Pre-packing the insolvency resolution process
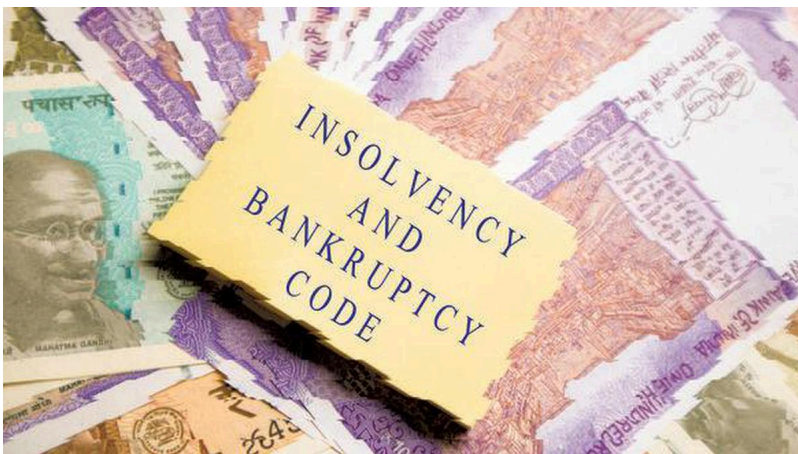
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Multiple competing choices for resolution of stress makes an economy a great place to do business

BY MS SAHOO

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The Insolvency and Bankruptcy Code, 2016 envisaged standard, plain vanilla processes to start with, but anticipated sophisticated options as the ecosystem matured. With considerable learning and maturity of the ecosystem, and a reasonably fair debtor-creditor relationship in place, the stage is set to push the envelope a bit further.

The IBC-envisaged corporate insolvency resolution process (CIRP) critically depends on the availability of resolution applicants (RAs). When most companies, industries and

economies are reeling under stress on account of the Covid pandemic, the likelihood of finding an RA to rescue a failing company is low.

This may remain a concern for some time as there is no clarity as to when Covid-19 will subside fully and even after that the business and economy may take some time to return to normal. Further, the CIRP is not available in respect of defaults below ₹1 crore and those that arose during the last one year.

This has two consequences — either the company remains under stress for too

long or the creditors use available means to recover their dues. In either case, the company may not survive long. This necessitates exploring novel options that attempt to resolve stress but do not yield liquidation for want of an RA.

The CIRP has a set process and, therefore, some amount of inflexibility, which may limit its use in certain circumstances. It shifts control of the company to an interim resolution professional and then to a resolution professional and finally to the successful RA, which may cause business disruptions.

The displacement of the current management disincentivises companies to initiate the CIRP voluntarily in case of stress. This partly explains non-cooperation by the current promoters and management, leading to intense litigation in some cases.

Determination of several issues, including avoidance transactions, has been a challenge to the limited capacity of the Adjudicating Authority leading to breach of timelines in some CIRPs.

The market prefers flexibility to

work out a tailor-made resolution best suited to the unique circumstances. It, however, does not like complete flexibility; it appreciates a guided path and wishes to avail itself of benefits and sanctity of a formal process.

In other words, the market prefers a semi-formal process that side-steps the difficulties of a formal process but retains its benefits and sanctity. In a sense, the formal process and informal process are two ends of a spectrum and a variety of semi-formal processes, that blend elements from both, may exist to suit the

convenience of the stakeholders.

The pre-pack option

The most popular semi-formal option is pre-pack, which starts with an informal understanding among stakeholders, engages with them formally in between, and ends with a judicial blessing of the outcome. The insolvency laws around the world provide a variant of pre-pack, though the nuances differ across jurisdictions. The formal processes in India (withdrawal under the CIRP, compromise or arrangement under the Companies Act, 2013 and the RBI's prudential

framework) have some elements of pre-pack.

As compared to the CIRP, pre-pack is typically more flexible, cost effective, time effective, less disruptive to business and devoid of stigma, and more conducive for group insolvency. It increases possibility of reorganisation and entails a limited role of the courts and IPs.

It has, however, its share of concerns such as 'serial pre-packing' (controlling parties acquire the company successively to avoid debt rather than rescue the company). Private negotiation and

understanding among a set of stakeholders prior to commencement of formal process, which contribute to its advantages, is often a source of concern. Though emanated from market practice, pre-pack is getting formal and regulated to address the concerns.

The market has been advocating and anticipating pre-pack resolution process for some time. In recognition of the need, the government had set up a sub-committee of the Insolvency Law Committee to recommend an India-centric pre-pack.

Within the basic structure

of the IBC, the sub-committee has designed a pre-pack process where the financial creditors have extensive control, the company enjoys moratorium during the process, and the outcome is binding on all.

The proposed pre-pack process has the features that make a CIRP sacrosanct, and has the rigour and discipline of the CIRP. It is informal up to a point and formal thereafter. It blends debtor-in-possession with creditor-in-control. It is neither a fully private nor a fully public process — it allows the company, if eligible under

Section 29A, to submit the base resolution plan which is exposed to Swiss Challenge for value maximisation. It safeguards rights of stakeholders as much as in the CIRP and has adequate checks and balances to prevent any potential misuse.

Now that the haze around moratorium has been cleared by the Supreme Court, the suspension of initiation of insolvency proceedings has expired, and the trajectory of Covid-19 is fairly understood, it is the most opportune time to introduce pre-packs, which is a natural step in the evolution of

insolvency regimes, within the Code.

It will enrich the menu of options for resolution of stress and take the Indian insolvency journey to the next level. It will also serve as one of the alternative methods of debt resolution envisaged in the last Budget.

The writer is Chairperson, Insolvency and Bankruptcy Board of India

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