Report of the Sub-Committee of the Insolvency Law Committee on
Pre-packaged Insolvency Resolution Process
Ministry of Corporate Affairs
Government of India

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Pre-packaged Insolvency Resolution Process

October, 2020
Sub-Committee of Insolvency Law Committee

To
The Secretary to the Government of India
Ministry of Corporate Affairs
'A' Wing, Shastri Bhawan
New Delhi - 110001

Dear Sir,

The sub-committee of the Insolvency Law Committee to recommend a regulatory framework for pre-pack insolvency resolution process, constituted vide office order No. 30/20/2020-Insolvency Section, dated 24th June, 2020, have the privilege and honour to present this Report to the Ministry of Corporate Affairs.

2. Taking note of the progress in insolvency reforms, maturity of the systems and practices relating to insolvency in the country, and learning from the experience of pre-packs in other jurisdictions, the sub-committee has designed a pre-pack framework within the basic structure of the Insolvency and Bankruptcy Code, 2016, for the Indian market.

3. We thank you for providing us this opportunity to put our thoughts together to design a vital framework for resolution of stress, which we believe is the next step in the evolution of insolvency regime in the country.

Yours sincerely,

Sd/-
(Dr. M. S. Sahoo)
Chairman

Sd/-
(Gyaneshwar Kumar Singh)
Member

Sd/-
(U. K. Sinha)
Member

Sd/-
(Saurav Sinha)
Member

Sd/-
(Sunil Mehta)
Member

Sd/-
(Bahram Vakil)
Member

Sd/-
(Akhil Gupta)
Member

31st October, 2020
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## Abbreviations

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<td>AA</td>
<td>Adjudicating Authority</td>
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<tr>
<td>BLRC</td>
<td>Bankruptcy Law Reforms Committee</td>
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<td>CD</td>
<td>Corporate Debtor</td>
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<td>CIRP</td>
<td>Corporate Insolvency Resolution Process</td>
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<td>CoC</td>
<td>Committee of Creditors</td>
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<td>COVID-19</td>
<td>Coronavirus Disease</td>
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<td>FC</td>
<td>Financial Creditor</td>
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<td>FV</td>
<td>Fair Value</td>
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<td>IBC / Code</td>
<td>The Insolvency and Bankruptcy Code, 2016</td>
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<td>IBBI</td>
<td>Insolvency and Bankruptcy Board of India</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>ICA</td>
<td>Inter Creditor Agreement</td>
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<td>ILC</td>
<td>Insolvency Law Committee</td>
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<td>IM</td>
<td>Information Memorandum</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IP</td>
<td>Insolvency Professional</td>
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<td>IRP</td>
<td>Interim Resolution Professional</td>
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<td>IRPC</td>
<td>Insolvency Resolution Process Cost</td>
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<td>IU</td>
<td>Information Utility</td>
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<td>LLP</td>
<td>Limited Liability Partnership</td>
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<td>MCA</td>
<td>Ministry of Corporate Affairs</td>
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<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
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<td>NBFCs</td>
<td>Non-Banking Financial Companies</td>
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<td>NCLAT</td>
<td>National Company Law Appellate Tribunal</td>
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<td>NCLT</td>
<td>National Company Law Tribunal</td>
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<td>NPA</td>
<td>Non-Performing Asset</td>
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<td>OC</td>
<td>Operational Creditor</td>
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<td>PCD</td>
<td>Pre-pack Commencement Date</td>
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<td>PPIRP</td>
<td>Pre-packaged Insolvency Resolution Process</td>
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<tr>
<td>RBI</td>
<td>Reserve Bank of India</td>
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<td>RA</td>
<td>Resolution Applicant</td>
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<td>RP</td>
<td>Resolution Professional</td>
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<td>RV</td>
<td>Resolution Value</td>
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<td>SoA</td>
<td>Scheme of Arrangement (under the Companies Act, 2013)</td>
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<td>SEBI</td>
<td>Securities and Exchange Board of India</td>
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<td>SIP</td>
<td>Statement of Insolvency Practice 16 (of UK)</td>
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<td>SIRP</td>
<td>Special Insolvency Resolution Process</td>
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<td>SMA</td>
<td>Special Mention Account</td>
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<tr>
<td>UNCITRAL</td>
<td>United Nations Commission on International Trade Law</td>
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Acknowledgements

I would like to record my deepest appreciation to all those who assisted the sub-committee in discharge of its task. I owe special thanks to Mr. Shardul S. Shroff, Executive Chairman, Shardul Amarchand Mangaldas & Co. and Member of the Insolvency Law Committee for providing inputs on design of pre-pack and raising some concerns.

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Thanks are due to Whole-time Members [Dr. Navrang Saini, Dr. (Ms.) Mukulita Vijayawargiya and Mr. Sudhakar Shukla] and Executive Directors [Mr. Ritesh Kavdia, Mr. K. R. Saji Kumar, and Dr. (Ms.) Anuradha Guru] of IBBI for placing on the table their perspectives on several complex issues for consideration of the sub-committee, for active participation in the meetings of the sub-committee and for practical suggestions and helpful guidance.

Mr. Methil Unnikrishnan, General Manager, Mr. Asit Behera, Assistant Manager, and Mr. Kahnav Mahajan, Research Associate at IBBI deserve a special appreciation for their relentless support, excellent research, and drafting assistance.

I am deeply indebted to each member of the sub-committee for the high-quality debate in the meetings and bringing different viewpoints, which make this report comprehensive and practical. Their openness to consider out of the box ideas and sincerity to arrive at a consensus are remarkable. I also appreciate painstaking corrections made by them in several earlier drafts of this report.

Sd/-
(Dr. M. S. Sahoo)
Chairman
Sub-Committee
1. Background

1.1. The Central Government has been aggressively carrying out deep economic reforms to make India a great place to do business. It established a modern insolvency regime in no time to rescue businesses in stress and thereby promote competition and innovation at marketplace, and entrepreneurship and credit availability in the economy. Consequently, India’s rank moved up from 136 to 52 in terms of ‘resolving insolvency’ in the last three years in the World Bank Group’s Doing Business Reports. In the Global Innovation Index, India’s rank improved from 111 in 2017 to 47 in 2020 in ‘Ease of Resolving Insolvency’. The Government is continuing its drive to improve ‘resolving insolvency’ and ‘ease of doing business’ further by enriching the insolvency regime with innovative options and features, with primary focus on time bound rescue of businesses as going concerns.

1.2. A company in a market economy fails mostly on account of innovation and competition. It may belong to an industry where business is no more viable for exogenous reasons such as innovation. Most such companies are generally unviable. It is necessary to facilitate their closure and release their resources for other competing uses and the entrepreneur to pursue emerging opportunities. However, a company may belong to an industry where other companies in the industry are doing well, but the company in question is not doing well for endogenous reasons such as inefficiency of the management to compete at marketplace. Most such companies are generally viable. A company may not be doing well for force majeure circumstances such as coronavirus disease (COVID-19). Most such companies are viable but for these circumstances and they would start earning normal profits as soon as the normalcy returns. Closure of such viable businesses is not in the interest of the stakeholders - shareholders, creditors, employees, suppliers, and customers - and the economy. It is necessary to facilitate stakeholders to resolve the stress well in time before the financial stress degenerates to economic stress making resolution impossible. If it is easier to resolve stress in an economy, it would encourage companies - domestic and overseas - to do business in the country.

INSOLVENCY REGIME

1.3. With the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), an altogether new insolvency regime that is proactive, incentive compliant, market led, and time-bound, came into existence in India. The Code and the underlying reforms, in many ways, was a journey into an unchartered territory - a leap into the unknown and a leap of faith. Many institutions required for implementation of a modern and robust insolvency regime did not exist. The law was to be laid down; infrastructure to be created; capacity to be built; professions to be developed; the markets and practices to emerge; and stakeholders to understand the change in the offing, accept it and learn to use it. It was, therefore, natural that the Code envisaged standard processes to start with.

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1 World Bank, Ease of Doing Business Reports for various years
2 World Intellectual Property Organisation, Global Innovation Index, Different Editions
Evolving Law

1.4. The Code, however, anticipated sophisticated options with the maturity of the ecosystem. For example, the Bankruptcy Law Reforms Committee (BLRC), which conceptualised the Code, attempted to comprehensively address issues of insolvency and bankruptcy as a purely domestic question. While noting this as an important first milestone for India, it observed that the next frontier lies in addressing cross-border issues. Similarly, the BLRC believed that until the Indian market for insolvency practitioners becomes sufficiently developed and sophisticated, it may not be advisable to allow pre-pack sales without the involvement of the court or the National Company Law Tribunal (NCLT). However, such sales could be allowed as part of an NCLT supervised scheme of arrangement and operationalised through rules at an appropriate stage after wider consultation with the stakeholders. Usually, pre-pack is a natural step in the evolution of insolvency regimes.

1.5. An economic law is essentially empiric. It evolves continuously through experimentation. To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation. The Code is no exception; it has been a road under construction. The very first resolution plan approved under the Code yielded a haircut of 94% for financial creditors (FCs), while promoters wrested control of the company. This was considered rewarding unscrupulous persons at the expense of creditors, which was not acceptable. The Code made prompt course correction through an Ordinance that prohibited persons with specified ineligibilities from submitting resolution plans in a corporate insolvency resolution process (CIRP) to ensure sustained resolution of stress. Probably as a precursor to pre-pack, the next amendment to the Code enabled closure of a CIRP with approval of 90% of voting share of committee of creditors (CoC). The Code has so far witnessed five legislative interventions, four of which are by way of Ordinances in view of urgencies which demonstrate the keenness of the Government to continuously improve resolution framework. Each of these five amendments have strengthened the processes in sync with the emerging market realities and reinforced the primary objective of the Code, namely, revival of companies. Apart from the presumption of constitutionality, the courts have extended a certain degree of deference in the legislative judgment in economic choices.

Revival of Companies

1.6. The Code recognises a wider public interest in resolving corporate insolvencies. It endeavours to rescue the life of a company when it experiences serious threat to its life. It is a
beneficial legislation which puts the corporate debtor (CD) back on its feet. The first and foremost objective of the Code is reorganisation and insolvency resolution of CD.\textsuperscript{12} The second order objective is maximising value of assets of the company and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests of all stakeholders. This order of objectives is sacrosanct.\textsuperscript{13} If there is a resolution applicant (RA) who can continue to run the CD as a going concern, every effort must be made to try and see that this is made possible.\textsuperscript{14} Even after an order for liquidation is made, the law enables the liquidator to sell the CD as a going concern.\textsuperscript{15} It enables revival and continuation of the CD by protecting it from its own management and from death by liquidation.\textsuperscript{16}

1.7. The Code mandates revival of a company in a time-bound manner, as undue delay is likely to reduce the enterprise value of the company. When the company is not in sound financial health, prolonged uncertainty about its ownership and control may make the possibility of resolution remote. The strict adherence to timelines is of essence to both the triggering process and the insolvency resolution process.\textsuperscript{17} It is mandatory to complete a CIRP within 180 days, with a one-time extension of up to 90 days.\textsuperscript{18} The regulations provide a model timeline for each task in the process, which needs to be followed as closely as possible.\textsuperscript{19}

1.8. The Code envisages rescue of a CD as a going concern. It obliges an insolvency professional (IP) to run the CD as a going concern, prohibits suspension or termination of supply of essential and critical services, mandates continuation of licences, permits and grants; stays execution of individual claims, enables raising of interim finances for running the CD, insulates the RAs from the misdeeds of the CD under the erstwhile management, etc. It enables, facilitates, and empowers the stakeholders to take commercial decisions. It provides a competitive, transparent market process, which identifies the person, who is best placed to rescue the CD and selects the resolution plan, which is the most sustainable under the circumstances. All the five legislative interventions mentioned earlier aim at preventing danger to life of a CD, rescuing its life when it is in danger, and ensuring sustained life, post rescue. Interestingly, the fifth amendment to the Code prohibits use of the CIRP in times of COVID-19, in sync with the objective of the Code.\textsuperscript{20}

**Debtor Creditor Relationship**

1.9. The BLRC believed that a company has two main sets of immediate stakeholders: shareholders and creditors. If debt is serviced, shareholders have complete control of the company and creditors have no say in how the business is run.\textsuperscript{21} When the company fails to service the debt, the control of the company should shift to the creditors for resolving insolvency.

\textsuperscript{12} Supreme Court (2019), Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors., 4 SCC 17
\textsuperscript{13} NCLAT (2018), Binani Industries Limited Vs. Bank of Baroda & Anr.
\textsuperscript{14} Supreme Court (2018), Arcelor Mittal India Private Limited Vs. Satish Kumar Gupta and Ors.
\textsuperscript{15} Regulation 32 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016
\textsuperscript{16} Supreme Court (2019), Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors., 4 SCC 17
\textsuperscript{17} Supreme Court (2017), Mobilox Innovations Private Limited Vs. Kirusa Software Private Limited (Civil Appeal No. 9405 of 2017)
\textsuperscript{19} Supreme Court (2018), Arcelor Mittal India Private Limited Vs. Satish Kumar Gupta and Ors.
\textsuperscript{20} The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020
\textsuperscript{21} BLRC (2015), The Report of the Bankruptcy Law Reforms Committee
The erstwhile regime did not enable this. The creditors had to wait till the cows come home to realise the debt. The Code redefined the balance of power among the stakeholders of a company in terms of their interests and rights. While disposing of the very first matter under the Code, the Supreme Court delivered a detailed judgment to emphasise this paradigm shift in the law. It held that entrenched managements are no longer allowed to continue in management if they cannot pay their debts.

1.10. In the years since then, several companies, including exceptionally large ones, changed hands consequently. The credible threat of IBC process redefined the debtor-creditor relationship. The defaulter’s paradise was lost. Many debtors today prefer to resolve stress at early stages and are making best effort to avoid consequences of CIRP: they are resolving stress when it is imminent, on receipt of a notice for repayment but before filing an application to initiate CIRP, after filing application but before its admission, and even after admission of the application. The evidence is: withdrawal of applications filed for initiation of CIRP in respect of 14,510 CDs at pre-admission stage, closure of CIRPs of 218 CDs under section 12A of the Code, termination of CIRPs by the Adjudicating Authority (AA), closure of CIRPs on taking note of settlement recorded by the mediator, and even settlements at the level of the Apex Court - where the parties worked out a resolution amicably resulting in swift revival of the CDs. A fair debtor-creditor relationship, induced by the Code, has prompted several resolutions in its shadow or on its account. Both empirical and anecdotal evidence suggest that the Code has rebalanced the relationship between debtors and creditors to a large extent and is leading to more responsible decision making by both debtors and creditors which is encouraging a large number of out-of-court workouts. The relationship between creditor and debtor continues evolving worldwide and is about to be tested all over again.

CORONAVIRUS DISEASE

1.11. The world seems under the grip of the COVID-19. With many countries having passed through long periods of lockdown to contain the spread of the virus, the economic activity across the world had come to a standstill till about end of May, 2020 and is now limping back to a ‘new normal’, albeit at a snail’s pace. Estimates point to a generalised global recession matching the Great Depression of the 1930s. The global economy is projected to contract sharply by 4.4% in

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23 Supreme Court (2018), M/s. Innoventive Industries Ltd. Vs. ICICI Bank & Anr., 1 SCC 407
24 Supreme Court (2019), Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors., 4 SCC 17
26 IBBI (2020), Insolvency and Bankruptcy News, April-June, 2020
28 NCLAT (2019), Parvinder Singh Vs. Intec Capital Ltd. & Anr., Company Appeal (AT) (Insolvency) No. 968 of 2019
29 Supreme Court (2017), Lokhandwala Kataria Construction Private Limited Vs. Nisus Finance and Investment Managers LLP (CA No. 9279 of 2017)
32 UNCTAD (2020), From Global Pandemic to Prosperity for All: Avoiding Another Lost Decade, Trade and Development Report, 2020
2020. Similar shocks of a comparatively lower intensity in the past witnessed a sharp increase in corporate and personal insolvencies all over the world. For example, the number of corporate bankruptcies increased in the United States by 40% in the wake of the 2008 global financial crisis. Since the onset of COVID-19, several companies - big and small - are filing for bankruptcies all over the world. 64% of businesses across all industries in UK were at risk of insolvency in September, 2020. Globally, corporate insolvencies are forecast to increase by 26% in 2020.

1.12. As around the world, in India as well, the impact of COVID-19 on business in the country has been severe. India’s economy is projected to contract by 10.3% by International Monetary Fund (IMF), 9% by Asian Development Bank, and 9.6% by World Bank in 2020-21, reflecting impact of nationwide lockdown and the income shock experienced by households and firms. As per provisional data, Gross Domestic Product (GDP) at constant prices in Q1 of 2020-21 recorded a contraction of 23.9% as compared to 5.2% growth in Q1 2019-20. The real GDP is projected to contract by 9.5% in 2020-21 with risks tilted to the downside: (-)9.8% in Q2, (-)5.6% in Q3 and 0.5% in Q4. The macro stress tests indicate that the Gross Non-Performing Asset ratio of all Scheduled Commercial Banks (SCBs) may increase from 8.5% in March, 2020 to 12.5% by March, 2021 under the baseline scenario and may escalate to 14.7% under the very severely stressed scenario. The system level Capital to Risk Weighted Assets Ratio is projected to drop from 14.8% in March, 2020 to 13.3% in March, 2021 under the baseline scenario and to 11.8% under the very severe stress scenario. Business Assessment Index for Q1:2020-21 hit its lowest mark in the survey’s history. The manufacturing Purchasing Manager’s Index remained in contraction, shrinking further to 46.0 in July from 47.2 in the preceding month.

1.13. In the context of possible rise in corporate and individual insolvencies in the aftermath of the COVID-19 pandemic, the World Bank and IMF have listed out the challenges and key responses required to meet those challenges to prevent economies from facing a fate like the Great Depression. They suggest the implementation of those responses in a three-phased approach to help the economy transition smoothly towards the positive side of the graph. In the first phase, copious interim measures need to be taken to halt insolvency and debt enforcement activities. In the second phase, when a huge wave of insolvencies is anticipated, it may be addressed by transitional measures, such as special out-of-court workouts, to ‘flatten the curve’
of insolvencies. The third phase calls for regular debt resolution tools to address the remaining debt overhang and support economic growth in the medium term.

1.14. Governments have responded with measures such as moratorium on loan repayments, sector specific forbearance, infusion of liquidity into the banking system to provide credit to financially distressed firms, relief in asset classification banking norms, flexibility in director’s obligations to initiate insolvency proceeding, relief from compliance with specific legal obligations, etc. Some of them are reviewing pre-pack in anticipation of increased use of pre-pack sales to rescue viable businesses and save jobs at this hour. The Government of India has also taken several measures to ameliorate the pains emanating from COVID-19. It increased the threshold of default for filing of an insolvency application from Rs. 1 lakh to Rs. 1 crore to prevent Micro, Small and Medium Enterprises (MSMEs) from being pushed into insolvency proceedings. Reserve Bank of India (RBI) permitted lending institutions to extend the moratorium on term loan instalments by six months and time for resolution under prudential framework by 180 days.

1.15. CIRP requires an RA to rescue a failing company through a resolution plan. When every company, every industry and every economy is reeling under stress, the likelihood of finding an RA to rescue a failing company is remote. If all failing companies were to undergo insolvency proceeding, most of them may end up with liquidation for want of savours to rescue them. Upon such liquidation, the companies would have a premature death, while the assets would have distress sale, realising abysmally little for creditors. This neither resolves the stress nor maximises the value of assets and, hence is not consistent with the objectives of the Code. In view of non-availability of RAs, the Code made another course correction to suspend filing of applications for initiation of CIRP in respect of defaults arising during COVID-19 period, which is six months commencing on 25th March, 2020 to start with, but can be extended up to a year, if warranted. This period has been extended till 24th December, 2020. This insulated a company, which did not have a default as on 25th March, 2020, but commits a default during the COVID-19 period, from being pushed into an insolvency proceeding.

1.16. This, however, took away an effective option for resolution in respect of COVID-19 debt. The availability of RAs will continue to be a concern for quite some time, particularly when there is no clarity as to when COVID-19 will subside and even after that the business and economy would take considerable time to recover. At the same time, CIRP may not yield a desirable outcome even for non-COVID-19 defaults for want of RAs. It is necessary to provide an effective dispensation, which enables the stakeholders to find a resolution during COVID-19 period and even on the other side of COVID-19. Pre-pack is being suggested as a useful dispensation in times of COVID-19.

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47 The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, which has since been regularised by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2020

48 MCA (2020) Notification NO. S.O. 3265(E) dated September 24

RESOLUTION OPTIONS

1.17. A company in stress often resolves stress on its own by improving its competitiveness at marketplace. It may not, however, succeed always. It may sit across a table with its stakeholders, either individually or collectively, to work out a plan to resolve stress. It may resort to a formal framework which provides a guided path for resolution and defines the role of stakeholders in the framework for resolution of stress. There are two court supervised statutory options, namely, (a) CIRP under the Code, and (b) scheme of compromise or arrangement (SoA) under the Companies Act, 2013, and two out-of-court options, namely, (a) the RBI’s prudential framework for resolution of stressed assets and (b) informal understanding between a debtor and creditor, with /without help of a mediator. A creditor has access to these options to resolve stress of its debtors, in addition to several options for recovery of its loans.

CIRP under the Code

1.18. A threshold amount of default entitles a stakeholder to trigger CIRP of the CD and if triggered, the CD moves away from ‘debtor-in-possession’ to ‘creditor-in-control’ and management of debtor and its assets vest in an IP. An IP runs the CD as a going concern. He constitutes a CoC to take commercial decisions in respect of the CD. He invites feasible and viable resolution plans from eligible and credible RAs for resolution of insolvency of the CD. A resolution plan envisages limitless possibilities of resolution and may entail a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of organisation, business model, ownership, balance sheet; strategy of turn-around, buy-out, acquisition, takeover; and so on. If the CoC approves a resolution plan within the stipulated time with 66% voting share, the CD continues as a going concern. If the CoC does not approve a resolution plan with the required voting share within this period, the CD mandatorily undergoes liquidation. A resolution approved by the AA is binding on all stakeholders, including Central Government, State Governments, and any local authority to whom the CD owes debt under any law. It enjoys several privileges like moratorium, and binding outcome, and regulatory benefits such as, exemption from public offer under takeover Code, set off of brought forward loss against book profits for the purpose of Minimum Alternate Tax, etc.

1.19. The outcome through CIRPs has been encouraging. Till June, 2020, it has rescued 250 CDs through resolution plans, one third of which were in deep distress. It has referred 955 CDs for liquidation, three-fourth of which were either sick or defunct. The CDs rescued had assets valued at Rs.1.01 lakh crore, while the CDs referred for liquidation had assets valued at Rs.0.38 lakh crore when they were admitted to CIRP. Thus, in value terms,72% of distressed assets were rescued. The realisable value of the assets available with the CDs rescued, when they entered the CIRP, was only Rs.1.01 lakh crore. The resolution plans recovered Rs.1.94 lakh crore, which is about 192% of the realisable value of these CDs. Any other option of recovery or liquidation would have recovered at best Rs.100 minus the cost of recovery/liquidation, while the creditors recovered Rs.192 under the Code. The excess recovery of Rs.92 is a bonus because of the Code. Though recovery is incidental under the Code, the FCs recovered 45% of their claims, which is the highest

68 IBBI (2020), Insolvency and Bankruptcy News, April-June, 2020
among all options available to creditors for recovery. In terms of the World Bank’s data, the overall recovery rate for creditors jumped from 26.0 to 71.6 cents on the dollar and the time taken for resolving insolvency also came down significantly from 4.3 years to 1.6 years.\textsuperscript{51} Beyond revival of firms and realisations for creditors, the Code is prompting resolutions in the early stages of stress when most CDs are rescued. Only a few CDs, which fail to address the stress in earlier stages, pass through CIRP. At this stage, the value of the CD is substantially eroded, and hence some of them are rescued, and others liquidated.

1.20. A CIRP shifts control of CD to an interim resolution professional (IRP) and then to a resolution professional (RP) and later to a successful RA, which may cause business disruptions. It allows only capable and credible persons to submit resolution plans, which has the potential to oust the current promoters. These disincentivise the CDs to initiate CIRP voluntarily in case of stress. The data indicate that less than 3\% of CIRPs that commenced during 2019-20 were self-initiated by CDs.\textsuperscript{52} This partly explains non-co-operation by the current promoters and management in some CIRPs, leading to intense litigation. The litigation and determination of several issues, including avoidance transactions, has been a challenge to the limited capacity of the AA. For several reasons, including litigation, it has generally not been possible to adhere to timelines envisaged under the Code as regards commencement of CIRPs as well as their closure. The 250 CIRPs, which have yielded resolution plans by the end of June, 2020, took, on average 380 days (after excluding the time excluded by the AA), for conclusion. Similarly, the 955 CIRPs, which ended in orders for liquidation, took, on average 312 days, for conclusion.\textsuperscript{53} The longer a CD stays in the state of insolvency, the higher is the cost, both direct and indirect.\textsuperscript{54}

1.21. As stated earlier, CIRP is not available in respect of defaults arising during COVID-19 period. It is not available in respect of defaults of less than Rs.1 crore as well as for stress before default. Further, the availability of RAs would continue to be a concern for quite some time, as the business conditions are unlikely to return to pre-pandemic levels soon. The inevitable consequence when a CIRP fails to find an RA discourages the stakeholders to resort to CIRP.

Schemes under the Companies Act, 2013

1.22. Section 230 of the Companies Act, 2013 offers Scheme of Arrangement (SoA), which enables a company to restructure its liabilities and/or capital structure to turnaround the business, with the approval of NCLT. Though it has genesis in the English law, it has evolved in India through the Indian Companies Act, 1882, the Indian Companies Act, 1913, the Companies Act, 1956 and eventually the Companies Act, 2013. Consequently, it has acquired a substantial body of rich jurisprudence. The courts have given a very wide interpretation to the terms ‘compromise’ and ‘arrangement’ to include a wide array of transactions of the nature of financial and corporate restructuring.

\textsuperscript{51} World Bank, Ease of Doing Business Reports for various years
\textsuperscript{52} IBBI (2020), Insolvency and Bankruptcy News, April-June, 2020
\textsuperscript{53} IBBI (2020), Insolvency and Bankruptcy News, April-June, 2020
1.23. SoA is an in-court framework, where an application is made by the company, any creditor, any member, or the liquidator before the NCLT proposing a compromise or arrangement between a company and its (i) creditors or any class of them; (ii) members or any class of them. Upon such application, the NCLT may order meeting of creditors or class of creditors, or members or class of members, as the case may be. It may dispense with the meeting of creditors or class of creditors where such creditors or class of creditors having at least 90% value confirm, by way of an affidavit, to the SoA. A notice of the meeting is sent to all creditors and members along with the details of the proposed SoA, apart from publishing it on the website of the company and in the newspaper. Notice is also sent to Central Government, income-tax authorities, respective stock exchange, SEBI, Competition Commission of India, if necessary, and such other regulator or authorities which are likely to be affected by the SoA and are required to make representations, if any, within a period of thirty days from the date of receipt of the notice, failing which it is presumed that they have no representations to make on the proposed SoA.

1.24. Any objection to the SoA can be made only by persons holding at least 10% of the shareholding or having at least 5% of the total outstanding debt. If the SoA is approved by three-fourths in value of creditors or class of creditors, or members or class of members, as the case may be, and is also sanctioned by the NCLT, it becomes binding on the company, all the creditors or class of creditors, members or class of members, as the case may be, and also the liquidator and the contributories of the company. Further, NCLT, while approving the SoA or at any time, thereafter, may make any modifications in the SoA for proper implementation of the scheme. Where it is satisfied that the sanctioned scheme cannot be implemented satisfactorily, it may order winding up of the company.

1.25. Though SoA has certain advantages such as wider scope, availability for stress prior to default, less disruption to business, cram down and binding effect, in practice, it has not garnered much traction as a tool for resolution of financial stress. Some of the reasons attributed for this are: (a) The absence of any calm period, like moratorium in case of CIRP, often leads to fast tracking of suits, proceedings, and enforcement actions by stakeholders against the company during the process; (b) An SoA requires approval by three-fourths in value of creditors or members, which is challenging at times, as compared to threshold of 66% voting share of creditors under the Code; (c) An SoA is binding on the company, all the creditors or class of creditors, members or class of members, as the case may be, unlike everyone in case of CIRP; and (d) There is no time limit within which the process must be completed and has the potential of misuse, particularly as it is based on debtor-in-possession model. A total of 1099 applications, including applications for debt restructuring and merger and amalgamations, were filed under section 230 of the Companies Act, 2013 during 2018-19.¹⁵

**RBI’s Prudential Framework**

1.26. The RBI provides a prudential framework for early recognition, reporting and time bound resolution of stressed assets.¹⁶ The framework applies to entities such as banks and non-banking

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¹⁵ MCA (2019), Annual Report for 2018-19
financial companies (NBFCs) regulated by RBI. It requires the lenders to put in place its Board approved policies for resolution of stressed assets, including the timelines for resolution. In case of default by any of the borrowers, the lenders are required to undertake a review of the borrower’s account and decide on the resolution strategy, including nature of resolution plan within the review period, which is thirty days from such default. The lenders may also choose to initiate legal proceedings for insolvency or recovery. In cases where the resolution plan is to be implemented, the framework requires the lenders to enter into an inter-creditor agreement (ICA) during the review period. In respect of large accounts, where aggregate exposure of borrower to the lenders is above Rs.1500 crore, the resolution plan needs to be implemented within 180 days from the end of the review period. Where a viable resolution plan in respect of a borrower is not implemented within the specified timelines, the lenders are required to make additional provisions as percentage of total outstanding. However, the framework introduces certain incentives once resolution is pursued under the Code. It provides that half of the additional provisions would be reversed on filing of insolvency application and the remaining upon admission into CIRP. It also incentivises the lenders to provide interim finance to CDs undergoing CIRP by allowing them to treat such finance as ‘standard asset’ during CIRP.

1.27. The prudential framework, however, is beset with certain challenges, which include: (a) The framework is available in respect of stress of a CD which has RBI regulated creditors; (b) The framework hinges on an ICA to provide that any decision by lenders representing 75% by value of total outstanding credit facilities and 60% of lenders by number shall be binding upon all the lenders. This has been difficult to obtain, particularly from creditors like insurance companies, mutual funds, debenture holders, real estate allottees, offshore creditors, etc., who are outside RBI’s domain. Such creditors may invoke the formal insolvency resolution process under the Code that jeopardises resolution under the prudential framework; (c) Being out-of-court mechanism, the framework does not provide for breathing space in the form of a moratorium on suits, proceedings, and recovery actions against the CD during the restructuring; (d) The plan binds only those FCs who are signatories to the ICA. It does not also bind OCs. This limits the scope of the plan to only financial restructuring, which may not be adequate to resolve stress.

1.28. The framework has been recently modified to provide a special window to resolve pandemic induced stress, without change of ownership, within the said prudential framework. This envisages lenders to implement resolution plans of eligible borrowers, having stress on account of COVID-19, without change in ownership, while classifying such exposures as 'standard', subject to specified conditions. This is in departure to the norms whereunder a resolution plan involving any concession to the borrower requires an asset classification downgrade, except when it is accompanied by a change in ownership. This framework applies to both personal loans and corporate exposures. With respect to corporates, only those accounts which were classified as standard and not in default for more than 30 days with any lending institution as on 1st March, 2020 (i.e., not beyond SMA-0) and which continues to be standard till invocation of resolution process, are eligible.

1.29. The resolution process is invoked with an agreement between the borrower and the lending institution, in cases involving single lending institution, and between the borrowers and the lenders

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representing 75% by value and 60% by number, in cases involving multiple lending institutions. The resolution under this framework is to be invoked not later than 31st December, 2020 in case of corporate loans and must be implemented within 180 days from the date of invocation. In cases involving multiple lending institutions, where resolution process is invoked all lending institutions are required to sign the ICA within 30 days. It is open to lenders not covered by the framework also to sign ICA if they so desire. If lending institutions representing minimum of threshold do not sign the ICA, the process ends, and it cannot be invoked again under the framework. The framework also incentivises the lenders to sign ICA, by prescribing different norms of additional provisioning and reversal of such provisioning in respect of non-signatories to ICA.

1.30. The framework, inter alia, envisages constitution of an Expert Committee by RBI to make recommendations on the required financial parameters to be factored in the resolution plans, with sector specific benchmark ranges for such parameters. The Expert Committee shall also undertake the process validation for the resolution plans to be implemented under this framework, without going into the commercial aspects, in respect of all accounts with aggregate exposure of Rs.1500 crore and above at the time of invocation.

1.31. The RBI has also extended its existing scheme of one-time restructuring in respect of existing loans to MSMEs which are classified as ‘standard’. This is made available to those MSMEs whose aggregate exposure to banks and NBFCs do not exceed Rs.25 crore as on 1st March, 2020 and it was a standard asset as on that date. It provides asset classification benefits by allowing borrower account classification to be retained as standard and allowing upgradation of classification as standard in respect of those accounts which slipped into NPA category between 2nd March, 2020 and date of implementation. The restructuring needs to be implemented by 31st March, 2021. It is, however, early to see the outcome of resolution framework introduced on 6th August, 2020.

Informal Options

1.32. The debtor and creditors may address the stress outside any formal framework, whether there is a default or not. They may sit across a table to work out a resolution that meets their requirements, with or without assistance of mediators. Since implementation of the Code, there is a preference to resolve stress without resorting to a formal framework. As mentioned earlier, 14,510 applications filed with NCLT for initiation of CIRP were withdrawn at pre-admission stage, indicating resolution arrived at by the relevant parties. However, such informal resolutions are not popular for reasons like the stakeholders find it difficult to travel on an unguided path, there is no moratorium, resolutions arrived at by them do not enjoy the sanctity and benefits of a resolution arrived under a formal framework, etc.

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Summary of Options

1.33. Each of the resolution options has certain advantages as also limitations. The option under the Code is more comprehensive in terms of parties involved and scope and strategies for resolution of stress and usually includes an element of restructuring. It offers certain advantages and privileges such as moratorium during resolution period, binding nature of resolution plan, clean slate post resolution, regulatory benefits, etc., which are not available in case of other options. This explains market preference for CIRP as a mode of resolution and demand to revoke suspension on filing of applications for initiation of CIRPs. Table 1 presents the key features of these four resolution options.

### Table 1: Extant Frameworks for Resolution

<table>
<thead>
<tr>
<th>Feature</th>
<th>CIRP under the Code</th>
<th>Scheme under the Companies Act, 2013</th>
<th>RBI’s Prudential Framework</th>
<th>Bilateral Negotiations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available for</td>
<td>Companies, LLPs, and entities with limited liability</td>
<td>Companies</td>
<td>All entities with debt from RBI regulated lenders</td>
<td>All entities</td>
</tr>
<tr>
<td>Stress covered</td>
<td>Default above Rs.1 crore (other than COVID-19 defaults)</td>
<td>Pre and post default, including stress in group companies</td>
<td>Pre and Post default</td>
<td>Pre and post default</td>
</tr>
<tr>
<td>Initiation by</td>
<td>Debtor or a creditor</td>
<td>Company, a member, a creditor, or the liquidator</td>
<td>RBI regulated lenders</td>
<td>Debtor and creditors</td>
</tr>
<tr>
<td>Oversight of process</td>
<td>Insolvency Professional</td>
<td>X</td>
<td>(Expert Committee for exposure &gt; Rs.1500 crore with COVID-19 stress)</td>
<td>X</td>
</tr>
<tr>
<td>Debt-in-possession</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Moratorium</td>
<td>✓</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interim finance with</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>super priority</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scope of resolution plan</td>
<td>Very wide</td>
<td>Wider</td>
<td>Only financial liabilities</td>
<td>Financial and operational liabilities</td>
</tr>
<tr>
<td>Cross-class cramdown</td>
<td>✓</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Protection of OCs and</td>
<td>✓</td>
<td>NA</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>dissenting FCs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Approval by stakeholders</td>
<td>66% FCs by value</td>
<td>75% creditors by value</td>
<td>75% of RBI-regulated FCs (and other voluntary signatories to the ICA) by value and 60% by number</td>
<td>100% consent of creditors or class of creditors</td>
</tr>
<tr>
<td>Regulatory benefits</td>
<td>More</td>
<td>Less</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Court approval</td>
<td>✓</td>
<td>✓</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Binding on</td>
<td>All stakeholders</td>
<td>Company and its creditors, members, and contributories</td>
<td>As per the terms of ICA</td>
<td>As per terms of the agreement</td>
</tr>
<tr>
<td>Liability of CD in respect of</td>
<td>Ceases (Section 32A of the Code)</td>
<td>Continues</td>
<td>Continues</td>
<td>Continues</td>
</tr>
<tr>
<td>past offences</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Time Limit</td>
<td>180 days</td>
<td>X</td>
<td>180 days (without additional provisions) for large accounts</td>
<td>X</td>
</tr>
<tr>
<td>Consequence of failure</td>
<td>Liquidation</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>
1.34. While the preferred option for resolution, namely, CIRP has difficulties at this hour, the liabilities of the debtor in respect of defaults - COVID-19 induced or otherwise - under various other laws are not suspended, except to the extent of moratorium allowed by RBI. This has two consequences - either the company remains under stress for too long without any resolution or the creditors seek every means to recover their dues. In either case, the company may not be able to survive. This calls for a resolution mechanism that side steps the difficulties of the CIRP and that brings into its fold the resolutions already happening in the shadow of the Code. Further, a formal framework has a set process and, therefore, some amount of rigidities. However, market prefers flexibility to work out a tailor-made resolution best suited to the circumstances. This calls for a semi-formal or hybrid option which has an element of informality, but sanctity and advantages of a formal process. The most popular form of such a semi-formal option is pre-pack. Informal (out-of-court) resolutions, pre-packs and CIRPs are all part of a continuum of avenues for resolution of stress.60

PRE-PACK RESOLUTION

1.35. With considerable learning and maturity of the ecosystem, and a reasonably fair debtor-creditor relationship in place, the ground seems ready to experiment new options for resolution of stress under the Code in furtheance of its objectives. The experience from implementation of the Code, including evolution of the ecosystem, stabilisation of processes, growing jurisprudence has prepared ground to look at new initiatives to further improve the effectiveness of the Code.61 The then Minister of Finance and Corporate Affairs advocated that going forward, once an honest creditor-debtor relationship was restored on account of the Code, there would be a need to marry the insolvency framework with out-of-court settlement schemes.62 Since then the market has been advocating and anticipating a resolution framework which is a hybrid of the court supervised insolvency framework and out-of-court restructuring schemes to facilitate resolutions that are happening today in the shadow or on account of the Code. In recognition of the need, the Government started exploring the feasibility of implementing a ‘pre-packaged’ bankruptcy scheme, to aid the existing insolvency framework and cut cost and time of the resolution process.63 It invited suggestions for implementation of pre-packaged insolvency resolution.64

1.36. Pre-pack has emerged as an innovative corporate rescue method that incorporates the virtues of both informal (out-of-court) and formal (judicial) insolvency proceedings.65 It seems to be preferred hybrid framework, as it empowers stakeholders to resolve the stress of a CD as going concern, with the minimum assistance of the State. It is considered fast, cost efficient, and effective in resolution of stress, much before value deteriorates, with the least business disruptions and without attracting the stigma attached with the formal insolvency process. It

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61 MCA (2020), Order No. 30/20/2020-Insolvency Section dated June 24
63 MCA(2018), Monthly Newsletter, November
65 Bo Xie (2016), Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue, Edward Elgar Publishing
starts with an informal understanding, engages the stakeholders in between, and ends with a judicial blessing of the outcome, though the nuances differ across jurisdictions. The insolvency laws around the world provide a variant of pre-pack, in addition to regular resolution process.

1.37. All the extant formal resolution options in India already have a blend of pre-pack. Section 12A of the Code allows the parties to close a CIRP, with approval of 90% of CoC. Rules allow withdrawal of an application for initiation of CIRP before its admission, with the approval of the AA. An application for SoA needs to include any scheme of corporate debt restructuring consented to by not less than 75% of secured creditors in value. RBI’s prudential framework envisages: (i) a consensual process between creditors and the CD for resolution, (ii) expert committee to do process validation for the resolution plans in respect of large accounts having COVID-19 stress, and (iii) debtor-in-possession with no change in ownership, etc.

1.38. Pre-pack should blend enough informality that enables the stakeholders to mould it to fit to all circumstances, making it a sort of ‘some sizes fit all’ as much as pre-arranged and pre-packaged proceedings are considered more efficient than both the formal reorganisation proceedings under Chapter 11 of the US Bankruptcy Code and pure out-of-court restructurings. It must, however, be within the basic structure of the Code: it must imbibe all those features which make a CIRP sacrosanct and, therefore, enjoy all the benefits and privileges associated with CIRP. It must also have inbuilt immunity to prevent any potential misuse.

1.39. Both the out of court restructuring process and the bankruptcy process need to be strengthened to make them effective, transparent, speedier and not susceptible for gaming by unscrupulous promoters. Then only the vast majority of cases would be restructured out of bankruptcy, with the CIRP acting as a court of last resort if no agreement is possible. The stakeholders should first look at out-of-court resolution of stress and should use court / CIRP as the last resort. Pre-pack will be effective only if CIRP is effective.

1.40. Pre-pack has its share of concerns such as ‘serial pre-packing’ (controlling parties buy the company successively to avoid debt rather than rescue the company), and lack of transparency for unsecured creditors. Though emanated from market practice, pre-pack is getting formal and acquiring regulations to address these concerns. A recent example is the proposal in UK to make regulations to require an independent opinion, or creditor approval, for pre-pack.

1.41. Since pre-pack is relatively new, there is a suggestion to experiment it in a controlled regulatory sand box environment before a full-fledged plan is rolled out. However, given the

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66 Akhil Gupta (2020), Some Sizes Fit All, Penguin Random House India Private Limited
68 MCA (2020), Order No. 30/20/2020-Insolvency Section dated June 24
71 Shri Anurag Singh Thakur, Minister of State for Finance and Corporate Affairs (2019), Keynote Address at the Indian Banks’ Association’s 72nd Annual General Meeting on September 10
72 Teresa Graham (2014), Graham Review into Pre-pack Administration, June
limitations of ‘one size fits all’ standard CIRP, which is also not available in respect of COVID-19 defaults and defaults less than Rs.1 crore at this hour when the economy needs to recover fast, one may substitute sand box experiment by a careful design of pre-pack based on learning from experiment of pre-packs in other jurisdictions. Possibly the starting point could be a variant of pre-pack which requires the least preparation and can be rolled out within the existing ecosystem. It is important that it is made available; it is the right time to introduce pre-packs under insolvency law in India. 

SUB-COMMITTEE OF ILC

1.42. The Insolvency Law Committee (ILC), in its meeting held on 14th May, 2020, decided to constitute a sub-committee to propose a detailed scheme for implementing Pre-packaged Insolvency Resolution Process (PPIRP) under the Code. It advised that the sub-committee shall take into consideration the issues emerged in its meeting. A sub-committee of ILC was thus constituted on 24th June, 2020 to propose a detailed scheme for implementing pre-pack and prearranged insolvency resolution process. The sub-committee was tasked: “To study and recommend the regulatory framework for prepack insolvency resolution process which shall include pre-requisite for initiation of PPIRP in terms of default and threshold, appointment of Insolvency Professional, role and responsibility of committee of creditors, moratorium, expected cost of process and timelines for completion of process.” The order of constitution of the sub-committee is annexed to this report as Annexure A. Table 2 presents composition of the sub-committee.

Table 2: Composition of sub-committee of ILC

<table>
<thead>
<tr>
<th>Sl.</th>
<th>Members</th>
<th>Role</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Dr. M. S. Sahoo, Chairperson, Insolvency and Bankruptcy Board of India (IBBI)</td>
<td>Chairman</td>
</tr>
<tr>
<td>2.</td>
<td>Mr. Gyaneshwar Kumar Singh, Joint Secretary, Ministry of Corporate Affairs (MCA)</td>
<td>Member</td>
</tr>
<tr>
<td>3.</td>
<td>Mr. U. K. Sinha, Former Chairman, Securities and Exchange Board of India</td>
<td>Member</td>
</tr>
<tr>
<td>4.</td>
<td>Mr. Saurav Sinha, Executive Director, Reserve Bank of India</td>
<td>Member</td>
</tr>
<tr>
<td>5.</td>
<td>Mr. Sunil Mehta, Chief Executive Officer, Indian Bank’s Association</td>
<td>Member</td>
</tr>
<tr>
<td>6.</td>
<td>Mr. Bahram N. Vakil, Partner, AZB &amp; Partners, Advocates &amp; Solicitors, and</td>
<td>Member</td>
</tr>
<tr>
<td>7.</td>
<td>Mr. Akhil Gupta, Chairman, Bharti Infratel</td>
<td>Member</td>
</tr>
</tbody>
</table>

1.43. The ILC had desired that the sub-committee shall take into consideration the issues that emerged in its meeting held on 14th May, 2020, the inputs of members of the ILC received before the said meeting and further inputs that they may send after the meeting. Accordingly, members of the ILC were requested to provide their inputs. In response, Mr. Shardul S. Shroff and

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75 Insolvency Service (of UK) (2020), Pre-pack sales in administration report, October
78 ILC is a standing committee constituted by Government to continuously review the implementation of the Code to identify issues and make recommendations to address them.
Mr. Bahram N. Vakil submitted their inputs. The Federation of Indian Chambers of Commerce & Industry (FICCI) Committee on Stressed Assets had an interaction with Chairman of the sub-committee on 12th August, 2020 and shared their suggestions for design of pre-pack framework, which are broadly in consonance with the thinking of the sub-committee.

1.44. The sub-committee had three meetings. Though the deliberations in the meetings presumed availability of special insolvency resolution process (SIRP) for MSMEs, the pre-pack framework recommended in this report should work with or without SIRP in place. The sub-committee took note of global literature and best practices followed in other countries, to better understand the kinds of challenges that have and may come up, in pre-packaged insolvency proceedings. It delineated the three principles that should guide the design of pre-pack framework. These are: (i) the basic structure of the Code should be retained; (ii) there should be no compromise of rights of any party; and (iii) the framework should have adequate checks and balances to prevent any abuse. It identified three features, namely, creditor in control, moratorium during resolution and binding nature of an approved resolution plan, which could be considered as part of basic structure of the Code. It envisaged a pre-pack framework that provides a level playing field and does not disturb the balance of power too much to preserve the credit discipline that has been achieved with implementation of the Code in the last three years.

1.45. Several drafts of this report were circulated to members for comments, suggestions, and improvement. Considering the deliberations in the sub-committee and inputs of members on earlier drafts, this report has been finalised. It is divided into three Chapters. This Chapter sets the context and need for pre-packs in India and details of the sub-committee. Chapter 2 introduces pre-pack, what it entails, and its benefits and concerns, and provides an international perspective of pre-pack. Chapter 3 lays down principles that should guide design of pre-pack framework for India and, based on the same, recommends a pre-pack framework.
2. Understanding Pre-pack

2.1. It appears that ‘pre-pack’ has no statutory definition. It is probably because it has evolved over the time, differently in different jurisdictions and every jurisdiction has a unique variant(s) of pre-pack, which allows the stakeholders to modify it further to an extent to suit their needs. It has different nomenclature such as pre-packaged insolvency resolution, pre-arranged insolvency resolution and pre-plan sale in the USA, pre-pack sale in the UK, scheme of arrangement in Singapore, etc. As nomenclature suggests, pre-pack is a restructuring plan which is agreed to by the debtor and its creditors prior to the insolvency filing, and then sanctioned by the court on an expedited basis. In the UK context, it generally refers to a pre-agreed business sale by an insolvency practitioner which does not require prior court and/or creditor sanction.

2.2. The United Nations Commission on International Trade Law (UNCITRAL) uses the term ‘expedited reorganisation proceedings’ for pre-packs, as these proceedings follow the procedure of reorganisation, but on an expedited basis, combining voluntary restructuring negotiations, where a plan is negotiated and agreed to by the majority of affected creditors, with reorganisation proceedings commenced under the insolvency law to obtain court confirmation of the plan in order to bind dissenting creditors. The IMF observes two variants of pre-packs, namely, (a) pre-packaged plans, where both the negotiation and voting for the plan take place prior to commencement of the rehabilitation procedure and court approval is sought immediately upon commencement, and (b) pre-negotiated plans, where the plan is negotiated prior to commencement but formal voting takes place once the proceedings have commenced. In a pre-pack, a troubled company and its creditors negotiate the terms of an insolvency resolution plan prior to the commencement of the formal insolvency process, which allows formal process to be implemented at maximum speed. The most prevalent form of pre-pack process envisages a resolution plan, which is negotiated and finalised between the creditors and the debtor before the commencement of statutory proceedings, and is sanctioned under the statute.

PRE-PACKS IN SELECT JURISDICTIONS

United Kingdom

2.3. The Insolvency Act, 1986, did not provide for or regulate pre-pack, which has developed out of market practice through business and professional innovation, though Courts have supported the evolution. It is commonly used as a strategy for selling a business as a going concern, by using administrator’s power to sell a company’s assets without creditors’ approval. Typically, it

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77 United Nations (2005), UNCITRAL Legislative Guide on Insolvency Law
78 IMF (1999), Orderly and Effective Insolvency Procedures Key Issues
79 Vanessa Finch (2009), Corporate Insolvency Law Perspectives and Principles, 2nd Edn, Cambridge University Press
commences with the company resolving to appoint an insolvency practitioner as an Advisor, with the understanding that possibly he would be appointed as the Administrator. Once the terms of sale are agreed, the insolvency practitioner is officially appointed as the Administrator and the sale is concluded immediately following his appointment. However, the practice threw up concerns such as transparency and accountability, particularly when sale is made to a connected party or where there is a conflict of interest of the insolvency practitioner. To address the concerns, Insolvency Practitioners Association issued Statement of Insolvency Practice 16 (SIP) in 2009 to regulate pre-pack through regulation of Administrator.

2.4. The continued concern relating to pre-pack sales led to commissioning Ms. Teresa Graham to carry out an independent review. The Graham Review, concluded in 2014, highlighted the lack of transparency around pre-pack sales for unsecured creditors, particularly in case of sale to a connected person and ‘serial pre-packing’. To address the concerns, it recommended a set of voluntary measures, which included the establishment of a group of experienced business people, called pre-pack pool, to provide an opinion on a pre-pack sale, and improvements to marketing and valuation requirements and supply of information to creditors. The SIP adopted these voluntary measures in November, 2015. Simultaneously, the Insolvency Act, 1986, was amended to empower the Government to regulate, within the next five years, pre-pack sale to connected persons. The said power expired in May, 2020, before its use. The Corporate Insolvency and Governance Act, 2020, revived it provided it is exercised before the end of June, 2021.

2.5. The SIP defines pre-pack sale as an arrangement under which the sale of all or part of a company’s business or assets is negotiated with a purchaser prior to the appointment of an Administrator and the Administrator effects the sale immediately on, or shortly after, appointment. The gap between the appointment of the Administrator and the subsequent sale of the business can be a matter of hours, as every details of the sale is finalised prior to the appointment. The SIP prescribes a set of guidelines for Administrators to ensure transparency and objectivity while entering a pre-packaged sale. Since an Administrator is primarily required to rescue the company itself, he is required to record the reasons for opting for a pre-pack sale considering other alternatives available. He is required to provide a detailed disclosure statement to the creditors explaining why a pre-packaged sale has been undertaken and demonstrating how he has acted with due regard to their interests. This disclosure statement, which is forwarded to the Insolvency Service, requires the Administrator to provide details of: (i) the purchaser and whether any related or connected party of the seller was involved in the transaction; (ii) the assets sold; (iii) the sale consideration received; and (iv) how the valuation of the business assets was decided. If a pre-packaged sale involves a related or connected party, it should be endorsed by a member of the pre-pack pool that evaluates whether the sale is fair or not. However, seeking opinion of pre-pack pool is voluntary and a negative opinion from the pool does not mean that a pre-pack sale cannot be made. If the Administrator decides to proceed with the connected party sale, he must explain to the creditors why he feels the sale is appropriate, given the opinion of the pool. While the process does not require any approval of the court or

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81 Teresa Graham (2014), Graham Review into Pre-pack Administration, June
83 The pool has 19 members. https://www.prepackpool.co.uk/about-the-pool
creditors, in practice the company and insolvency practitioner extensively consult the secured creditors.

2.6. On a review of effectiveness of voluntary measures introduced in 2015, the UK Government observed the limited use of the pre-pack pool designed to give confidence to creditors and other stakeholders that a connected party pre-pack sale is appropriate. It has proposed to introduce new regulations to require scrutiny of pre-pack sales to connected parties, to build on the existing voluntary measures and to mitigate any adverse consequences in the increased use of pre-pack sales arising from the pandemic. Thus, the pre-pack which started as an informal arrangement between the parties is gradually getting regulated to address the emerging concerns.

United States of America

2.7. The US Bankruptcy Code facilitates three forms of pre-packs, namely, pre-plan sales under section 363, pre-packaged bankruptcy proceedings and pre-arranged bankruptcy proceedings under Chapter 11. Pre-plan sales is somewhat similar to pre-pack sales in UK. It allows a bankruptcy trustee, equivalent of administrator in UK, to sell all or substantial assets of a CD once it enters reorganisation proceedings. It requires the debtor or trustee to give a notice to every interested party, to provide them an opportunity to object to the proposed transaction and obtain the approval of the bankruptcy court to ensure that such sales are made ‘free and clear’ of any interest in such assets, where such sale is not in the ordinary course of business. The law does not prescribe either any standards or guidelines that guide judicial evaluations of pre-plan sales or the mode in which a sale should take place. Accordingly, courts have developed their own standards to adjudicate applications and sale typically involves a public auction and a public sale process. Owing to the flexibility in procedure, stalking horse method is often used for conducting sale.

2.8. In the case of pre-packaged bankruptcy proceeding, the CD reaches an agreement on the terms of a plan with key creditors and solicits approval of the agreement from specific classes of creditors. It circulates the plan with a disclosure statement to all creditors. With the requisite votes in favour of the plan, the CD files a Chapter 11 petition. In the case of pre-arranged (also known as pre-negotiated) bankruptcy proceeding, the CD reaches an agreement with its key creditors but does not circulate the plan or solicit actual votes on the plan prior to filing Chapter 11 petition. The solicitation of votes and confirmation of the plan are sought after filing. In either proceeding, the plan must be accepted by every class of impaired parties with at least two-thirds in amount and more than one-half in number accepting the plan. Where the required majority has voted in favour of the plan, the class is deemed to have accepted it, making it binding on all parties in the class. The interested parties, whose interests are not impaired by the plan, are also deemed to have accepted it. A class of interested parties, whose members do not receive or retain any property under the plan is deemed to have rejected the plan. The plan filed with Chapter 11 petition is approved by the court subject to compliance with the stipulated disclosure requirements. Once a reorganisation plan is confirmed by the bankruptcy court, it binds all

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84 Insolvency Service (of UK) (2020), Pre-pack sales in administration report, October

85 A stalking horse offer, agreement, or bid is a bid for a bankrupt firm or its assets that is arranged in advance of an auction to act as an effective reserve bid. The intent is to maximize the value of its assets or avoid low bids, as part of (or before) a court auction.
claimants notwithstanding whether they individually voted in favour of it or not. The debtor’s obligations to creditors prior to the plan are replaced with those enumerated in the plan.

Singapore

2.9. Section 211I of the Companies Act empowers the court to approve a compromise or arrangement. Where a compromise or an arrangement is proposed between a company and its creditors or any class of those creditors, the Court may, on an application made by the company, make an order approving the compromise or arrangement, even though no meeting of the creditors or class of creditors has been ordered. The compromise or arrangement is binding on the company and the creditors or a class of creditors meant to be bound by the compromise or arrangement. The court may approve the arrangement, if the court is satisfied that had a meeting of the creditors or class of creditors been summoned, the conditions in section 210(3AB) (a) and (b) (in so far as they relate to the creditors or class of creditors) would have been satisfied. The Singapore model gives very wide discretionary powers to the court for approving the scheme of arrangement even if no meeting of creditors is held to seek their vote. The provisions relating to compromise or arrangement have been shifted to the Insolvency, Restructuring and Dissolution Act, 2018, which came into force with effect from 30th July, 2020.

2.10. The Insolvency, Restructuring, and Dissolution (Amendment) Bill, 2020 proposes to introduce a new pre-pack scheme for micro and small companies in the COVID-19 environment. An automatic moratorium would come into place when a company is accepted into the scheme. There would be no requirement to convene a meeting of the company’s creditors. Instead, the court can approve the scheme, provided that the company can satisfy the court that if a meeting had been called, a majority representing at least two-thirds in value of the creditors would have approved the proposed scheme.

France

2.11. Under the French law, there are four categories of proceedings that can be used depending upon the financial situation of the CD. They are:

(i) Mandat ad-hoc: Operational companies with financial stress but not insolvent can take recourse to this procedure without the existing management losing control over the assets of the CD. The court appoints a mediator upon the request of the CD. This procedure has no time limit.

(ii) Conciliation: A CD which is insolvent for less than 45 days or on anticipation of legal, economic, or financial stress may request the tribunal for initiation of the conciliation procedure. The conciliation proceedings are confidential in nature as only the judgement approving the agreement is made public. The agreement arrived at through conciliation or

86 <https://sso.agc.gov.sg/Bills-Supp/36-2020/Published/20201005?DocDate=20201005>
(iii) **Safeguard (sauvegarde):** This process is available to CDs approaching insolvency. The object of the proceedings is to reorganise the CD through a reorganisation plan. It is a debtor-in-possession model proceeding. The time available for safeguard proceedings is 6 months which may be extended once, by a reasoned ruling. The scope of the reorganisation plan is like that of the resolution plan under the Code. It allows for debt write-offs, debt rescheduling, debt-to-equity swaps, cash contributions to the CD, by existing stakeholders or newcomers, by way of debt or equity. In case of CDs with more than 150 employees or annual sales of more than €20 million, the plan is approved by two separate committees of creditors comprising of FCs and trade creditors with the approval of two-third creditors in value, in each committee. It also includes fast track safeguard which has an outer limit of three months and fast track financial safeguard proceedings which has a maximum duration of two months.

(iv) **Insolvency procedure (redressement judicaire):** It consists of two proceedings, namely, reorganisation proceedings and liquidation. Recourse to these proceedings is available only where the CD has stopped making payments for longer than 45 days. Reorganisation proceedings can be initiated by CD, its creditors or public prosecutor. The proceedings have the same objective as safeguard proceedings. The court usually appoints an administrator to assist the promoters/directors in management of the CD and ensure the protection of the interest of the creditors. The process ends with (i) repayment of the debt, (ii) sale to third party buyer, or (iii) liquidation of assets.

Different pre-pack structures are used by combining the conciliation proceedings with either the safeguard proceedings or insolvency procedure. Insolvency proceedings must be commenced if the debtor is insolvent. Pre-pack solution is resorted by a debtor by preparing a restructuring plan during out-of-court proceeding while negotiating with its main creditors, and the plan being implemented at a later stage during an in-court proceeding.

**Canada**

2.12. A management led pre-packaged sale of a financially distressed company as a going concern is often resorted, the proceeds of which are then used to make a proposal to creditors. Under a distressed scenario, a company typically commences efforts to sell the business. It then files for protection under the Company's Creditors Arrangement Act, after which management of the debtor company has the breathing space necessary to continue in its efforts to sell the company. The company is marketed as a going concern, as opposed to a liquidation, with job preservation being a fundamental driver and factor in the court approval process. Once a buyer is found, the court approves the sale transaction (without shareholder or bulk sales act approval) and issues an order, vesting title in the assets to the buyer free and clear of all liens, security interests and encumbrances all of which are transferred to the proceeds of sale."
BENEFITS AND CONCERNS OF PRE-PACK

Key Features

2.13. It is important to note the key features of pre-pack which make it advantageous as compared to regular insolvency process and the aspects which can be a source of concern.

(i) 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;

(ii) Pre-pack envisages a consensual process - prior understanding among or approval by stakeholders about the course of action to address stress of a CD, before invoking the formal part of the process. This ensures confidentiality of the process up to a point and minimises disputes and litigation;

(iii) The course of action could be a sale of business of the CD or a reorganisation plan to resolve stress of the CD. This requires varying levels of marketing depending on the context and purpose;

(iv) The understanding or approval could be limited to secured creditors, impaired creditors, or all creditors. This is arrived at after disclosures of relevant details to the stakeholders;

(v) During the process, the CD usually remains under the control and possession of the debtor (current promoters and management). This minimises disruption to business;

(vi) The formal part of the process usually enjoys moratorium;

(vii) The current promoters and management usually have the first right or the exclusive right to buy the business of the CD or submit a reorganisation plan;

(viii) In case of sale to a connected party in the UK, the sale is usually validated by a set of experienced persons;

(ix) It does not always require approval of a court. Wherever it requires approval, the courts often get guided by commercial wisdom of the parties. In the USA, the courts rely on commercial wisdom of the management in case of pre-plan sales and on the commercial wisdom of the creditors in case of pre-packed or pre-arranged bankruptcies. In some jurisdictions, they carry out the same level of scrutiny as applicable to normal reorganisation plans; and

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

2.14. Pre-pack combines “the best of both worlds” so that insolvency proceedings cause minimal disruption to debtors’ business activities by combining the efficiency, speed, cost, and flexibility of workouts with the binding effect and structure of formal insolvency proceedings.\(^88\) It offers several advantages as compared to the regular resolution process. Most of these emanate from two elements, namely, (a) the informal process, and (b) shorter time for closure. Since the process prior to commencement of formal proceeding is informal, pre-pack provides the stakeholders flexibility in working out a consensual, but efficient, strategy for effective resolution and value maximisation that may be difficult under the formal insolvency procedure. It takes less time because a substantial part of the proceedings is undertaken before the commencement of the formal proceeding by the court. The sub-committee took note of benefits of a typical pre-pack process.

2.15. Quick Resolution: It is difficult to keep a company going on in a stressful state for long. If stress is not resolved quickly, its value may erode and ultimately disappear making resolution difficult. Pre-pack, which enables a faster resolution, preserves and maximises value and increases the possibility of resolution. A pre-pack sale in the UK could be completed in matter of hours from the appointment of the administrator, as preparatory takes place before such appointment.\(^89\) Such sales represent around 29% of all administrations in the UK.\(^90\) The average time taken by courts to confirm a pre-packaged reorganisation plan, and a pre-arranged reorganisation plan, in the USA, is two and four months respectively, while the average duration of traditional Chapter 11 cases is eleven months.\(^91\) Pre-packs and pre-negotiated bankruptcy cases represent 65% of large cases filed under Chapter 11 in the US.\(^92\) Market is getting ready for ‘Ultrafast Pre-pack’ whereby Full Beauty Brands and Sungard Availability Services emerged from Chapter 11 bankruptcy in 24 hours and 19 hours, respectively.\(^93\) Longer time not only makes rescue difficult but also increases costs of resolution.

2.16. Cost Effective: Since the process takes less time, the cost of process linked to time becomes less. 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 IRP to RP and then to successful RA and continues to retains employees, suppliers, customers, and investors. It also saves the cost of IRP/RP to the extent he does not have to run the business of the CD as a going concern. Since the process remains away from limelight till the commencement of the formal process, it minimises indirect costs in terms of stigma and loss of reputation to the business. As substantial part of pre-pack is conducted outside the court and the formal part of the process has minimum involvement of the court, the cost associated with interface with a court is reduced.

\(^88\) Jose M. Garrido (2012), Out-of-Court Debt Restructuring, A World Bank Study, 66232
\(^90\) Insolvency Service (of UK) (2020), Pre-pack sales in administration report, October
2.17. **Value Maximisation:** A distressed asset has a life cycle and the longer it stays in a state of stress, the more value depletion it suffers. Its value depletes further by the costs associated with a longer resolution period. The value depletion is aggravated due to the public nature of a formal insolvency process, whereby the reputation and brand of the CD suffers. Pre-pack preserves value by cutting down these elements of the formal process. Early initiation and closure of the process as compared to the formal process, minimises the possibility of liquidation and thereby destruction of economic value in case of otherwise viable businesses. This is often key to saving small businesses that cannot withstand the costs of a prolonged insolvency, and thereby helps in maximising value. There is evidence in some jurisdictions to suggest that the speed and reduction of formal procedures in pre-packs result in improvement in recoveries of at least some classes of creditors.

2.18. **Job preservation:** Many SIP statements refer to the preservation of employment as one of the reasons for using a pre-pack administration. Since a pre-pack may commence at the earliest sign of distress, it facilitates continuity of its operations without any job loss. It ensures a company keeps going, in contrast to a more protracted formal insolvency process which risks losing customers and employees. The majority of pre-packs in the UK have been successful at preserving 100% of jobs. Very few (20 of the 499) pre-packs showed no employment preservation, which may be associated with the fact that the business in such cases was being partially or fully shut down prior to involvement of insolvency practitioner and all employees had already been made redundant. Pre-pack bankruptcy in the Netherlands increased employment retention in a company notwithstanding its level of stress. The mean employee retention post conventional bankruptcy was 34.6% whereas that of pre-packed bankruptcies was 54.1%.

2.19. **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. A research indicates that the pre-pack sale of the enterprise group to a single purchaser has resulted in a successful resolution in around 72% of the cases.

2.20. **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

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95 Teresa Graham (2014), Graham Review into Pre-pack Administration, June
96 Peter Walton and Chris Umfreville (2014), Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration, University of Wolverhampton, April, 2014 <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>
98 IBBI (2019), Report of the Working Group on Group Insolvency, September
99 Peter Walton and Chris Umfreville (2014), Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration, University of Wolverhampton, April, 2014 <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>
part of the process and requires minimum role of courts during formal process. Hence, it reduces litigation cost and delays and helps to decongest the overburdened courts.\textsuperscript{100} 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.\textsuperscript{101}

Concerns

2.21. Private negotiation and understanding among a set of stakeholders prior to commencement of formal process, which contribute to advantages of pre-pack, is often a source of concern. Graham Review best presents the concerns and measures to address them, as under:\textsuperscript{102}

\textbf{“Pre-packs lack transparency”}

3.8 The nature of pre-pack administrations leads to a lack of transparency before the sale as the parties work to secure the future of the business without risking the confidence of creditors, customers and employees. Unsecured creditors feel disenfranchised by this secrecy, particularly where the purchaser is connected to the insolvent company. Improved marketing and a fuller explanation of valuation methodology would help greatly to improve transparency, as could the voluntary introduction of an independent opinion on the deal’s outline and why it was necessary to proceed in this way, particularly in connected party cases.

\textbf{Marketing of pre-pack companies for sale is insufficient}

3.9 The quality of marketing of businesses that intend to pre-pack needs to improve. The evidence of our research shows that where no marketing is carried out pre-packs return less money to creditors. Improved quality of marketing may in some cases, assist the administrator in receiving a better return. It will also, and possibly just as importantly, improve creditors’ perceptions that they are getting the best deal available. This should improve confidence in pre-pack administration and in the insolvency regime more generally.

\textbf{More must be done to explain the valuation methodology}

3.10 According to our research, in the overwhelming majority of cases - 91% - an independent valuation was conducted as part of the pre-pack process. However these appear to be desk-top valuations only. Where there is a connected sale the purchase price often exactly matches the valuation figure. This leads to the suspicion that a purchaser has set a valuation as an indicator of how much it is prepared to pay, rather than the market value of the assets in question. The valuation

\textsuperscript{100} MCA (2018), Monthly Newsletter, November, 2018
\textsuperscript{101} Abhijit Vinayak Banerjee, et al. (Edited), (2019), What the Economy Needs Now, Juggernaut Books, 2019
\textsuperscript{102} Teresa Graham (2014), Graham Review into Pre-pack Administration, June
was often limited to certain assets, normally the assets and property, but not the intellectual property or goodwill. More could be done to explain the valuation methodology.

**No consideration is given to the future viability of the new company**

3.11 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. However both public perception and our research suggest that future viability, especially in the case of connected party pre-packs, is a concern for both transferring suppliers and new ones. Again I think more could be done to demonstrate the potential viability of the new business/company emerging from the pre-pack.

3.12 The regulation - and monitoring of that regulation – of pre-pack administration could be strengthened.”

2.22. Graham Review noted the concern about ‘serial pre-packing’ where pre-pack is used to avoid loan repayment and perpetuate unviable business. It, however, did not find evidence that it was a regular occurrence. It observed that often the connected party may be the only party willing to make the best or only offer for the business. They may see it as their livelihood and want to ‘have another go’. ‘Having another go’ can be a good thing only if that party has learnt from its previous mistakes. It advised several voluntary measures, including validation of sale by a ‘pre-pack pool’ on a voluntary basis before the sale. Government reviewed working of the voluntary measures and found improvements on several aspects. It reiterated the findings of the Graham Review that in many circumstances a pre-pack sale provides the best outcome for creditors following an insolvency. Instead of banning connected party sales in administration, it has proposed to mandate independent scrutiny of pre-pack administration sales where connected parties are involved.

2.23. Sale of business and assets of the CD to connected parties has resulted in harsh criticism from some market participants with some going to the extent of calling it a “sham to simply ditch debt”. The reason for such criticism is ‘phoenixing’ of companies “whereby companies are successively allowed to run down to the point of winding up, only to rise phoenix-like from the ashes as a new company formed and managed by an almost identical group of persons and utilising a company name similar to that under which the former company was trading.”

2.24. There is evidence, however, that some of these criticisms are overstated. For instance, a study conducted by Andrea Polo observed that recoveries by unsecured creditors are not worse in pre-packs, including connected party pre-packs, than in alternative insolvency procedures. It is also important to note that most of concerns are primarily levelled at the conduct of pre-packs in the UK.

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103 Teresa Graham (2014), Graham Review into Pre-pack Administration, June
104 Vanessa Finch (2009), Corporate Insolvency Law Perspectives and Principles, 2nd Edn, Cambridge University Press
Pre-pack Vs. CIRP

2.25. In the earlier Chapter, it was noted that there is a marked preference for CIRP over other modes of resolution for obvious reasons. The above paragraphs indicate that pre-pack addresses some of the concerns associated with CIRP. Table 3 juxtaposes pre-packs vis-à-vis CIRP in terms of advantages.

<table>
<thead>
<tr>
<th>Parameter</th>
<th>CIRP</th>
<th>Typical Pre-pack</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective</td>
<td>Going Concern Resolution, failing which, Liquidation</td>
<td>Going Concern Resolution</td>
</tr>
<tr>
<td>Transparency*</td>
<td>More</td>
<td>Less</td>
</tr>
<tr>
<td>Flexibility</td>
<td>Less</td>
<td>More</td>
</tr>
<tr>
<td>Cost Effectiveness</td>
<td>Less</td>
<td>More</td>
</tr>
<tr>
<td>Time Effectiveness</td>
<td>Less</td>
<td>More</td>
</tr>
<tr>
<td>Disruption to Business</td>
<td>More</td>
<td>Less</td>
</tr>
<tr>
<td>Conducive for Group Insolvency</td>
<td>Less</td>
<td>More</td>
</tr>
<tr>
<td>Value Maximisation **</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Possibility of Resolving Stress</td>
<td>Less</td>
<td>More</td>
</tr>
<tr>
<td>Supremacy of Stakeholders</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Regulatory Benefits</td>
<td>Yes</td>
<td>Generally, No</td>
</tr>
<tr>
<td>Role of Court and IP</td>
<td>More</td>
<td>Less</td>
</tr>
<tr>
<td>Binding Outcome</td>
<td>Yes</td>
<td>Generally, Yes</td>
</tr>
</tbody>
</table>

# ‘More’ or ‘less’ as compared to the other option.
* Different models of pre-packs in different jurisdictions have varying levels of transparency, but usually less than CIRP. However, it can be designed to enhance transparency.
** CIRP maximises the value of assets through a full public process. Pre-pack maximises value by concluding the process early with less cost. It can be designed to build elements of a public process to maximise value further.

KEY TAKEAWAYS

2.26. Each of the variants of pre-pack in different jurisdictions has tailor-made features. It is neither possible to adopt all such features from all jurisdictions nor all the features fit into the scheme of the Code. Hence, none of these variants can be replicated in the Indian context, without dovetailing it from the Code and general legal framework. For example, a deal with the existing promoters irrespective of their track record may not be acceptable in view of section 29A. Indian version of pre-pack will be unique that learns lessons from other jurisdictions and builds an India centric variant within the basic structure of the Code. The following are key takeaways from the study of pre-packs in select jurisdictions.

(a) Sale Vs. Reorganisation: Pre-pack has two broad variants, namely, sale and reorganisation. The UK pre-pack model is a sale of the business which is fundamentally opposite to the going concern resolution model under Indian Insolvency laws. The pre-pack sale prevalent in the UK has been highly criticised by the creditors due to the rise of phoenix companies, which leaves a
UNDERSTANDING PRE-PACK

shell entity behind with all the liabilities. Since the Code is focused on reorganisation through a resolution plan, and does not envisage even sale of assets during CIRP (except to the extent permitted under regulation 29 of the CIRP Regulations), it may not be feasible to consider pre-pack sale. Therefore, the scope of pre-pack may be limited to reorganisation of CD as a going concern.

(b) **Debtor-in-Possession:** The co-operation of the existing management is critical to the process. It needs to continue to be in possession of the CD and carry on the business as usual to minimise disruption to business. A third party or insolvency practitioner taking over business is a disruption and a dent to reputation which pre-pack endeavours to avoid. In pre-pack sale in the UK, though the CD moves to supervision of an administrator, the sale is often executed within hours of the appointment of the administrator. The management has control over the company before commencement of administration and substantial control over the process.

(c) **Connected party participation:** Pre-pack envisages that the resolution plan is pre-agreed between the debtor and creditors, which usually allows the existing promoters the first right or exclusive right to submit a resolution plan. Coupled with the confidentiality surrounding the process till formal process begins, the deals with connected persons have given rise to some concerns. This can be minimised by prohibiting dealing with the connected persons. This may, however, not be a feasible option, as there may not be anyone who is interested in the business of the stressed CD, particularly when the entire industry is in distress or the entire economy is in doldrums. Further, if it enables involvement of a third party in the informal stage, the process would no more be confidential, and the associated benefits would be lost.

(d) **Performance of pre-pack:** There have been issues about value maximisation. There is a possibility that the process does not maximise the value as it does not pass through a competitive market. There is also an equal possibility that it maximises value by concluding the process early, reducing further loss of value to the business and the possibility of failure of resolution. The performance of pre-pack can be improved by better marketing, disclosures, and valuation of assets. For example, it can be provided that lower the level of marketing, higher would be the level of protection for non-participating creditors.

(e) **Commercial wisdom:** The UK model presupposes a pre-pack pool of experienced business people who offer an opinion on the purchase of business and/or assets by connected parties to a company where pre-packaged sale is proposed. The effectiveness of such a pool is uncertain and most pre-pack sales in the UK do not use it. Further, it may take time to develop pools of

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[106] Insolvency Service (of UK) (2020), Pre-pack sales in administration report, October
[108] Insolvency Service (of UK) (2020), Pre-pack sales in administration report, October
[109] <https://www.prepackpool.co.uk/home>
[110] Insolvency Service (of UK) (2020), Pre-pack sales in administration report, October
experienced and independent businesspersons for this purpose. Possibly this can be substituted by commercial wisdom of creditors. In most of the jurisdictions, different classes of creditors are recognised while voting rights are available only to impaired creditors. The Code, however, recognises only two types of creditors - FCs and OCs - and confers on FCs the right to decide the fate of CD.

(f) **Transparency:** SIP in the UK provides a useful set of transparency guidelines. The insolvency practitioner provides creditors with sufficient information such that a reasonable and informed third party would conclude that the pre-pack sale was appropriate and that he has acted with due regard for the creditors’ interests. The level of detail is greater in a connected party transaction. Yet, pre-pack sale in the UK has been on the receiving end of the criticism for lack of transparency and for failing to protect the interests of unsecured creditors. The Code aims at balancing the interests of stakeholders along with maximisation of the value, which may be difficult if pre-pack does not adopt a transparent competitive method. On the other hand, if a full transparent public process is adopted, it becomes as good as CIRP and the inherent advantages may be lost. Further, pre-pack process envisages private negotiation between the debtor and the creditors. This can be particularly risky in the context of listed companies, as the negotiation of the plan requires that the debtor provide confidential information and the existence of the negotiation itself can be a price-sensitive information. The parties to the negotiation need to sign confidentiality agreements. Therefore, transparency needs to be balanced with confidentiality.

(g) **Insolvency Practitioner:** Any resolution process deals with rights and interests of stakeholders. Pre-pack envisages an oversight role for the insolvency practitioner to ensure that no stakeholder is short-changed, and all dealings are transparent. The insolvency practitioner should recognise the high level of interest the public and the business community have in pre-pack sales. Given his responsibilities, not only should he have the highest standards of integrity and professional competence, but also the concerned regulators should have effective oversight and monitoring of his work.

(h) **Blessing of Court:** Pre-pack envisages approval of Court to make the resolution binding and enable the successful RA to start on a clean slate. The courts follow two broad approaches. Courts in some jurisdictions have discretionary powers to approve the plan, regardless of the approval of creditors. However, courts in other jurisdictions have limited role and they mostly bless the commercial decision taken by stakeholders unless something *mala fide* is apparent on the face of it requiring the court to look deeper. The second approach is ingrained in the Indian law and practice.

(i) **Process Regulation:** It has been the endeavour of the authorities to address the concerns emerging from pre-pack rather than ban it. In the UK, it was attempted to regulate the process through regulation of insolvency practitioners. Such regulations were gradually made more elaborate and strengthened to address the concerns. The UK Insolvency Act now enables the Government to regulate pre-packs and Government has issued draft regulations to regulate pre-

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111 Jose M. Garrido (2012), Out-of-Court Debt Restructuring, A World Bank Study, 66232
pack sale to connected parties. The regulation will ensure that all sales to connected parties are properly scrutinised - protecting the interests of creditors and the general public, as well as the distressed company.112 It appears that pre-pack, which evolved from market practice, is gradually acquiring force of regulations - statutory or self-regulation. It is better to address the concerns at design stage rather than letting them arise during implementation and then fix them. One must, however, guard against overregulation or overly prescriptive process lest the key advantage, that is, flexibility would be lost.113
3. Designing a Pre-pack Framework

3.1. In the interest of business, it is the endeavour of every country to provide several efficient, competitive options for resolution of stress. The available options for resolution of stress in India are competitive and market friendly, with a marked improvement over those in yester years. CIRP under the Code, which seems to be the most preferred option, has performed admirably well in resolution of stress and instilled credit discipline to a large extent in the economy. It has, however, constraints at this time, as discussed in Chapter 2. Further, the options available for resolution today are either fully formal or fully informal and, therefore, they may not be conducive for all circumstances. The business needs an alternate option for resolution, which is between formal and informal options. Pre-pack is the most popular semi-formal option and is a natural step in the evolution of insolvency regimes. Some of the formal options such as RBI’s prudential framework have a blend of pre-pack. With matured ecosystem and a fair debtor-creditor relationship in place, it is time for exploring pre-packs as an additional option for resolution of stress. With the likelihood of increase in insolvencies as suspension on initiation of CIRP expires, coupled with the limited capacity of the AA, it is the right time to introduce pre-packs in India. It should be available side by side with CIRP so that CIRP is used as the last resort for resolution of stress\textsuperscript{1} and liquidation becomes a matter of last resort.\textsuperscript{2} One member of the sub-committee, however, felt that it may be advisable to observe the experience of implementation of SIRP, which may have some features of pre-pack, for a while before introduction of a full-fledged pre-pack framework.

DESIGN PHILOSOPHY

3.2. Considering the design and experience of pre-packs in other jurisdictions and the key takeaways discussed in Chapter 2, the following considerations should guide design of pre-pack in India to make it optimal and sustainable.

Optimal Semi-formal Option

3.3. Table 4 presents the benefits and concerns of CIRP, out-of-court options and a typical pre-pack. **Pre-pack for India should be the most optimal semi-formal option that harnesses the benefits of all three options, avoids the associated concerns and does not dilute the gains made so far from implementation of the Code** (Table 4). It should retain the flexibility of out-of-court options and typical pre-packs and should enjoy the sanctity and privileges of CIRP. To the extent possible, it should avoid concerns and difficulties associated with CIRP as also the concerns of out-of-court options in India and typical pre-packs experienced in other jurisdictions. It should endeavour to make minimum use of the court, while providing flexibility

\textsuperscript{1} Shri Anurag Singh Thakur, Minister of State for Finance and Corporate Affairs (2019), Keynote Address at the Indian Banks’ Association's 72nd Annual General Meeting on September 10

\textsuperscript{2} Supreme Court (2020), Kridhan Infrastructure Pvt. Ltd. Vs. Venkatesan Sankaranarayan & Ors. (CA.3299/2020)
to stakeholders to conclude resolution process as going concern, expeditiously with least cost and
disruption to business, and minimising the possibility of liquidation of otherwise viable
companies.

3.4. **It is advisable to start with the simplest variant of pre-pack, which can be rolled out with the existing ecosystem.** In course of time, many variants, including sophisticated variants, could be introduced. The sub-committee has attempted to design the simplest variant in this report.

### Table 4: Benefits and Concerns of Different Resolution Options#

<table>
<thead>
<tr>
<th>Benefits / Concerns</th>
<th>Resolution Option</th>
<th>CIRP</th>
<th>Informal Options</th>
<th>Typical Pre-pack</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resolution of stress</td>
<td>Post-default stress</td>
<td>Pre- and post-default stress</td>
<td>Pre- and post-default stress</td>
<td></td>
</tr>
<tr>
<td>Guided path</td>
<td>Yes</td>
<td>No</td>
<td>Partially</td>
<td></td>
</tr>
<tr>
<td>Moratorium</td>
<td>Yes</td>
<td>No</td>
<td>Generally, No</td>
<td></td>
</tr>
<tr>
<td>Transparency</td>
<td>More</td>
<td>Nil</td>
<td>Less</td>
<td></td>
</tr>
<tr>
<td>Flexibility</td>
<td>Less</td>
<td>Most</td>
<td>More</td>
<td></td>
</tr>
<tr>
<td>Cost effective</td>
<td>Less</td>
<td>Most</td>
<td>More</td>
<td></td>
</tr>
<tr>
<td>Time effective</td>
<td>Less</td>
<td>Most</td>
<td>More</td>
<td></td>
</tr>
<tr>
<td>Business disruption</td>
<td>More</td>
<td>Nil</td>
<td>Less</td>
<td></td>
</tr>
<tr>
<td>Group resolution</td>
<td>Difficult</td>
<td>Easy</td>
<td>Easier</td>
<td></td>
</tr>
<tr>
<td>Supremacy of markets</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Value maximisation</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Load on Court</td>
<td>More</td>
<td>Nil</td>
<td>Less</td>
<td></td>
</tr>
<tr>
<td>Cross-class Cramdown</td>
<td>Yes</td>
<td>No</td>
<td>Generally, Yes</td>
<td></td>
</tr>
<tr>
<td>Binding outcome</td>
<td>Yes</td>
<td>No</td>
<td>Generally, Yes</td>
<td></td>
</tr>
<tr>
<td>Clean Slate, post resolution</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Possibility of misuse</td>
<td>Less</td>
<td>NA</td>
<td>More</td>
<td></td>
</tr>
<tr>
<td>Liquidation on failure</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
</tbody>
</table>

# ‘More’ or ‘less’ as compared to the other option.
Within Basic Structure of the Code

3.5. Pre-pack would be effective if it has the privileges associated with CIRP. It needs to be introduced under the Code with necessary checks and balances. It must, therefore, have the rigour and discipline of IBC. This translates to three things: the basic structure of the Code should be retained; there should be no impairment of rights of any party beyond what is provided in the Code; and the framework should have adequate checks and balances to prevent any abuse.

3.6. There is probably no formal identification of what constitutes basic structure of the Code. There are apparently three features, which make CIRP sacrosanct, which are unique to CIRP as compared to other formal or informal options of resolution, and which are unique selling proposition of the Code as compared to other resolution options. These are: FCs have extensive control over the distressed company during resolution and the authority to the decide its fate; the CD enjoys moratorium during resolution period; and the outcome of resolution is binding on all concerned.

3.7. No stakeholder should be worse off through pre-pack as compared to CIRP unless one voluntarily opts for the same. For example, an OC, who does not sit on the decision-making table, must have the protection as to its minimum entitlement provided under section 30(2) of the Code. The framework must avoid the concerns like serial pre-packing, phoenixing, or sub-optimal resolution plan.

Objectives of Pre-pack

3.8. The Code recognises a wider public interest in resolving corporate insolvencies. Since pre-pack is envisaged as another option within the Code, it should pursue the same objectives as the Code does. In fact, these objectives are broadly the same all over the world.

3.9. Rehabilitation of the CD: Rehabilitation is the most essential objective of insolvency proceedings all over the world. This is the first order objective of the Code. Liquidation of a CD is a matter of last resort. Unlike pre-pack sale of assets or business in some jurisdictions, it should be pre-pack resolution of the CD in India. To encourage resolution, it is proposed to have approval of resolution plan by required majority of creditors, present and voting, and a decision to liquidate a CD will require a higher threshold of approval. If the CoC does not approve any resolution plan, the pre-pack should close without any consequence and an eligible stakeholder may initiate CIRP. However, where liquidation is the only option for resolution of stress, the CoC may proceed for liquidation, but with a higher threshold of voting.

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116 MCA (2020), Order No. 30/20/2020-Insolvency Section dated June 24
119 NCLAT (2018), Binani Industries Limited Vs. Bank of Baroda & Anr., (CA (AT) No. 82,123,188,216 & 234-2018)
120 Supreme Court (2020), Kridhan Infrastructure Pvt. Ltd. Vs. Venkatesan Sankaranarayan & Ors. (CA.3299/2020)
3.10. **Maximising value of assets**: The assets of the CD are subject to the claims of the creditors. The individual claim enforcement against the common pool of assets results in value destruction for both the creditors and the debtor. The insolvency laws around the world follow the principle of maximising value of assets. The second order objective of the Code is maximising value of assets of the company. The pre-pack should harness value through cost savings, least disruption to business, avoidance of liquidation, and adequate marketing and disclosures.

3.11. **Prioritising the distribution rights**: There are competing interests involved in the estate of an insolvent CD. The insolvency proceeding must aim to provide a priority distribution order. It should neither be pitting one creditor against another to fight for its claim nor allow ‘first come, first serve’ approach. As stated in its long title, the Code alters the order of priority. It provides a waterfall of the distribution rights in liquidation, which serves as a guide for distribution of resolution proceeds in a CIRP and should also guide the distribution in the pre-pack process.

3.12. **Forum for voicing interests**: A corporate insolvency has many stakeholders including the CD itself, FCs, employees, workmen, suppliers, Government, etc. Many of them may or may not represent capital claims but are as much affected by the insolvency of the CD. It is important for an insolvency procedure to provide a forum where all the affected stakeholders can be heard, and rights and interests are validated. A forum to voice interests is reflected in insolvency laws. The Code also provides for the AA where the affected parties can voice their interests. However, it cannot be an indefinite process as the CD is in urgent need of a solution, therefore, only affected parties can be heard.

**Legal Framework**

3.13. Traditionally, pre-packs have developed out of market practice. Legal framework has evolved around them in course of time to impart sanctity and address concerns. Consequently, they have become a popular option for resolution of stress. It is a typical chicken and egg problem as to what comes first. Unless market develops, there is nothing to regulate, and market does not develop unless it has protective shield of regulation. Development and regulation feed on each other in a virtuous circle for an orderly growth of market. As other jurisdictions notice the market, they import the regulatory framework and indigenise it to suit to their local environment. If a market / product exists somewhere along with a regulatory framework, another jurisdiction usually seeks the regulatory framework to be in place first so that they get a guided path for undertaking transactions. Further, the formal part of pre-pack needs to be explicitly provided in the statute. To make its outcome binding, the pre-pack needs to be formally blessed by the AA. Therefore, the legal framework for formal part of pre-pack needs to be laid out upfront, while informal part could be left to market practice or guided by self-

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regulation, guidelines, best practices, etc.

3.14. A complete law envisages all the possible future contingencies.\textsuperscript{125} It is difficult to have an almost complete law for several reasons such as limited human foresight, the ambiguities of language, and the high cost associated with the entire birth cycle of law.\textsuperscript{126} A law, particularly relating to financial markets, is therefore, almost incomplete and empiric. Such laws become complete with subordinate legislation which keeps the law evolving in sync with market developments and needs. Addressing daily market challenges is something like hitting a moving target. In fact, regulation emerged in a response to the fundamental problem of incompleteness of the law, which even a well-functioning court system could not solve and proactive law enforcement by regulators emerged largely in response to the problem in areas where reactive law enforcement proved ineffective.\textsuperscript{127} The Securities and Exchange Board of India Act, 1992 is an example of such lean statute, which gave rise to an evolving body of voluminous subordinate legislation. The recent International Financial Service Centre Authority Act, 2019 could also prove to be so soon. In keeping with this best practice, the Code may make a skeletal provision enabiling pre-pack, and prescribing the contours of subordinate legislation. This will keep the process flexible that will allow emergence of many sophisticated variants of pre-pack in course of time and enable plugging in learning from market continuously. Given the urgency to roll out pre-pack, the Code may be amended quickly, preferably by an Ordinance.

3.15. The subordinate legislation should not be overly prescriptive which may choke innovation in market or take away the essence of pre-pack. It should be grounded on realities and address the market failure and do no more. The following principles of good regulations may serve as a guidance for design of regulations for pre-packs:\textsuperscript{128}

\textit{Proportionality:} Regulators should only intervene when necessary. Their remedies should be appropriate to the risk posed, and costs identified and minimised.

\textit{Accountability:} Regulators must be able to justify their decisions and be subject to public scrutiny.

\textit{Consistency:} The Statute, rules, regulations, and standards must be joined-up and implemented fairly.

\textit{Transparency:} Regulators should be open and keep regulations simple and user-friendly.

\textit{Targeting:} Regulation should be focused on the problem, and minimise side effects.


DESIGN FEATURES

A. Availability of Pre-pack

3.16. There was a detailed deliberation whether pre-pack should be available for every company. In case of MSMEs, which are companies, with simpler corporate structure and fewer liabilities, a full-fledged CIRP appears a little burdensome. Some of them may not have stamina to survive prolonged insolvency proceedings spanning 180/270/330 days, as envisaged in the Code or withstand the extended timelines, that often prevail in practice. Pre-pack could be a pressing need for them. However, it was noted that there is a proposal to make available an SIRP for MSMEs under section 240A of the Code as part of ‘Aatmanirbhar Bharat, Part V: Government Reforms and Enablers’. Since MSMEs would have an alternate option in SIRP, pre-pack may be made available as an alternate option for non-MSMEs. It is, however, not clear whether SIRP would be a permanent feature or would have a sunset clause. It was further noted that limiting pre-pack either for MSMEs or non-MSMEs would require determination of the status of a CD at the admission stage, which could be an additional burden on the limited capacity of the AA. At the same time, making pre-pack available for all CDs, without commensurate capacity augmentation of the AA, could result in process delays.

3.17. After detailed deliberations and weighing pros and cons of each of the options, the sub-committee concluded that given the benefits of pre-pack and difficulties of CIRP and policy objective to provide another option for resolution of stress in addition to CIRP, there is no reason to deny pre-pack to anyone and, therefore, it should be available for all CDs. However, its implementation could be phased by the Government keeping in view the capacity of the AA, and availability of SIRP. If it is decided to make it available for a set of CDs and not all, they could be distinguished based on the size of default which is objective rather than on the size of the company. Accordingly, the sub-committee recommends making pre-pack available for all CDs, but it could be implemented in phases. It may commence in respect of defaults from Rs.1 lakh to Rs.1 crore and COVID-19 defaults for which CIRP is not available today.

B. Initiation of Pre-pack

Who should Initiate?

3.18. 3911 CIRPs have commenced till 30th June, 2020. 6.6% of them were initiated by CDs themselves. Interestingly, about 60% of CIRPs admitted in 2016-17 were initiated by CDs. The percentage reduced drastically thereafter as FCs and OCs started initiation of CIRP, while the threat of losing the CD deterred the promoters from initiating CIRP. The threat came from three sources, namely, (a) section 29A made persons with certain disabilities from submitting a resolution plan, which possibly made some of the promoters ineligible; (b) the promoters may not submit the most competitive plan and, therefore, may lose out to competitors; and (c) if there
is no resolution plans acceptable to CoC, the CD will necessarily undergo liquidation. Only 3.2% of CIRPs, that commenced in 2019-20, were initiated by CDs.  

3.19. The CD understands the company, its stress, and the possibility of its resolution better. In many cases it could be the only person who is interested in resolution of stress of the CD and can do so. In recognition of this, the pre-pack framework in every other jurisdiction allows only the CD to initiate the process voluntarily and obtain consent of key stakeholders before approaching the Court. When it does so voluntarily with consent of stakeholders, the threat of losing company or the possibility of liquidation reduces considerably.

3.20. A suggestion was made to consider allowing creditors to initiate pre-pack in circumstances where the promoter may not be willing to do so and creditors may find out a third party who is willing to take over the CD. While recognising the merit of this suggestion, the sub-committee considered it to be premature and its implementation could be difficult in the absence of cooperation of promoters. In any case, creditors have the option of doing so through CIRP. The sub-committee, therefore, recommends that CD may initiate pre-pack.

Who should authorise initiation?

3.21. To ensure that the process is undertaken with all seriousness to find a resolution of stress and to prevent any potential misuse, adequate safeguards need to be built into the framework. Several safeguards have been suggested in this report at appropriate places. Before making an application for initiation of pre-pack, the proposal should have buy-in of a certain threshold of its stakeholders to have reasonable assurance of resolution. Such threshold on both sides of the debt, namely, the creditors and CD, should neither be too low nor too high. If it is too low, the likelihood of resolution becomes less. If it is too high, the process may not take off.

3.22. The Code recognises two kinds of creditors, namely, FCs and OCs. Some of them could be related parties of the CD. In the scheme of the Code, any creditor can initiate CIRP. However, only the unrelated FCs, through CoC, have the authority to consider and approve a resolution plan for the CD or its liquidation. In sync with this spirit, the sub-committee felt that the CD should have consent of unrelated FCs to initiate a pre-pack. The decision to accept a resolution plan or proceed for liquidation of the CD requires approval of FCs with 66% voting share. In case of classes of creditors, a decision requires the approval of more than 50% voting share of FCs, who cast their votes. Thus, the thresholds for initiation of CIRP and decisions in a CIRP are different. Pre-pack builds consensus around resolution of the CD before its commencement and anticipates the consensus to translate into approval of resolution plan after commencement of the process. Therefore, it is desirable that the process begins with an understanding with the threshold of creditors (66% voting power) which is required to approve a resolution plan. However, it may be difficult to have consent of creditors with 66% voting power before initiation when there is not much clarity about resolution plan. As the details of resolution plan becomes visible, more

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128 IBBI (2020), Insolvency and Bankruptcy News, April-June, 2020
creditors are likely to support it. The sub-committee, therefore, recommends consent of simple majority of unrelated FCs for initiation of pre-pack. Wherever the CD does not have any unrelated FC, similar approval of unrelated OCs may be taken.

3.23. As regard consent of the CD for initiation, different options were considered. In the interest of confidentiality of the process and simplicity, it was considered whether the process could commence with approval of the Board of Directors of the CD. It may, however, pose practical difficulties if after commencement of the process, the CD fails to obtain requisite approval of shareholders. It could be misused to commence pre-pack with sole objective of availing the benefit of moratorium. It was noted that section 10 of the Code requires the CD to furnish, along with the application for initiation of CIRP, a special resolution passed by shareholders of the CD. However, the rigour and consequences of CIRP are much deeper, as the management of the CD shifts to an IP and, most likely, to a third person ultimately. Since the CD continues with the existing management during pre-pack, and the existing promoters have a preference to submit a resolution plan, an ordinary resolution of shareholders should be adequate. The sub-committee, therefore, recommends consent of simple majority of shareholders of the CD for initiation of pre-pack. The application for initiation of CIRP shall enclose evidence of consent of simple majority of shareholders and consent of simple majority of unrelated FCs.

When to Initiate?

3.24. Several suggestions in this regard were considered. The RBI’s prudential framework requires bankers to identify incipient stress in an account by classifying it as a special mention account (SMA) [SMA-0: overdue less than 30 days, SMA-1: overdue between 31-60 days, and SMA-2: overdue between 61-90 days]. There was a suggestion to enable pre-pack when an account becomes SMA-0. An alternate suggestion was to enable pre-pack when an account becomes SMA-1 or SMA-2. It was, however, noted that SMA classification is based on the number of days an account is overdue, that is, the duration of default. When the Code allows CIRP if there is a default for a day, it makes no sense to deny pre-pack for defaults for 30/60 days. If one cannot initiate pre-pack till it is classified as SMA-2 for example, that is, till expiry of 60 days from default, it may willy-nilly resort to CIRP and in that case, the pre-pack framework would serve no useful purpose. Further, SMA classification is relevant only in case of credit extended by RBI regulated entities, which may constitute a small sub-set of total number of creditors. Therefore, SMA status of an account may not serve as a good basis for initiation of pre-pack.

3.25. Pre-pack is a voluntary consensual process between debtors and creditors to resolve stress. The state of stress, whether reflected in default or not, should not matter for initiation of pre-pack. Several jurisdictions enable use of pre-pack for resolution of stress prior to default, as initiation of process in early stage of stress minimises the possibility of liquidation. Some jurisdictions allow normal insolvency proceeding for inability to pay debt, even though there is no default. The preferred test to commence an insolvency proceeding should be the debtor’s inability to pay debts as they mature.\(^\text{130}\)

\(^{130}\) World Bank (2016), Principles for Effective Insolvency and Creditor/Debtor Regimes
3.26. However, stress, as a trigger, is prone to misuse and its determination could be subject to litigation. A CD making handsome profits, but lower than that of a competitor, may claim to be under stress. Initiation of pre-pack for every stress may pose a challenge to the limited capacity of the AA. Further, the Code provides certain privileges to resolve genuine business stress. Such privileges have a cost to the society and other stakeholders. It is not advisable to allow such privileges where it is difficult to determine if the CD deserves them. Similarly, the Code mandates liquidation of the CD where CIRP fails to get a resolution plan. A CIRP commences only on default of a threshold amount. Thus, liquidation should arise where the CD has committed a default of Rs.1 crore and such default has not arisen during COVID-19 period. It may not be prudent to subject a CD to liquidation (the proposed framework enables the CoC to decide to liquidate CD with approval of 75% voting powers in case of pre-pack) where it has not even defaulted.

3.27. Default is not immune from misuse. A healthy CD may deliberately default to take advantage of pre-pack or a sick company may hide default by serial loans - taking a fresh loan to repay a maturing loan - to prevent an insolvency proceeding. A profit-making CD may default on its liabilities due to liquidity mismatch. Despite its limitations, default is the most objective test of insolvency and is easier to determine. Anyone creating a default to take advantages of the Code can always be punished. Given the difficulties of using pre-default stress and SMA status of an account, the sub-committee recommends default as the basis for initiation of pre-pack. The Code prohibits initiation of CIRP in respect of COVID-19 defaults forever. If pre-pack is not available in respect of COVID-19 defaults, such defaults would never be resolved under the Code. It may be advisable to extend pre-pack, which is a consensual process, to COVID-19 defaults as well.

3.28. The Code enables the Central Government to specify the threshold amount of default between Rs.1 lakh and Rs.1 crore for initiation of CIRP. The threshold was Rs.1 lakh, which has been enhanced to Rs.1 crore in the wake of COVID-19 to insulate MSMEs from being pushed into insolvency proceedings. Depending on considerations like situations such as COVID-19, capacity of the AA, etc., the Government may modify the threshold from time to time within the band. Since pre-pack is a consensual process, unlike CIRP where one creditor initiates it and all must join the process, the Government may consider a lower threshold of default for pre-pack as compared to that of CIRP. In course of time, pre-default stress may be considered after having consent of a higher threshold of stakeholders, including OCs. Thus, pre-pack may be introduced in phases: (i) Default ranging from Rs.1 lakh to Rs. 1 crore and COVID-19 defaults, (ii) Default above Rs.1 crore, (iii) Default from Re.1 to Rs.1 lakh, and (iv) Pre-default stress. The phase (iv) should, however, require consent of higher threshold (say 75%) of creditors to avoid any potential misuse.

When not to initiate?

3.29. Since pre-pack is proposed under the Code as an additional option to CIRP, it creates the possibility of a CD availing both or being subjected to multiple proceedings simultaneously. It is simply not possible to run both the processes simultaneously because these are entirely different from one another. For example, pre-pack retains control of the CD with current management, while CIRP shifts it to an IP. Further, multiple proceedings increase costs on all stakeholders
apart from creating legal uncertainty. The sub-committee, therefore, recommends that no two proceedings - pre-pack and CIRP - under the Code shall run in parallel. Thus, where a CD is undergoing CIRP, it should have no recourse to pre-pack. Similarly, where a pre-pack is on, the recourse to CIRP should not be available, as it has consent of majority of unrelated FCs.

3.30. There can be a situation where the CD has reached understanding with creditors and taken all steps required for filing an application for pre-pack, and the AA receives an application from a creditor to initiate CIRP. In such cases, the CD should submit the progress before the AA to enable it to take a view on application for CIRP.

3.31. Some concerns were expressed that there could be process shopping if pre-pack is initiated immediately after closure of a CIRP under section 12A, and if CIRP is initiated immediately after closure of a pre-pack. Another view was that while the concern may be valid, it may be difficult to disallow pre-pack after CIRP is withdrawn or disallow CIRP after pre-pack has closed without resolution as these are inherent rights of creditors. The concern may be addressed by a requirement of cooling off that a pre-pack cannot be initiated within three years of closure of another pre-pack. This is like a CIRP cannot be initiated within 12 months of closure of another CIRP, as provided in section 11.

C. Corporate Debtor

3.32. The success of the pre-pack hinges upon the co-operation and active participation of the CD, its promoters, management, and Board of Directors in the process. They typically have several responsibilities and obligations.

Tasks Before Commencement

3.33. Pre-pack envisages completion of several tasks before submission of application to the AA for initiation of pre-pack. Then only the process can be closed faster than a CIRP. These tasks include: board meeting followed by general meeting of shareholders of the CD to approve the proposal to initiate pre-pack, engagement with creditors for approval by majority of unrelated FCs to the proposal, identification of an IP to act as RP, preparation and updating of records and information, preparation of resolution plan, etc. It is difficult to provide for these matters in law and monitor them. In the interest of flexibility which make pre-pack advantageous, the process before the admission should be flexible and not codified. It should be left to mutual understanding among the stakeholders and such understanding or process of understanding should be informal. For example, the law should not prescribe whether a meeting of creditors is required to obtain approval, when it should be organised, who will chair the meeting, how votes will be taken, etc. It should be sufficient if the proposal to explore pre-pack has approval of majority of unrelated FCs. However, since pre-pack is an initiative of the CD and it has all the information and records, it should undertake and or facilitate all tasks beforehand and be responsible for sanctity of those tasks. For example, it knows who are its FCs, what are the amounts due to each of them, who are related to it, what constitutes majority of unrelated FCs,
etc. and accordingly, it shall ensure that the proposal has approval of majority of unrelated FCs. It shall be liable if it misses, whether by inadvertence or otherwise, any claim which has a bearing on determination of majority of creditors.

3.34. After preparing itself for pre-pack and having complied with the specified requirements, the CD needs to file an application to the AA for initiation of pre-pack. The sub-committee recommends that the law should specify requirements for making an application to the AA, but not the manner of complying with these requirements.

Management of CD

3.35. A debtor-in-possession model is the preferred option for resolution of stress through pre-packs. This avoids inevitable shocks to the operations associated with CIRP where the CD shifts from the current management to the IRP and then to the RP and then finally to the successful RA. This incentivises the CD to initiate pre-pack, as its management continues to run the business and has high possibility of retaining it through a resolution plan. This is necessary particularly when the business needs resolution and the market may not have many third parties interested in business of the CD. The sub-committee recommends debtor-in-possession model for pre-packs. This makes the process simpler and its closure quicker, while helping the CD operate at its optimum level during the resolution.

3.36. The sub-committee is, however, cognisant of the balance of power envisaged under the Code. The debtor-in-possession must not dilute the hold of creditors over the CD. The management of the CD shall have a certain set of duties, in addition to its fiduciary duties under the Companies Act, 2013 towards the creditors of the CD, similar to those that an IRP/RP has in a CIRP with regard to managing the operations of the CD. The CD shall also continue to be liable for all compliances, which are otherwise the responsibilities of the RP during a CIRP. The transactions envisaged under section 28 are not routine operation related matters. Ideally, such transactions should not be undertaken during the pre-pack. However, complete prohibition may compromise the interests of CD or creditors in certain circumstances. Hence, decisions in matters enumerated under section 28 of the Code shall be taken by the CD with the approval of the CoC.

3.37. The CoC may have liberty to close the process with 66% of those who are present and voting, if the CD engages in any activity which has potential to cause depletion of assets or value to the detriment of creditors. The CoC may even decide with 75% of voting power to liquidate the CD at any time during the pre-pack process, where the conduct of the CD is not above Board, the CD does not have a viable business, or for any other reason. This will ensure that the CD behaves well and makes a sincere effort to resolve stress. The creditors will also behave responsibly as the liquidation may not always be in their interest and they may find it difficult to have approval by 75% of voting share unless the rationale for liquidation is strong. The sub-committee, therefore, recommends a hybrid approach of debtor-in-possession with creditor-in-control for pre-pack with clear demarcation of responsibilities of the CD, RP, and creditors.
D. Resolution Professional

Role of Resolution Professional

3.38. In a pre-pack, the management of the CD does not shift to an IRP and then to RP. The RP does not have the responsibility of running the business of the CD as a going concern in a pre-pack. He does not take possession and custody of assets of the CD and is not responsible for protecting and preserving their value. He does not exercise the powers of the Board of Directors; nor is he responsible for complying with all the applicable laws on behalf of the CD. Yet the RP has a critical responsibility of oversight of the process to ensure that no stakeholder is short-changed, and all dealings are fair and transparent. His presence instills confidence of the stakeholders who trust him for his professionalism, independence, and integrity. He guides the CD in all tasks prior to initiation and assists the stakeholders in the formulation and approval of a resolution plan. Involvement of an independent professional in a pre-pack process is common in other jurisdictions. In the UK, the SIP mandates an insolvency practitioner to act professionally and with objectivity, given the high level of interest the public and the business community have in pre-pack sales in administrations.  

3.39. The sub-committee, therefore, recommends that the RP should ensure transparency and fairness of the process, safeguard the interests of stakeholders, business, and the public, and ensure compliances with the law as regards the process. While the business is run by the existing management, the RP should make sure that the CD is managed during the process in a manner which is not detrimental to the interest of the creditors. He should be entitled to attend the meetings of the Board of Directors of the CD as an observer, without any voting rights, for this purpose. He must act independent of the CD and the creditors, in the best interest of all stakeholders, while assisting the CD and creditors in negotiating and drafting the resolution plan. He should be responsible for collating and verifying the list of claims against the CD, constituting the CoC, and inviting resolution plans from prospective RAs, wherever required, in accordance with the process laid down hereafter. He may file applications before the AA as regards issues relating to conduct of the process, and not relating to the conduct of business of the CD.

3.40. An IP is an independent professional. He is the fulcrum of the CIRP and the link between the AA and stakeholders involved in the process. He is required to be a fit and proper person and must abide by a Code of Conduct that providers for integrity, independence, objectivity, and impartiality. The insolvency profession has experience of more than 4000 CIRPs, and 2000 liquidations, including extremely complicated, large ones. They have acquired expertise and maturity and earned trust and respectability of the stakeholders over the last four years. They are fully equipped to effectively play the role of RP in pre-packs. The sub-committee recommends that IPs may play the role of RPs in pre-packs. It considered the need for having a specialised pool of IPs for pre-packs. It did not favour it as the relevant business savvy stakeholders can select the IP having right capability matching their need.

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3.41. An IP has a role prior to formal commencement of the process and after the process commences. In the UK, the directors appoint an insolvency practitioner as advisor in the informal stage with an understanding that he would be appointed as the administrator in the formal stage. The advisor advises the promoters /directors during the negotiation phase to ensure the transparency and fairness of the negotiations. The negotiation stage includes several important steps such as conduct of valuation, preparation of statement of affairs, marketing, identifying the potential buyer, etc. Once the directors/promoters finalise the negotiations, an application is made to the court for appointment of the administrator. The sub-committee considered the role of an insolvency practitioner during the pre-admission stage in negotiations and compliances. After deliberations, it concluded that the role of an RP in pre-admission stage and the manner of appointment of RP need not be defined and codified in the interest of flexibility. The stakeholders should have the liberty to use an IP to help them in tasks prior to formal process. The sub-committee, therefore, recommends that the formal role of RP may begin with admission of the pre-pack, as it happens with CIRP.

Appointment of RP

3.42. In a CIRP, the applicant brings in the IP to act as IRP. The CoC, on its constitution, decides to retain the IRP as RP or bring in another IP as RP. The CoC, which is a collective body of creditors, may replace an IRP, who is choice of the applicant. Since pre-pack begins with consent of majority of unrelated FCs, which is a sort of collective body, there is no need to have an IRP to start with and replace him by RP. Along with consent of creditors to pre-pack process, their consent to the choice of IP to act as RP may be obtained. This will minimise disruption to the process. The sub-committee, therefore, recommends that the choice of IP to act as RP, and the terms of his appointment may have consent of majority of unrelated FCs (unrelated OCs where the CD does not have any unrelated FC) and such IP may be appointed as RP by the AA. The RP shall meet the standard eligibility norms, as specified, to avoid conflict of interests, etc.

Replacement of RP

3.43. The Code empowers the CoC to replace an RP in a CIRP, wherever required. Since RP is being appointed in a pre-pack process with the consent of majority of unrelated FCs, and he is not required to manage the operations of the CD, the need for replacement of RP should be rare. The IRP has been replaced by an RP in about 27% of CIRPs\(^\text{132}\) where he has responsibility to run business and is brought in by a single applicant. Further, any replacement of RP could derail the process and disturb the shorter timeline of pre-pack. Therefore, the sub-committee does not recommend any specific provision for removal/replacement of RP except in case of death or incapacitation. It would anyway be open to the AA to order for replacement in extreme situations. Such replacement must not extend the maximum time permissible for completion of the process.

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E. Committee of Creditors

Role of Creditors

3.44. The sub-committee considered role of creditors in pre-pack in other jurisdictions. In the UK, no creditor approval is mandatory and pre-pack is concluded with execution of sale by administrator. On the other hand, a plan cannot be approved by the court in the USA unless it has been approved by at least one class of impaired creditors. The discipline of the Code requires that the CoC must be the decision-making authority in a resolution process. It is a core feature of the Code and has stood the test of judicial scrutiny. The Apex Court has upheld the supremacy of commercial wisdom of CoC. It has also proved effective in terms of taking the commercial decisions that are appropriate for the resolving insolvency of a CD. The sub-committee recommends that the CoC should approve or reject a resolution plan, like it does in a CIRP. It shall also approve decisions relating to (a) termination of process, (b) liquidation of the CD, and (c) matters under section 28.

Constitution of CoC

3.45. The discipline of the Code requires that the CoC must comprise of unrelated FCs. The Apex Court has upheld the constitutional validity of composition of CoC. The RP constitutes CoC in about 30 days in a CIRP, considering claims of creditors. Since pre-pack envisages a simpler and quicker process for claim collation, the RP should constitute CoC comprising of unrelated FCs (unrelated OCs where the CD does not have any unrelated FC) within seven days of the pre-pack commencement date (PCD), based on the list of claimants provided by the CD and verified by the RP. However, he shall consider claims and make correction in claims even after seven days of the PCD and reconstitute the CoC, as may be required. This will not affect the decisions taken by CoC prior to such reconstitution. Further, OCs should be entitled to receive notice of meeting of CoC subject to meeting the criteria under section 24(3)(c) but shall not be entitled to voting rights as is the case of CIRP.

3.46. Since pre-packs require prior understanding among stakeholders, it does not work well where the number of creditors is large or they are dispersed and have disparate interests. To partially deal with number, the CIRP envisages representation of classes of creditors in the CoC through an authorised representative. However, dispensing with such representation will make the pre-pack process faster as it will avoid one additional layer in the decision-making process and disputes about correct communication of mandate of the creditors in a class. Technology may be used to enable participation of every FC directly.

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133 Schedule B1, the Insolvency Act,1986
134 Section 1129(a)(10), 11 U.S. Code
135 Supreme Court (2019), Committee of Creditors of Essar Steel India Limited Vs. Satish Kumar Gupta & Ors. (CA No. 8766-67 of 2019)
136 Supreme Court (2019), Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors., 4 SCC 17
Approvals by CoC

3.47. The Code provides for three thresholds of majority for approval of various matters. First, it requires a 90% majority for withdrawal of an application for CIRP, after its admission. This is not relevant as withdrawal after its admission under the pre-pack framework is not envisaged. Second, it provides for approval by 51% majority for matters related to operations of the CD. Since the operations remain with the CD, this becomes redundant. Third, it requires approval by 66% voting shares for matters under section 28, replacement of RP and approval of resolution plan. This requirement may continue. Since the pre-pack aims to reduce the possibility of liquidation, the decision to liquidate a CD should require approval by a higher threshold of creditors. The sub-committee recommends approval by the CoC with 75% of voting power for liquidation of CD for whatever reason.

3.48. The stakeholders are expected to manage their own risk efficiently and to actively participate in the resolution process in their own interest. However, it is not unusual to see lack of interest of some creditors in some CIRPs. The process suffers where FCs do not participate in the resolution process or try to hold-out by not voting. To deal with the impasse, it was held that those members of the CoC who are absent in the meeting, their voting shares shall not be counted. The Code was amended to provide that the decision by the creditors in a class shall be taken with the approval of more than 50% voting share of FCs, who have cast their votes. The Corporate Insolvency and Governance Act, 2020 in the UK provides for approval by creditors, present and voting. The sub-committee recommends that the CoC should take decisions with votes of the required majority of those present and voting. This may be complemented by requirement of a quorum in the meetings of the CoC. The requirement of present and voting, however, shall not apply to decision of the CoC to liquidate a CD, which must require approval of the CoC by 75% of voting power.

F. Tasks during Process

Public Announcement

3.49. The sub-committee noted the extant provisions relating to public announcement in newspapers and timelines for the same in case of CIRP. It, however, observed that public announcement may be required primarily for giving notice of commencement of pre-pack and not for inviting claims. Considering the shorter timeline available for pre-pack, and the simplified claim collation and verification process, as proposed elsewhere, the publication of public announcement on the website of CD and on the website designated by IBBI may suffice. The outreach of information utility (IU) should be leveraged to disseminate information about the commencement of pre-pack to the creditors of the CD. However, it will always be open to any creditor, who has not received intimation from RP regarding his claims, to submit details of his
claim, on coming to know of process from the website or the IU. **The sub-committee recommends an electronic publication of public announcement and dissemination of the same by the IU.**

**Claims Collation**

3.50. The process of claim collation and verification under the normal CIRP is relatively lengthy and expensive. To make it pre-pack friendly, the CD should be obligated to make available an updated list of outstanding claims, including contingent and future claims and a draft information memorandum (IM), based on its books, which may be certified by its Chairman/Managing Director/Managing Partner on behalf of the Board of Directors of the CD, to the RP on the day he is appointed by the AA. The RP should provide the details of claims, based on books of the CD and records of the IU, to each creditor and seek confirmation/objections. Where a creditor objects the claims on record, he should substantiate his claim with relevant documents. The RP shall verify those claims where a creditor has an objection or where he has reason to believe that the claim as per the records or claim submitted by a creditor is not genuine. The process will get frustrated if the CD does not provide complete and accurate information about its debts and claims. The claims, which do not appear on records, can neither be fastened onto the CD post resolution especially if the resolution process yields change in management, nor be extinguished. To mitigate any such possibility, the Board of Directors should supply complete and correct record of all claims, including contingent and future claims, with an indemnification that if any claim is omitted by them, **they will be personally liable to make such claim good.** Further, if the CD willfully provides any wrong information or omits to provide material information with respect to any claim, **the same shall attract criminal liability.** The entire process of claim verification can be automated by encouraging the use of IUs, with the CD submitting financial information to IUs and the IU developing necessary infrastructure to deal with such information, which can further reduce the cost associated with the process. **The sub-committee recommends a simplified and faster claim verification process, as detailed above, to be specified through Regulations.**

**Information Memorandum**

3.51. It is imperative in any corporate resolution process to have complete and correct information of the CD to enable the stakeholders to take an informed decision. The Code envisages preparation of an IM and sharing of the same among relevant stakeholders. However, preparation of IM by the RP often consumes considerable time during a CIRP, either because the books of the CD are not available, complete/up-to-date, the available books are not reliable, or the suspended management of the CD does not co-operate. Since pre-pack is initiated by the CD, which is in possession of all relevant financial information, it is in a better position to provide a clear and reliable state of affairs of the CD and a separate exercise of preparation of IM afresh by the RP may not be necessary. **The sub-committee recommends that the CD shall prepare a draft IM which shall be certified by the Chairman/Managing Director on behalf of the Board for its completeness and accuracy. The IM shall be handed over to the RP on the PCD.** This will save considerable time and efforts of RP and reduce the chances of information asymmetry. To mitigate
any chance of misinformation by the CD, the Chairman/Managing Director certifying the draft IM shall be personally liable for any advertent omission or wrong information. However, to ensure that the IM is drawn up in accordance with provisions of the Code, the RP shall finalise the same.

3.52. In the interest of efficiency, the reliance on physical files and documents should be avoided in course of time and the CD should be encouraged to adopt the emerging technologies to maintain records and provide complete and correct information for IM. They could voluntarily furnish financial information to an IU, which will facilitate upfront generation of standardised draft IMs to expedite the process.

Valuation of Assets

3.53. The regulations governing CIRP envisage estimation of fair value and liquidation value of the assets of the CD. These values serve as reference for evaluation of choices, including liquidation, and selection of the choice that decides the fate of the CD, and consequently of the stakeholders. A wrong valuation may liquidate an otherwise viable company, which may be disastrous for an economy. Further, valuation provides a basis for strategic negotiations and determines entitlements of dissenting creditors and other stakeholders who do not have voting power. It is necessary that valuation is conducted by an independent third party that does not have any earthly interest in the CD. Independent valuation is mandated under the pre-pack framework in the UK as well, though obtained by the CD. The sub-committee recommends that the RP shall appoint two registered valuers to determine the ‘fair value’ and ‘liquidation value’ of the CD. This will ensure to a large extent that pre-pack is not misused by the management of the CD to write off its debts or to defraud creditors.

Avoidance Transactions

3.54. In the interest of value maximisation, a typical formal insolvency process provides for claw back of value lost through avoidance transactions. The Code requires the RP to determine avoidance transactions entered by the CD prior to commencement of CIRP and to file applications before the AA for appropriate orders. The Apex Court has delineated the duties and responsibilities of the RP in respect of avoidance transactions. Since pre-pack framework envisages a shorter time frame, it may be difficult for the RP to deal with the entire spectrum of avoidance transactions. There was a suggestion to consider limiting his responsibilities to only fraudulent transactions. It was, however, noted that the incidence of avoidance transactions, for which applications have been filed in CIRPs so far, does not indicate that such transactions are rare. Overlooking such transactions completely under pre-pack may not be in the best interest of the CD. It may raise moral hazard issues and one may use pre-pack to escape such transactions. The sub-committee, therefore, recommends application of normal provisions relating to avoidance transactions to pre-pack.

Interim Finance

3.55. A CD may require working capital to run its operations and remain as a going concern during the process. The US law authorises a CD to avail new unsecured credit facility and such credit facility may be given super priority over any or all administrative expenses, with the approval of the court. The Code provides for such a facility during CIRP with the approval of CoC. Therefore, a CD should have access to interim finance during the pre-pack period. At the same time, uncontrolled access to new capital may jeopardise the interest of existing creditors. Requiring approval of court, as in US, may not be feasible in the Indian context. The access to interim finance should be available subject to the approval of CoC, as is the current requirement under section 28 of the Code and it shall be included in the insolvency resolution process cost (IRPC).

Insolvency Resolution Process Cost

3.56. The IRPC has two broad components, namely, (a) cost incurred on running the business operations to keep the CD as going concern, and (b) cost incurred to run the process. Since the existing management will be in control over the operations of the CD, the costs, which are normally incurred by the IRP/RP for managing the operations of business of CD as a going concern, should not be part of IRPC. Therefore, the IRPC for the purpose of pre-pack shall mean interim funding secured during the process, fees of the RP and other process related costs approved by CoC. The fees of RP shall be reasonable and as fixed by the CD. It shall be borne by the CD, and to the extent ratified by the CoC, shall form part of IRPC.

G. Moratorium and Timeline

Moratorium

3.57. Moratorium is a core feature of insolvency proceedings under the Code. It provides a calm period for working out a resolution plan, while the business of the CD continues uninterrupted and its assets remain intact. The moratorium prohibits institution or continuation of suits or proceedings against the CD; suspension or termination of supply of essential services to the CD; any action to foreclose, recover or enforce any security interest; transfer or alienation of the assets of the CD, etc. It is important to have similar calm period to facilitate resolution during pre-pack. It should, however, be for a minimum period and no extension may be granted to prevent any misuse of the process. Various options and their duration, and practices in foreign jurisdictions were considered. The sub-committee recommends that moratorium under section 14 should be available from the PCD till closure of process, whether by approval of resolution plan or otherwise. The moratorium should not, however, cover essential and critical services as the promoters will continue to run the operations and the RP would neither decide critical services nor control the operations. The possibility of its misuse may be minimised by measures such as (a)

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102 Section 364 of Chapter 11 of US Code
moratorium shall not be automatic or as a matter of right of the CD; it may be ordered by the AA; (b) the CoC may terminate the process early for reasons, including misuse of process; (c) the CoC exercises control through approval for matters under section 28 of the Code.

Sale during Moratorium

3.58. The Code envisages resolution of stress of the CD as a going concern. It does not allow any sale of assets of CD outside the ordinary course of business, except to a very limited extent of not exceeding 10% of total admitted claims, and, that too, with the approval of CoC as per the extant regulations. Recently, the AA has allowed sale of non-core assets in the interest of CD, though it is not allowed in ordinary circumstances. Taking a cue from the evolving jurisprudence, it may be advisable to allow sale of an asset/group of assets with the approval of the CoC, if it serves the interests of CD. Suitable carve out from the provisions of moratorium to this effect is necessary, the details of which may be provided in the Regulations. However, there is an alternate view that resolution process does not envisage sale for resolution; the assets are sold in liquidation.

Timeline

3.59. Since the CD and creditors have agreed beforehand to undertake pre-pack, they should be able to complete the process sooner. It should be possible for the CD to present the resolution plan on the day after the PCD and for the CoC to take a view as soon as it is constituted. Coupled with provision of swiss challenge, it should be possible to submit the resolution plan to the AA for approval, within 90 days of the PCD. A shorter timeline will encourage CD and creditors to pre-negotiate resolution plans, in sync with the philosophy behind pre-pack. A longer timeline will discourage creditors to agree to pre-pack as they are withholding exercise of their right to initiate CIRP, which may give a resolution if pre-pack fails. Further, a moratorium comes at a cost and it cannot be prolonged where it is not mandatory for the process to yield a resolution plan. A suggestion was considered whether the process can continue beyond 90 days without moratorium. It did not find support as it would deprive a creditor to initiate CIRP.

3.60. Since the stakeholders have agreed upon the resolution plan, and the submission of resolution plan is accompanied by a detailed compliance certificate by the RP, the AA should be able to approve it in about a week. It was noted that the Code presently provides for a consolidated timeline that includes time for market participants as well as the AA in case of CIRP and this has not yielded desired result. It may be better to provide timeline for market participants and the AA separately. The sub-committee, therefore, recommends, 90 days for market participants to submit the resolution plan to the AA, and 30 days thereafter for the AA to approve or reject it.

H. Resolution Plan

3.61. The sole objective of pre-pack is resolution of stress. The law should not limit the possibilities of resolution and it should be left to the imagination of stakeholders if it achieves the

143 Regulation 29 of the CIRP Regulations, 2016
144 NCLT (2020), Mr. Ashish Chhawchharia and Ors. Vs. Jet Airways, CP(IB).2205/MB/2019
objective. The scope of resolution plan to provide for resolution of business or an undertaking was considered. However, keeping in view the jurisprudence that has emerged so far, it was felt to continue with the extant definition of resolution plan. The resolution plan may provide for any permutation and combinations of measures, as available for a CIRP. Regulation 37 of CIRP Regulations provides an inclusive list of measures for insolvency resolution of a CD for maximisation of value of assets.

3.62. Pre-pack is not a framework for sale of the CD or its business, which may leave the shell entity behind, possibly with the liabilities. The resolution plan may, however, provide for ‘sale of all or part of the assets, whether subject to any security interest or not’, as provided in regulation 37 of the CIRP Regulations. It should be in order if a financial entity submits a resolution plan, with an intention to revive the CD over years and ultimately sells it. It is neither feasible nor desirable to prescribe and monitor how the RA deals with the CD or its assets, after resolution. This clarity needs to be provided in view of a case law, where it was held that the resolution plan should be planned for insolvency resolution of the CD as a going concern and not for addition of value with intent to sell it. The sub-committee, therefore, recommends clarity in this regard.

Resolution Applicants

3.63. Section 29A prohibits persons with specified disabilities to submit resolution plan in a CIRP. The sub-committee was of the firm view that this provision must not be diluted in design of the pre-pack framework, as it has been instrumental in bringing about significant behavioural change and establishing a fair debtor-creditor relationship. The people with questionable background and who let down their companies, employees, lenders and stakeholders do not deserve a second chance. It was, however, noted that section 240A of the Code relaxes the ineligibilities specified under clauses (c) and (h) of section 29A for RAs for MSMEs. Clause (c) prohibits a person who has an account or who is in control of an account which has been classified as NPA and at least one year has passed from the date of such classification till the commencement of CIRP. There was disagreement on applicability of clause (c) to existing promoters for non-MSME CDs under pre-pack, as discussed in the next section.

Promoter Participation

3.64. A minority of members of the sub-committee (Dr. Sahoo, Mr. Mehta and Mr. Gupta) advocated partial relaxation of clause (c) of section 29A. They submitted that no other restructuring framework, including RBI’s prudential framework, prohibits an NPA account holder to work out a resolution. Even internationally, there is no bar on the CDs from submitting resolution plans. In the US, a CD is encouraged to submit plans for its own reorganisation. Once an insolvency application is filed under Chapter 11, the CD has the exclusive right to submit a plan for a period of 120 days. Most pre-packs sales in the UK are in the form of sales to connected parties or persons who are directors, shadow directors or associates of the company.

3.65. The minority contended that business cycles run much longer than a year. If an account has

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145 NCLAT (2019), Superna Dhawan & Anr. vs. Bharati Defence and Infrastructure Ltd. & Ors. CA(AT)(Insolvency)195-2019
become NPA on account of business cycle and for no fault of the promoter, it may not become a standard account in a year. A CD may fail on account of force majeure circumstances like COVID-19. If it was viable before the onset of COVID-19, it may become viable again, after the impact of pandemic subsides. It would, however, take years to wipe off the deep stress that arose during COVID-19 period. Depending on the nature of the industry and specific strength of a CD, one may recoup the loss in one year while another may take many years, or even decades. In such cases, NPA may last for years. In recognition of lasting impact of COVID-19 stress, the law keeps such default out of insolvency proceedings forever. It may not, therefore, be fair to prohibit the promoters from submitting resolution plans in such situations.

3.66. ‘Having another go’ is not a bad idea except when it is *mala fide*. The BLRC distinguished between malfeasance and business failure. In a growing economy, firms make risky plans of which some plans will fail and will induce default. If default is equated to malfeasance, this can hamper risk taking by firms. Bankruptcy law must enshrine business failure as a normal and legitimate part of the working of the market economy. It must also block such behavior, which is undoubtedly malfeasance. It must give honest debtors a second chance, and penalise those who act with *mala fide* intentions in default. A study in the UK reveals that most pre-packs were filed for companies that failed due to market conditions. The Graham Review noted that when a CD is experiencing financial difficulties due to an industrial slow down, it is unlikely that other companies in the industry will be willing to purchase the business of the CD. In such cases, the incumbent management is often the only one willing to purchase the business of the company. In these situations, sales to connected parties are often the only option to preserve the business of the company. Britain is following America giving debt defaulters a second chance rather than punishment. Participation of promoters is justified not only because they are often the only ones who are interested in the business of the CD, but also because they are not always responsible for its distress.

3.67. Considering the stress anticipated on account of COVID-19 pandemic and scarcity of third-party RAs to participate in resolution process, a carve out for promoters from clause (c) of section 29 is warranted. The minority, therefore, suggested that a promoter having ineligibility only under clause (c) should be able to submit a resolution plan. However, a promoter which has any NPA account, other than the CD concerned, for more than a year, and any third person having NPA account for more than a year should not be allowed to submit resolution plan. If there are no third parties interested in the business of the CD and the existing promoters are ineligible, pre-pack framework may not take off and COVID-19 default would never be resolved.

3.68. However, a majority of members (Mr. Singh, Mr. U. K. Sinha, Mr. Saurav Sinha, and Mr. Vakil) strongly felt that clause (c) of section 29A must not be relaxed, this being a sort of basic feature of the Code. This has yielded considerable benefits and has been upheld by the Apex
Court. Any relaxation raises moral hazard issues and impacts the positive effect made by the Code to lender-borrower relationship. They stated that if someone has an NPA account for a year, there is something structurally wrong with the promoter or the business of CD and the distress may not be resolved even under the pre-pack. Pre-pack sales to related parties had thrice the odds of failing compared to sales to unconnected parties. The majority felt that pre-pack is essentially meant for resolution in early days of default, and not for habitual/chronic defaulters. They further stated that section 29A disqualification may not be a material issue as the RBI’s Prudential Framework already provides for COVID-19 affected accounts to continue to be classified as standard upon restructuring. In any case, the disqualification under clause (c) of section 29A is not irremediable and requires only the payment of overdues by the CD before submission of the resolution plan. Therefore, the sub-committee, with majority, does not recommend any dilution in clause (c) of section 29A for pre-pack.

Validation of Outcome

3.69. A suggestion was made to provide for a pre-pack pool (an independent body of experienced businesspersons) to offer an opinion on the resolution plan, like pre-packaged sale in UK, to avoid the possibility of low value realisation. A parallel was drawn to the Committee of Experts envisaged in the 6th August, 2020 circular of RBI in this regard. It was, however, noted that pre-pack envisaged for India is quite different from pre-pack in the UK on the material aspects, namely, (a) It is a sale in the UK whereas it is a resolution plan in India, (b) Pre-pack sale does not require any approval of the creditors and the court, while resolution plan under pre-pack framework in India needs to be approved by FCs having 66% of voting share, present and voting and thereafter, by the AA; (c) Pre-pack sale to a connected party may have validation by a member of the pre-pack pool, whereas the resolution plan in India is validated by market with participation of third-party RAs; and (d) There is no restriction on existing promoters to buy the assets in pre-pack sale, while promoters eligible under section 29A can submit resolution plan in India. It is neither mandatory to have validation from the pre-pack pool nor the opinion of the pre-pack pool is binding. The utility of pre-pack pool appears doubtful as many pre-pack sales do not use it and there is a proposal to introduce new regulations to require scrutiny of pre-pack sales to connected parties. Since the CoC is validating the value under resolution plan, which is being approved by the AA under pre-pack, having another layer (pre-pack pool) for validation may contribute to delay and amount to overregulation. After detailed discussion, a view emerged that this could be considered at a future date if concerns arise.

3.70. A suggestion was made that the framework may set the floor for realisations under a resolution plan. It was suggested that no resolution plan should be approved where resolution value (RV) is less than the fair value (FV) of the CD. After detailed discussion, it was noted that market may offer a value which is different from FV, which is only an estimation by a professional. In common parlance, RV refers to the amount of money an RA puts on the table for resolution of a CD as a going concern. It is less than FV to the extent the resolution plan allows pre-resolution shareholders to continue with the CD, post-resolution. It is more than FV to the extent the resolution plan provides for purposes, such as, infusion of funds to rehabilitate / scale up the business post resolution, over and above settlement of all claims. It varies from FV depending on

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153 Teresa Graham (2014), Graham Review into Pre-pack Administration, June
the strategy of resolution. For example, if a resolution plan converts all claims to equity, RV could be zero. Many other factors, including market imperfections, contribute to RV diverging from FV. The sub-committee noted that there is no such stipulation in case of CIRP. The Apex Court has blessed a resolution plan in a CIRP, which offered an RV less than the liquidation value\textsuperscript{154}, which is usually less than FV. Since the value is discovered through swiss challenge, the sub-committee recommends against any floor for RV.

**Value Maximisation**

3.71. Pre-pack envisages maximisation of value of assets of the CD through a resolution plan. The CIRP achieves value maximisation by allowing the entire market to compete to submit resolution plans. If a similar approach is followed in case of pre-pack, it will no more be pre-pack. Instead, the sub-committee proposes adequate incentives and disincentives to ensure value maximisation, without compromising the essence of pre-pack.

3.72. **The sub-committee recommends that the pre-pack should start with a base resolution plan.** It considered two options for generation of the base resolution plan. One, promoters should keep a plan ready, preferably in consultation with stakeholders, before application for pre-pack and submit it within 2-3 days of the PCD. Where the promoter is not eligible under section 29A or does not wish to submit a plan, yet initiates pre-pack, the creditors should arrange for submission of a resolution plan to serve as a base plan. Where the promoter has chosen not to submit resolution plan at the beginning, it would not have the option to submit a plan at any stage later. Second, the IP, who is proposed to be appointed as RP, or the creditors may run a private and confidential process to invite resolution plans from promoters and other investors and select the best of the plans received at the pre-pre-pack stage to serve as the base plan. The second option, it is argued, will induce the promoters to offer the best to cross the first hurdle to retain the CD. It was, however, felt that while market may be encouraged to do this, it may be difficult to prescribe and monitor pre-admission activities. Further, there is a possibility that the CD may not initiate pre-pack process at all if the promoters fail at this stage. Instead, the first option could be designed to induce the promoters to offer the best plan at first go by provisions such as: (a) the base plan will face the swiss challenge, (b) the CD will proceed for liquidation if the CoC decides so with 75% of voting share at any time during the process; and (c) the CD will undergo CIRP if a creditor initiates CIRP on closure of pre-pack.

3.73. There was a detailed discussion on different levels of marketing vis-à-vis the extent of realisations for creditors, particularly those who are not sitting on the decision-making table. If interests of stakeholders, who are not decision makers, are fully protected, the CoC may opt for lower marketing. This is like deemed approval of unimpaired creditors in the US regime. After detailed deliberations, the sub-committee recommends that the pre-pack should offer two optional approaches, namely, (i) without swiss challenge but no impairment to OCs, and (ii) with swiss challenge with rights of OCs and dissenting FCs subject to minimum provided under section 30(2)(b). The first approach may facilitate resolution plan arrived at under the existing frameworks outside the Code, which generally do not impair the rights of OCs, to have the blessings of the Code.

\textsuperscript{154} Supreme Court (2020), Maharashtra Seamless Limited Vs. Padmanabhan Venkatesh & Ors., CA Nos. 4967-4968 of 2019
3.74. The base resolution plan submitted by promoters shall form the basis for swiss challenge, where the details of the plan are disclosed. The sub-committee noted that swiss challenge is a time-tested mechanism and has proven to be highly effective in value maximisation and ensuring transparency of the process. However, the rights and interests of promoters and RAs participating in the swiss challenge should be balanced carefully. If the promoter knows that someone may come up with a better offer, it will endeavour to offer the best value at the first instance. However, to prevent unexpected takeovers by third-party RAs, if a plan is submitted that offers a higher consideration than the plan offered by the promoters of the CD, the promoters should have an option to match such a plan. This would minimise the fear of loss of control by the existing management of CD and incentivise it to initiate the process at an early stage. However, if the promoters have an absolute right to match the offer of a challenger, then no RA will be interested to participate in the process, as they know that the promoter would ultimately match their offers. Conversely, it will incentivise the promoter to submit an undervalued resolution plan at the outset, knowing fully well that it can later match the value in case a higher value is offered. Further, there must not be more than one round of swiss challenge, as it will disturb the timeline and even discourage prospective RAs to participate in the process. However, after swiss challenger is identified, the CoC may allow multiple chances to the promoter and the swiss challenger to improve their plans in quick succession. Therefore, design of the swiss challenge needs to balance the incentives and disincentive of the promoters and the swiss challenger to drive value maximisation. Details of such design needs to be worked out and specified through Regulations. A model of swiss challenge for pre-pack, designed by two members, namely, Mr. Gupta and Mr. Vakil, is placed at Annexure B.

I. Other Aspects

Closure of Process

3.75. A pre-pack process may conclude by an order of the AA, based on an application by the RP, under any of the following circumstances:

(a) Approval of Resolution Plan: Where the process yields a resolution plan which is approved by the CoC, the RP shall file the same with the AA in the manner provided under section 30(6) for its approval. Upon approval of the plan by the AA, it shall be binding on the CD and other stakeholders, as provided under section 31 for CIRP.

(b) No resolution received or approved: The process will close where no resolution plan is received, where no resolution plan is approved by the CoC, or where resolution plan is not approved by the AA, whichever is the earliest. On closure, a stakeholder may use CIRP to resolve stress of the CD.

(c) Expiry of Timeline: The pre-pack process shall close on the expiry of 90th day, except where the application for approval of resolution plan has been submitted to the AA for approval.

(d) Termination by CoC: The conduct of the CD is critical. For example, it needs to fully co-operate

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with the RP and the CoC to complete the process. The CoC may close the process with 66% of creditors, present and voting if the CD does not conduct well. Since the process is initiated on an application of the CD, it may not be closed by withdrawal of application after admission.

\[(e) \textit{Liquidation}:\] The CoC may decide anytime, including in its first meeting, to liquidate the CD for any reason, including commercial considerations, conduct of the CD, with 75% of voting share. There will, however, be no liquidation where pre-pack was initiated for pre-default stress, default below the threshold for initiation of CIRP (which is Rs. 1 crore at present) or COVID-19 defaults.

**Prevention of abuse**

3.76. The sub-committee noted that with the introduction of pre-pack and conferment of benefits available, as available for CIRP, on pre-pack, the possibility of certain purely commercial deals entered into between corporates being portrayed as resolution plans under pre-pack cannot be ruled out. To prevent such abuse, the sub-committee proposes several safeguards. It proposes a stopcock at the entry point by limiting access to the CD, upon meeting certain criteria such as having updated, audited financial statements and consent of 51% unrelated FCs by value to start the process and to the choice of the RP. During the process, the RP is obliged to determine avoidance transactions and file applications for the same before the AA; the CoC is empowered to close the process for misconduct of the CD and to even decide to liquidate the CD, the stress is resolved by a resolution plan and not by sale, only section 29A eligible persons are allowed to participate in the process, there is a swiss challenge to drive valuation, the resolution plan protects the entitlement of OCs and dissenting FCs under section 30(2) of the Code, and there is a cooling off of three years before a CD can take recourse to the pre-pack again to resolve its insolvency.

**NCLT Role & Infrastructure**

3.77. The sub-committee highlighted the concerns relating to the capacity and infrastructural constraints of NCLT to handle proceedings which may arise on account of pre-pack. Though pre-pack is lighter for the AA, the number of pre-packs could be overwhelming. The pendency of applications for admission, which is huge, may increase once the suspension of application for CIRP in respect of COVID-19 period default expires. The case load may increase further once the proposed SIRP for MSMEs is implemented. While appreciating the efforts of the Government to augment the capacity of NCLT, the sub-committee recommends substantial increase of bench capacity of NCLT. It suggested to explore if admission of a pre-pack could be done by an Administrative Agency or the Registrar of NCLT. If that is not possible, the admission could be made by either a judicial or technical member, instead of a bench comprising two members.

**SUMMARY OF RECOMMENDATIONS**

3.78. The recommendations of the sub-committee are summarised as under:

(a) It is opportune time to provide a framework for pre-pack for resolution of insolvency under
DESIGNING A PRE-PACK FRAMEWORK

the Code. It should be an additional option for resolution, which blends features of both formal and informal options. It should start with the simplest variant, as envisaged here, which may acquire advanced features in course of time. It should yield a resolution plan, as envisaged under the Code.

(b) The framework must be within the basic structure of the Code. It should have the rigour and discipline of IBC and pursue the same objectives as the Code does. It should not impair rights of any party beyond what is provided in the Code and should have adequate checks and balances to prevent any abuse. It should enjoy the same regulatory benefits as are available to CIRP.

(c) The Code may be amended quickly, preferably by an Ordinance, to provide for formal part of pre-pack. The Code may make a skeletal provision enabling pre-pack, while informal part could be left to market practice or guided by self-regulation, guidelines, best practices, etc.

(d) Pre-pack should be available for all CDs and for any stress - pre-default and post-default. Depending on policy objective, capacity of the NCLT and availability of SIRP for MSMEs, the implementation could be phased. It may commence in respect of defaults from Rs.1 lakh to Rs.1 crore and COVID-19 defaults for which CIRP is not available today, followed by default above Rs.1 crore, and then default from Re.1 to Rs.1 lakh. Pre-pack in respect of pre-default may be considered with consent of higher threshold (say 75%) of all creditors, after successful implementation of post-default resolutions.

(e) The CD shall initiate pre-pack with consent of simple majority of (a) unrelated FCs (b) its shareholders. No two proceedings - pre-pack and CIRP - shall run in parallel. There shall be a cooling off that a pre-pack cannot be initiated within three years of closure of another pre-pack.

(f) The CD shall remain under the control and possession of the current promoters and management during pre-pack process. Decisions on matters enumerated under section 28 of the Code, including interim finance, shall be taken by the CD with the approval of the CoC.

(g) The CD shall make available an updated list of outstanding claims, including contingent and future claims, and a draft IM, based on its books, duly certified by its Chairman/Managing Director/Managing Partner along with an indemnification that if any claim is omitted, they will be personally liable to make such claim good. Further, if the CD willfully provides any wrong information or omits to provide material information with respect to any claim, the same shall attract criminal liability.

(h) The moratorium under section 14 shall be available from the PCD till closure or termination of process, whether by approval of resolution plan or otherwise. It shall not, however, cover essential and critical services.

(i) An IP shall play the role of RPs in pre-packs. He shall conduct the process and not run the operations of the CD. He shall ensure transparency and fairness of the process, safeguard the interests of stakeholders, business, and the public, and ensure compliances with the law as regards the process.
(j) The choice of IP and his terms of appointment shall have consent of majority of unrelated Fcs.

(k) The RP shall publish the public announcement on an electronic platform, which shall be disseminated to the creditors by an IU. He shall verify claims and finalise IM.

(l) The RP shall constitute the CoC comprising unrelated FCs (unrelated OCs where the CD does not have any unrelated FC) within seven days of the PCD.

(m) The RP shall get valuation – liquidation value and fair value - of the CD done by two registered valuers.

(n) The RP shall conduct the usual due diligence and make applications to the AA in respect of avoidance transactions.

(o) The CoC shall take decisions with the approval of required majority of votes, present and voting. Only the decision to liquidate the CD would require approval by 75% of voting share.

(p) The CoC may decide to close the process with approval of 66% of voting share, present and voting, if the CD engages in any activity which has potential to cause depletion of assets or value to the detriment of creditors. It may even decide with 75% of voting share to liquidate the CD at any time during the pre-pack process.

(q) There shall be no dilution of provisions of section 29A in respect of Ras for submission of resolution plans.

(r) The pre-pack should start with a base resolution plan, which will face swiss challenge. This should come from the promoters if they are eligible and interested. Otherwise, the CoC may arrange a base plan.

(s) The pre-pack should offer two optional approaches, namely, (i) without swiss challenge but no impairment to OCs, and (ii) with swiss challenge with rights of OCs and dissenting FCs subject to minimum provided under section 30(2)(b).

(t) It shall not be necessary that the resolution value shall be higher than the realisable value. There shall be no requirement of validation of the resolution value by an experienced person.

(u) The design of the swiss challenge needs to balance the incentives and disincentives of the promoters and the swiss challenger to drive value maximisation. Details of such design should be specified through Regulations.

(v) The pre-pack shall not end up with liquidation, except when the CoC decides to liquidate the CD with 75% voting share. There will, however, be no liquidation where pre-pack was initiated for pre-default stress, default below the threshold for initiation of CIRP and COVID-19 defaults.

(w) The IRPC shall include interim finance, fees of the RP and other process related costs approved by CoC and not include cost incurred to run the process.
(x) The pre-pack should allow 90 days for market participants to submit the resolution plan to the AA, and 30 days thereafter for the AA to approve or reject it.

(y) The resolution plan approved by the AA shall be binding on everyone. The successful resolution applicant shall start on a clean slate. The regulatory benefits, as are available for CIRP, shall be available for pre-pack.

(z) The bench capacity and infrastructure of the NCLT need considerable enhancement.

3.79. The salient features of proposed pre-pack vis-à-vis CIRP are presented in Table 5.

3.80. A Typical Pre-pack Process Flow is presented at Annexure C.
### Table 5: Salient Features of Proposed Pre-pack vis-à-vis CIRP

<table>
<thead>
<tr>
<th>Parameter</th>
<th>CIRP</th>
<th>Proposed Pre-pack</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective</td>
<td>Resolution through a resolution plan</td>
<td>Resolution through a resolution plan</td>
</tr>
<tr>
<td>Legal framework</td>
<td>Relatively more in the statute and less in regulations</td>
<td>Relatively less in the statute and more in regulations</td>
</tr>
<tr>
<td>Applicability</td>
<td>Companies and LLPs</td>
<td>Companies and LLPs</td>
</tr>
<tr>
<td>Initiation of process</td>
<td>Default above Rs.1 crore, excluding COVID-19 Default</td>
<td>Pre and post default stress, including COVID-19 default. In a phased manner, if required</td>
</tr>
<tr>
<td>Initiation by</td>
<td>FC, OC, or CD</td>
<td>CD, with consent of majority of unrelated Fcs</td>
</tr>
<tr>
<td>Management of the CD</td>
<td>IP-in-possession with creditor-in-control</td>
<td>Debtor-in-possession with creditor-in-control</td>
</tr>
<tr>
<td>Role of IP</td>
<td>IRP appointed by the applicant and then RP by the CoC</td>
<td>RP, to be appointed with consent of majority of unrelated Fcs</td>
</tr>
<tr>
<td></td>
<td>Managing affairs of the CD and conducting the process</td>
<td>Conducting the process</td>
</tr>
<tr>
<td>Claim collation</td>
<td>IRP to invite and collate</td>
<td>CD to provide. RP to verify.</td>
</tr>
<tr>
<td>Information memorandum</td>
<td>Prepared by RP</td>
<td>Draft prepared by CD and finalised by RP</td>
</tr>
<tr>
<td>Moratorium</td>
<td>Moratorium under section 14</td>
<td>Limited Moratorium</td>
</tr>
<tr>
<td>Interim finance</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Avoidance transactions</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Valuation</td>
<td>By two valuers</td>
<td>By two valuers</td>
</tr>
<tr>
<td>IRPC</td>
<td>Includes cost of running operations</td>
<td>Does not include cost of running operations</td>
</tr>
<tr>
<td>Invitation for resolution plans</td>
<td>Public process</td>
<td>First right of offer to promoters, Swiss Challenge</td>
</tr>
<tr>
<td>Ineligibility for resolution plan</td>
<td>Section 29A to applies</td>
<td>Section 29A to apply</td>
</tr>
<tr>
<td>Early closure of process</td>
<td>Under section 12A, on request of the applicant</td>
<td>With approval of 66% of voting share, present and voting; Suo moto by CoC</td>
</tr>
<tr>
<td>Approval of resolution plan by CoC</td>
<td>66% of voting share</td>
<td>66% of voting share, present and voting</td>
</tr>
<tr>
<td>Consequence of termination of process</td>
<td>No termination allowed</td>
<td>Liquidation, with 75% of voting share of CoC</td>
</tr>
<tr>
<td>Consequence of failure of process</td>
<td>Liquidation</td>
<td>Closure</td>
</tr>
<tr>
<td>Binding outcome</td>
<td>Resolution plan binding</td>
<td>Resolution plan binding</td>
</tr>
<tr>
<td>Regulatory benefits</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Clean Slate, post resolution</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Role of IP and AA</td>
<td>Relatively more</td>
<td>Relatively less</td>
</tr>
<tr>
<td>Timeline</td>
<td>180 days till approval of resolution plan by the AA</td>
<td>90 days for filing of resolution plan with the AA plus 30 days for the AA to approve it</td>
</tr>
<tr>
<td>Cooling off</td>
<td>12 months between two CIRPs</td>
<td>Three years between two Pre-packs</td>
</tr>
</tbody>
</table>
Order No. 30/20/2020-Insolvency Section dated 24th June, 2020 of Ministry of Corporate Affairs constituting the Sub-Committee

No. 30/20/2020- Insolvency Section
Government of India
Ministry of Corporate Affairs

5th Floor, A Wing
Shastri Bhawan, New Delhi
Dated: 24th June, 2020

Order

Subject: - Constitution of sub-committee of Insolvency Law Committee to propose a detailed scheme for implementing prepack and prearranged insolvency resolution process.

The experience from implementation of the insolvency and Bankruptcy Code, 2016 (the Code) including evolution of the ecosystem, stabilisation of the processes, growing jurisprudence has prepared ground to look at new initiatives to further improve the effectiveness of the Code. The efficacy of out-of-court workouts in delivering speedier resolutions provided regulators extend the same regulatory exemptions as available to settlements made under the IBC framework was considered and it was felt that Pre-packaged insolvency resolution process (PPIRP) may be introduced under the Code with necessary checks and balances, as an option for resolving insolvency.

2. In this regard, during deliberation of meeting of Insolvency Law Committee (Standing Committee vide order dated 6.03.2019) dated 14.05.2020, it was decided to form a sub-committee for examining it further and to give its recommendation to this Ministry on the following terms of reference:

i. To study and recommend the regulatory framework for prepack insolvency resolution process which shall include pre-requisites for initiation of PPIRP in terms of default and threshold, appointment of Insolvency Professional, role and responsibility of committees of creditors, moratorium, expected cost of process, timelines for completion of process.

ii. The committee may also invite or co-opt practitioners, experts or individuals who have knowledge or experience in the subject matter. The committee may also consult other stakeholders as part of its deliberations.

3. Accordingly a sub-committee of Insolvency Law Committee is constituted as under:-

i. Dr. M.S. Sahoo, Chairperson IBBI & Member, ILC Chairman

ii. Sh. U.K. Sinha, Ex SEBI Chairman & Member, ILC Member
Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process

iii Sh. Sunil Mehta, Chief Executive Officer, IBA Member
iv Sh. Bahram Vakil, Partner, AZB & Member, ILC Member
v Sh. Akhil Gupta, Bharati Infratech Member
vi Joint Secretary, MCA representative Member
vii Nominee of Reserve Bank of India not below the rank of Executive Director & Member, ILC Member

4. Secretarial support to the committee will be arranged by Insolvency and Bankruptcy Board of India which will also bear the expenses incurred by the non-official members of the committee towards travel, local conveyance and other allowances as per extant government instructions, wherever the sponsoring agency is unable to bear their expenditure.

5. The committee shall submit its recommendations within three weeks from its first meeting.

6. This issue with the approval of Secretary, Corporate Affairs.

(Rakesh Tyagi)
Director

To
All members

Copy to:-
(i) PS to CAM
(ii) PS to MOS for CA
(iii) Sr. PPS to Secretary, MCA
(iv) Governor, RBI with a request to nominate an officer not below the rank of Executive Director as member of the sub-committee.
(v) PS to JS(G)
A base resolution plan should be ready before commencement of pre-pack. It could come from promoters if they are eligible under section 29A of the Code and wish to submit a plan, or from another person arranged by the creditors. Where creditors are arranging a resolution plan, they may run a private and confidential process to invite resolution plans from select investors and select the best of them to serve as the base plan.

On commencement of pre-pack, the base resolution plan shall be submitted to the RP. If such plan pays out the dues of OCs fully and the CoC feels that it gives the best value, it may decide to accept the plan. If it does not pay the dues of OCs fully, it shall necessarily conduct a swiss challenge. It shall release the commercials of the base plan and its weighted average score (WAS) as worked out by the CoC and invite resolution plans to challenge the base plan and select the best of them. Such invitation will be made only once.

The CoC now has two plans, the base plan (Plan A) from the promoter / investor and the plan (Plan B) of the swiss challenger. If WAS of Plan B is better than the Plan A by more than X%, Plan B will be accepted. If WAS of Plan B is better than Plan A by less than X%, the promoter / investor would have an option to improve the WAS of Plan A by at least Y% above that of Plan B. Thereafter, the swiss challenger will have an option to improve WAS of Plan B by at least Y% above that of Plan A. Then the promoter/investor would have option to similarly improve its plan further. This process will go on till one of then decides to quit. The opportunity for improvement will be closed in 24-48 hours. The person, who does not quit, becomes the successful resolution applicant. The processes will be backed up by usual legal arrangements to enforce the outcome.
Appendix C

A Typical Pre-pack Process Flow

1. Mutual Understanding
2. Shareholders Resolution (51%)
3. Consent of 51% Unrelated Fcs
4. Application to AA

Pre-admission

Limited Moratorium

Admission.
Process Begins
\( T_{+7} \)

RP constitutes CoC
\( T_{+7} \)

CD submits Resolution Plan
\( T_{+30} \)

Resolution Plan submitted by CD is placed for Swiss Challenge.
If the H-1 bidder is:
- Lower than CD plan - CD plan is selected.
- Higher than CD plan (by less than 5%) - CD is given a chance to match by paying 10% extra of H-1 Plan.
- Higher than CD plan by more than 5% then H-1 Plan is selected.

Process Begins
PPIRP fails.

CoC wants Swiss Challenge?

The claims of OC are not impaired in Resolution Plan

CoC considers the Resolution Plan

CoC approves the Plan?

Resolution Plan submitted by CD is placed for Swiss Challenge.
If the H-1 bidder is:
- Lower than CD plan - CD plan is selected.
- Higher than CD plan (by less than 5%) - CD is given a chance to match by paying 10% extra of H-1 Plan.
- Higher than CD plan by more than 5% then H-1 Plan is selected.

Anytime During the process, the CoC can decide to terminate the process.
Also the CoC can decide with 75% majority to Liquidate the CD.