# Insolvency and Bankruptcy Code (Amendment) Bill, 2021 - Pre-Packs

## Why in news?

- The Insolvency and Bankruptcy Code (Amendment) Bill, 2021 was recently passed by Lok Sabha, replacing an ordinance on the same.
- It has proposed 'pre-packs' as an insolvency resolution mechanism for Micro, Small and Medium Enterprises (MSMEs).

## How do 'pre-packs' work?

- A Pre-packaged Insolvency Resolution Process (PIRP) relates to the resolution of the debt of a distressed company.
- Pre-packs work through a direct agreement between secured creditors and the existing owners or outside investors.
- The agreement is an option instead of a public bidding process.
- Under it, financial creditors will agree to terms with the promoters or a potential investor.
- They then seek approval of the resolution plan from the National Company Law Tribunal (NCLT).
- The approval of at least 66% of financial creditors that are unrelated to the corporate debtor is required before a resolution plan is submitted to the NCLT.
- The NCLTs will be required to either accept or reject an application for a pre-pack insolvency proceeding before considering a petition for a CIRP.
- Corporate Insolvency Resolution Process (CIRP) is the existing mechanism.

## How do pre-packs differ from CIRP?

- One of the key criticisms of the CIRP has been the time it takes for resolution.
- At the end of March 2021, 79% of the ongoing insolvency resolution proceedings had crossed the 270-day threshold.
- A major reason for the delays is the prolonged litigation by erstwhile promoters and potential bidders.
- The pre-pack, in contrast, is limited to a maximum of 120 days.
- It has only 90 days available to stakeholders to bring a resolution plan for

approval before the NCLT.
- In the case of CIRP, a resolution professional takes control of the debtor as a representative of financial creditors.
- In the case of pre-packs, the existing management retains control.
- This would ensure minimal disruption of operations relative to a CIRP.

## What is the objective?

- Pre-packs are largely aimed at providing MSMEs with an opportunity to restructure their liabilities and start with a clean slate.
- Nevertheless, it provides adequate protections so that the system is not misused by firms to avoid making payments to creditors.
- Currently, only corporate debtors themselves are permitted to initiate a PIRP after obtaining the approval of 66% of their creditors.
- The pre-pack mechanism, however, allows for a 'Swiss challenge' to any resolution plan that provides less than full recovery of dues for operational creditors.
- [Under the Swiss challenge mechanism, any third party would be permitted to submit a resolution plan for the distressed company.
- The original applicant would have to either match the improved resolution plan or forego the investment.]

## What challenges can pre-packs bring?

- The timeline for the PIRP may be difficult to meet for lenders and distressed firms.
- Notably, forensic audits were particularly important in cases where the control of the firm remains with the same management.
- Ordinarily, where compromises are involved, forensic/transaction audits become imperative.
- And, a negative report from the audits becomes a roadblock in resolution involving the same management.
- Also, a firm can restructure its outstanding debt through a PIRP with the existing management retaining control.
- So, the NPA status of the company's account with lenders may not be automatically upgraded under RBI guidelines.

## What next?

- In order to motivate resolution under the PIRP, the RBI guidelines on account status may be aligned with the objective of IBC (Insolvency and Bankruptcy Code).
- Also, the lenders could be given the benefit of account upgradation upon

resolution.
- There is a need for the IBBI and RBI to find middle ground on these regulations to make the PIRP more attractive.
- [IBBI - Insolvency and Bankruptcy Board of India]

**Source: The Indian Express**

**Quick Fact**

## Insolvency and bankruptcy code (IBC)

- Insolvency and bankruptcy code 2016 was introduced to resolve the bankruptcy crisis in corporate sector.
- Under IBC, either the creditor (banks) or the loaner (defaulter) can initiate insolvency proceedings.
- It is done by submitting a plea to the adjudicating authority, the National Companies Law Tribunal (NCLT).
- According to IBC, a financial creditor holds an important role in the corporate insolvency process.
- The Committee of Creditors (CoC) under IBC includes all financial creditors of a corporate debtor.
- The CoC will appoint and supervise the Insolvency Professional.
- It has the power to either approve or reject the resolution plan to revive the debtor, or to proceed to liquidate the debtor.

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