Insolvency for Micro, Small and Medium Enterprises

Introduction

The Ministry of Law and Justice on 4th April 2021 introduced the Insolvency and Bankruptcy Code (Amendment) Ordinance 2021[1], to amend the Insolvency and Bankruptcy Code, 2016. Micro, small and medium enterprises (MSMEs) are critical for India's economy as they contribute significantly to its gross domestic product and provide employment to a sizeable population. Owing to the Covid-19 pandemic, the business operations of MSMEs have been adversely impacted, exposing many of them to financial distress. With the Parliament not in session, the President considered it necessary to address the specific requirements of MSMEs relating to the resolution of their insolvency. Due to the unique nature of their businesses and simpler corporate structures an alternative insolvency resolution termed as pre-packaged insolvency resolution process (PPIRP) has been enacted for corporate debtors classified as micro, small and medium enterprises under sub-section (1) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006. It seeks to ensure simpler, cheaper, time-efficient, 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 provisions related to pre-packaged insolvency resolution process are provided under Chapter IIIA in Part II of the Code.

PPIRP: Concept & Procedure

A PPIRP is a strategy wherein the resolution plan is an outcome of mutual consensus between the debtor and creditors. Under this mechanism, before initiating the insolvency process and appointing an Insolvency professional, the debtor drafts a base resolution plan and submits it to the financial creditors. If the financial creditors, not being corporate debtor's related parties and representing 66% of the voting shares, approve for initiating PPIRP, the corporate debtor can go ahead with filing of an application to the Adjudicating Authority for initiating the same.

The Ministry of Corporate Affairs has specified 10 lakh rupees as the minimum default threshold for which PPIRP can be initiated for MSMEs. An application for initiating PPIRP may be made in respect of a MSME, who commits a default, subject to the following conditions[2]:

- a. it has not undergone PPIRP or completed corporate insolvency resolution process (CIRP), as the case may be, during the period of 3 years preceding the initiation date;
- b. it is not undergoing a CIRP;
- c. no order requiring it to be liquidated is passed under section 33 of Chapter III;
- d. it is eligible to submit a resolution plan under section 29A of the code;
- e. the financial creditors of the corporate debtor, not being its related parties, representing such number and such manner as may be specified, have proposed the name of the insolvency professional to be appointed as resolution professional for conducting the PPIRP of the corporate debtor, and the financial creditors of the corporate debtor, not being its related parties, representing not less than 66% in value of the financial debt due to such creditors, have approved such proposal in such form as may be specified.
- f. the majority of the directors or partners of the corporate debtor, as the case may be, have made a declaration, in such form as may be specified, stating, inter alia,-
 - i. that the corporate debtor shall file an application for initiating PPIRP within a definite time period not exceeding 90 days;
 - ii. that the PPIRP is not being initiated to defraud any person; and
 - iii. the name of the insolvency professional proposed and approved to be appointed as resolution professional under clause (e);
- g. the members of the corporate debtor have passed a special resolution, or at least three-fourth of the total number of partners, as the case may be, of the corporate debtor have passed a resolution, approving the filing of an application for initiating PPIRP.

Where a corporate debtor meets the above requirements, a corporate applicant thereof may file an application with the Adjudicating Authority for initiating pre-packaged insolvency resolution process. The Adjudicating Authority shall, within a period of 14 days of the receipt of the application, by an order[3],--

- a. admit the application, if it is complete; or
- b. Reject the application, if it is incomplete: Provided that the Adjudicating Authority shall, before rejecting an application, give notice to the applicant to rectify the defect in the application within 7 days from the date of receipt of such notice from the Adjudicating Authority.

The pre-packaged insolvency resolution process shall commence from the date of admission of the application by the Adjudicating Authority. The Adjudicating Authority shall, on the pre-packaged insolvency commencement date, along with the order of admission[4]—

- a. Declare a moratorium;
- b. Appoint a resolution professional (i) as named in the application, if no disciplinary proceeding is pending against him; or (ii) based on the recommendation made by the Board, if any disciplinary proceeding is pending against the insolvency professional named in the application;
- c. Cause a public announcement of the initiation of the PPIRP to be made by the resolution professional, in such form and manner as may be specified, immediately after his appointment.

The corporate debtor shall submit the base resolution plan, to the resolution professional within 2 days of the pre-packaged insolvency commencement date, and the resolution professional shall present it to the committee of creditors (CoC). The resolution professional shall submit the resolution plan, as approved by the CoC, to the Adjudicating Authority within a period of 90 days from the pre-packaged insolvency commencement date. Where no resolution plan is approved by the committee of creditors within the time period referred, the resolution professional shall, on the day after the expiry of such time period, file an application with the Adjudicating Authority for termination of the PPIRP[5].

Framework

1. Debtor in possession: in an ordinary CIRP, the control of the corporate debtor is taken from the board of directors or partners, as the case may be, and shifted to the creditors through appointing a resolution professional. This is done under the belief that the Company's operations have been mismanaged under the existing owners leading it to financial problems and therefore opportunity for running and resolving the same must be given to the creditors who have extended loans to the Company. However, in such management style, the Resolution Professional due to lack of experience in that particular industry cannot take prompt decisions or even if able to, would restrain himself from doing so unless consent is taken from CoC so as to avoid any adverse consequences or allegations upon him. This generally makes it difficult to undertake new business operations during a CIRP. MSME businesses are generally managed by the promoters themselves and if the management is completely ousted, the object of revival may not be achieved. Therefore, as a result of the pandemic's economic impact, the Government has devised PPIRP as a quicker insolvency law that better equips small businesses to restructure or seek debt relief through simplified liquidation.

Moreover, the debtor-in-possession changes the mindset of the corporate debtors that they need to exhaust the entire working capital and funding before going for insolvency process. The sooner they initiate it, without feeling insolvency process as an embarrassment or punishment, the higher are the chances of keeping the corporate debtor a going concern and fetch a good resolution plan.

Nevertheless, where the committee of creditors, at any time during the pre-packaged insolvency resolution process period, by a vote of not less than 66% of the voting shares, resolves to vest the management of the corporate debtor with the resolution professional, the resolution professional shall make an application for this purpose to the Adjudicating Authority[6]. On such an application, if the Adjudicating Authority is of the opinion that during the PPIRP —

- a. The affairs of the corporate debtor have been conducted in a fraudulent manner; or
- b. There has been gross mismanagement of the affairs of the corporate debtor,

It shall pass an order vesting the management of the corporate debtor with the resolution professional[7].

2. Commercial wisdom of CoC: the NCLT in the matter of *State Bank of India v. Ushdev International Limited*[8] decided that the NCLT cannot interfere with the resolution plan passed with the commercial wisdom of CoC, except under limited scope under sections 30 and 31 of the code. PPIRP does not diminish or undermine the commercial wisdom of CoC. The approval of 66% of the financial creditors is required both to initiate the PPIRP and to successfully complete it with acceptance of the resolution plan. Akin to CIRP, The corporate debtor, during the PPRIP, shall take actions specified under section 28 of chapter II only after the due approval of the CoC.

The base resolution plan submitted by the corporate debtor to the resolution professional shall within 2 days of the pre-packaged insolvency commencement date be presented to the CoC[9]. The CoC may provide the corporate debtor an opportunity to revise the base resolution plan[10]. The CoC may approve the base resolution plan for submission to the Adjudicating Authority if it does not impair any claims owed by the corporate debtor to the operational creditors[11]. Where —

- a. The committee of creditors does not approve the base resolution plan; or
- b. The base resolution plan impairs any claims owed by the corporate debtor to the operational creditors;

The resolution professional shall invite prospective resolution applicants to submit a resolution plan or plans, to compete with the base resolution plan[12]. By incorporating this Swiss challenge mechanism, the PPIRP has maintained competition wherein the corporate debtor's base resolution plan would have to compete with third party resolution plans. The resolution professional shall present to the CoC, for its evaluation, resolution plans which conform to the requirements referred to in sub-section (2) of section 30[13]. The CoC shall evaluate the resolution plans presented by the resolution professional and select a resolution plan for approval from amongst them[14]. The CoC may or may not approve such resolution plan selected for approval to be submitted to the Adjudicating Authority[15].

While considering the feasibility and viability of a resolution plan, where the resolution plan submitted by the corporate debtor provides for impairment of any claims owed by the corporate debtor, the CoC may require the promoters of the corporate debtor to dilute their shareholding or voting or control rights in the corporate debtor. Where the resolution plan does not provide for such dilution, the CoC shall, prior to the approval record reasons[16]. Such option for dilution with the CoC acts as a deterrent against unreasonable terms in the resolution plan.

The Adjudicating Authority can reject the resolution plan where it is satisfied that the resolution plan does not conform to the requirements referred to in sub-section (2) of section 30 of the code.

3. Role of Resolution Professional (RP): RP is the one who shall conduct the Insolvency process however, role of the RP under the PPIRP is limited and more of supervisory since he doesn't manage the CD like in a CIRP.

Section 54B provides the duties of RP before initiation of the PPRIP:

- a. Prepare a report, confirming whether the corporate debtor and the base resolution plan conforms to the eligibility requirements referred to in section 54A;
- b. File such reports and other documents, with the Board, as may be specified; and
- c. Perform such other duties as may be specified.

Section 54F(2) provides the duties of RP during the PPRIP:

- a. Confirm the list of claims submitted by the corporate debtor;
- b. Inform creditors regarding their claims as confirmed under clause (a);
- c. Maintain an updated list of claims;
- d. Monitor management of the affairs of the corporate debtor;
- e. Inform the committee of creditors in the event of breach of any of the obligations of the Board

- of Directors or partners, as the case may be, of the corporate debtor, under the provisions of this Chapter and the rules and regulations made thereunder;
- f. Constitute the committee of creditors and convene and attend all its meetings;
 - g. Prepare the information memorandum;
 - h. File applications for avoidance of transactions under Chapter III or fraudulent or wrongful trading under Chapter VI, if any; and
 - i. Such other duties as may be specified.

The RP shall, in addition, exercise the powers provided under section 54F(3). The personnel, promoters and financial institutions maintaining accounts of the corporate debtor shall extend all assistance, cooperation and information to the resolution professional as may be required by him to perform his duties and exercise his powers.

PPIRP vs. CIRP

Following are some of the major differences between a PPIRP and a CIRP:

1. **Power to initiate:** Unlike a CIRP, that can be initiated by the Financial/ Operational creditors or the corporate debtor, a PPIRP can only be initiated by the corporate debtor with approval of the Financial Creditors (66%). However, The CoC, at any time after the pre-packaged insolvency commencement date but before the approval of resolution plan, by a vote of 66% of the voting shares, may resolve to initiate a CIRP in respect of the corporate debtor, if such corporate debtor is eligible for CIRP under Chapter II.
2. **Management of affairs:** as already discussed, in PPIRP the management of the affairs of the corporate debtor shall not transfer to the RP, as in the case of CIRP and shall continue to vest in the Board of Directors or the partners, as the case may be.
3. **Minimum threshold:** The ministry of corporate affairs has specified 10 lakh rupees as the minimum default threshold for which PPIRP can be initiated for MSMEs. The same is 1 crore to initiate CIRP.
4. **Time period:** time-limit for completion of PPIRP is 120 days whereas the time for completing CIRP stands at 330 days.
5. **Replacement of Resolution Professional:** The PPIRP framework does not provide for replacement of RP, however, the CoC can replace the RP at anytime during the CIRP, u/s 27 of chapter II.
6. **Withdrawal:** An application for initiation of CIRP can be withdrawn under Section 12A of the code. However, in case of PPIRP clarity on whether the insolvency process can be withdrawn or not is missing as no amendment has been made in Section 12A.

Termination of PPIRP

1. Where:

- a. Neither the base resolution plan is approved by the CoC u/s 54K(4)
- b. Nor any resolution plan selected for approval is approved by the CoC u/s 54K(12)[17]

The RP shall, after the expiry of 90 days from the pre-packaged insolvency commencement date file an application with the Adjudicating Authority for termination of the pre-packaged insolvency[18] and the Adjudicating Authority shall, within 30 days from the date of such application, by an order,

terminate the PPIRP[19].

2. Where the Adjudicating Authority has passed an order to vest the management of the corporate debtor with the RP and the resolution plan approved by the CoC, does not result in the change in the management or control of the corporate debtor to a person who was not a promoter or in the management or control of the corporate debtor, the Adjudicating Authority shall pass an order rejecting such resolution plan and terminating the PPIRP and passing a liquidation order in respect of the corporate debtor[20].

3. Where the Adjudicating Authority is satisfied that the resolution plan does not conform to the requirements as referred to in sub-section (2) of section 30, it may, within 30 days of the receipt of such resolution plan, by an order, reject the resolution plan and pass an order for termination of the pre-packaged insolvency[21].

4. Where the RP intimates the Adjudicating Authority of the decision of the CoC, approved by a vote of 66% of the voting shares, to initiate a CIRP in respect of the corporate debtor, the Adjudicating Authority shall, within 30 days of the date of such intimation, pass an order to terminate the PPIRP and initiate CIRP[22].

5. Where the RP, at any time after the pre-packaged insolvency commencement date, but before the approval of resolution plan, intimates the Adjudicating Authority of the decision of the CoC, approved by a vote of 66% of the voting shares, to terminate the PPIRP, the Adjudicating Authority shall pass an order within 30 days to terminate the PPIRP[23].

Conclusion

Pre-packaged Insolvency is expected to strengthen financial and operational position of MSMEs in wake of the Covid-19 pandemic. It must be borne in mind that when the CIRP was introduced under the IBC code, it took various amendments, judicial interpretations and clarifications to be properly evolved and used by the creditors. Similarly, it is only with time that the pros and cons of the PPIRP can be properly weighed, until then the MSMEs must cautiously make the decision of entering into it.

Reference

[1] 'Insolvency and Bankruptcy Code (Amendment) Ordinance 2021' (4th April, 2021) http://www.mca.gov.in/Ministry/pdf/IBCAmedOrdinanceBill_06042021.pdf

[2] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54A(2)

[3] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54C(4)

[4] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54E

[5] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54D(3)

[6] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54J(1)

[7] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54J(2)

[8] CP No. 1790/IBC/NCLT/MB/MAH/2017

[9] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(1)

[10] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(2)

[11] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(4)

[12] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(5)

[13] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(8)

[14] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K (9)

[15] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(12)

[16] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54K(14)

[17] *Supra* note 14

[18] *Supra* note 5

[19] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54N(1)

[20] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54L(3)

[21] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54L(3)

[22] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54-O(2)(a)

[23] Insolvency and Bankruptcy Code (Amendment) Ordinance 2021, Section 54N(2)

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