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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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CRITICAL ANALYSIS OF PRE-PACKAGED INSOLVENCY FOR MSMEs IN INDIA

AUTHORED BY - NEETI GOYAL¹

Introduction

Micro, Small, and Medium Enterprises (MSMEs) are the backbone of the Indian economy, contributing significantly to GDP and employment. However, the COVID-19 pandemic exposed the financial vulnerabilities of this sector, necessitating reforms to address insolvency challenges. One such reform is the introduction of the pre-packaged insolvency resolution process (PPIRP) under the Insolvency and Bankruptcy Code, 2016 (IBC), specifically for MSMEs. This article critically analyses the PPIRP framework, discusses relevant judicial precedents in India, compares it with global practices, and provides recommendations for improvement.

The Concept of Pre-Packaged Insolvency

Pre-packaged insolvency combines the benefits of informal workouts and formal insolvency proceedings. It involves a resolution plan negotiated between the debtor and creditors before initiating formal insolvency proceedings. Once the plan is finalized, it is presented to the adjudicating authority (National Company Law Tribunal, or NCLT) for approval. This mechanism aims to reduce delays, costs, and litigation, making it particularly suitable for MSMEs, which often lack the resources to endure prolonged insolvency processes.

Features of PPIRP for MSMEs in India

1. **Eligibility Criteria:** Only MSMEs, as defined under the Micro, Small, and Medium Enterprises Development Act, 2006, are eligible.
2. **Debtor-Initiated Process:** The process is debtor-driven, empowering MSME owners to retain control.
3. **Base Resolution Plan:** The corporate debtor submits a base resolution plan, which is shared with creditors.

¹ Assistant Professor, School of Law, UPES, Dehradun

4. **Swift Timelines:** The entire process must be completed within 120 days, with 90 days allotted for creditor approval and the remaining 30 days for NCLT confirmation.
5. **Moratorium:** A moratorium is imposed once the process begins, safeguarding the enterprise from external recovery actions.
6. **Simplified Procedure:** Reduced procedural requirements and minimal disruption to business operations.

Understanding Pre-Packaged Insolvency

Pre-packaged insolvency, often referred to as "pre-pack," is a hybrid mechanism that combines the advantages of informal restructuring with the legal sanctity and transparency of formal insolvency processes. It is designed to expedite the resolution of distressed businesses while minimizing costs and operational disruptions. Unlike traditional insolvency proceedings, where the resolution process starts after the declaration of insolvency, pre-packs involve the negotiation and finalization of a resolution plan before filing with the adjudicating authority.

In the Indian context, pre-packaged insolvency was introduced under the Insolvency and Bankruptcy Code (IBC), 2016, through the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021. This framework is specifically tailored for Micro, Small, and Medium Enterprises (MSMEs), recognizing their pivotal role in the economy and the unique challenges they face.

Key Features of Pre-Packaged Insolvency Laws in India

1. **Eligibility:**
 - Applicable exclusively to MSMEs, as defined under the Micro, Small, and Medium Enterprises Development Act, 2006.
 - The corporate debtor must not have undergone a pre-packaged insolvency process or a corporate insolvency resolution process (CIRP) in the preceding three years.
2. **Debtor-Initiated Process:**
 - Only the corporate debtor can initiate the pre-packaged insolvency process, providing promoters greater control over the proceedings.
3. **Base Resolution Plan:**
 - The corporate debtor prepares and submits a base resolution plan for creditors' consideration before filing for insolvency.

4. Approval and Timelines:

- Creditors holding at least 66% of voting rights must approve the resolution plan. The process must be completed within 120 days, with 90 days allocated for creditors' approval and 30 days for NCLT confirmation.

5. Moratorium:

- Upon commencement of the pre-pack process, a moratorium is imposed to shield the debtor from recovery actions by creditors.

6. Control and Continuity:

- The existing management typically retains control over the business, ensuring continuity of operations.

Insights from Committee Reports

- 1. Insolvency Law Committee (ILC) Report, 2020:** The ILC recommended the introduction of a pre-pack framework for MSMEs to ensure quick resolution without losing control of the business. The report emphasized that MSMEs often face unique challenges, such as limited access to credit and reliance on personal guarantees, which necessitate a simplified and expedited process.

- **Key Observations:**

- A pre-packaged process can prevent value erosion by minimizing delays.
- It aligns with the need for debtor-in-possession models, which balance creditor interests with business continuity.
- MSMEs should have the first right to propose a resolution plan to encourage their participation and ensure fair outcomes.

- 2. Bankruptcy Law Reforms Committee (BLRC):** Although the BLRC primarily focused on broader insolvency issues, its foundational principles underline the importance of speed, predictability, and creditor control in insolvency processes. These principles resonate with the objectives of PPIRP, particularly in ensuring timely resolution and reducing the burden on the NCLT.

- 3. Parliamentary Standing Committee on Finance (2021):** This committee highlighted the need for further simplification of the PPIRP framework, ensuring that it remains accessible and does not become overly procedural. It also stressed the importance of safeguarding against potential misuse by errant promoters.

4. **RBI Expert Committee on MSMEs (2019):** The committee underscored the necessity of tailored solutions for MSMEs, recommending mechanisms like PPIRP to address their specific insolvency challenges. It noted that a streamlined process could help MSMEs avoid liquidation and preserve employment opportunities.

Advantages of PPIRP

- **Speed and Efficiency:** By pre-negotiating the resolution plan, the process significantly reduces delays and administrative costs.
- **Debtor-Centric Approach:** MSME promoters retain control, preventing distress sales of viable enterprises.
- **Stakeholder Involvement:** Early negotiations foster trust among creditors, ensuring better acceptance of the resolution plan.
- **Preservation of Value:** Business continuity minimizes erosion of asset value, benefiting all stakeholders.

Challenges and Limitations

- **Limited Applicability:** Restricting PPIRP to MSMEs excludes larger firms that could benefit from a similar mechanism.
- **Potential for Misuse:** The debtor-centric model may lead to abuse, with promoters prioritizing personal interests over creditor recovery.
- **Capacity Constraints of NCLT:** The already overburdened NCLTs may struggle to meet the stipulated timelines.
- **Creditor Coordination:** Achieving consensus among diverse creditors, including financial institutions and operational creditors, remains a challenge.

Relevant Judgments on PPIRP in India

1. **Agarwal Structures Private Limited (2022):** The NCLT emphasized the importance of adhering to the stipulated timeline in PPIRP cases to ensure swift resolution.
2. **XYZ Manufacturing Co. (Hypothetical):** This judgment highlighted the role of creditors in scrutinizing the base resolution plan to prevent potential abuse by promoters.
3. **ABC MSME Case (Hypothetical):** The tribunal reiterated the importance of balancing debtor's interests with creditors' rights to prevent prejudicial outcomes.

Comparison with Global Practices

1. **United States (Chapter 11):** While Chapter 11 of the U.S. Bankruptcy Code is not specific to MSMEs, its debtor-in-possession model shares similarities with India's PPIRP. However, Chapter 11 offers greater flexibility and broader applicability.
2. **United Kingdom (Pre-Pack Administration):** The UK's pre-pack framework allows the sale of the debtor's business before formal insolvency proceedings, ensuring continuity. Unlike India, it lacks strict timelines, making it less predictable.
3. **Singapore's Simplified Insolvency Programme:** Targeted at micro and small businesses, this program emphasizes cost reduction and quick resolution, akin to India's PPIRP but with stronger regulatory oversight.

Suggestions for Improvement

1. **Widening Scope:** Expand the framework to include non-MSME entities with appropriate safeguards.
2. **Strengthening Creditor Protections:** Introduce mechanisms to prevent misuse by errant promoters, such as independent plan evaluation.
3. **Capacity Building:** Enhance NCLT's infrastructure and manpower to handle PPIRP cases efficiently.
4. **Awareness Campaigns:** Educate MSME stakeholders about the benefits and procedures of PPIRP to encourage wider adoption.
5. **Learning from Global Practices:** Adopt best practices from jurisdictions like the U.S. and Singapore to refine India's framework.

Conclusion

The pre-packaged insolvency resolution process for MSMEs is a promising initiative aimed at addressing the unique challenges faced by this critical sector. While it offers speed, cost efficiency, and continuity, its success hinges on robust implementation and addressing existing gaps. By incorporating global best practices, enhancing creditor safeguards, and expanding its applicability, India can ensure that PPIRP becomes a cornerstone of its insolvency resolution ecosystem, fostering resilience and growth for MSMEs.