

Pre-packaged Insolvency for MSMEs

- The Central Government has put up an order ordinance [in use of pre-packs as an insolvency resolution](#) mechanism for Micro, Small and Medium Enterprises (MSMEs) with defaults up to Rs 1 crore, under the Insolvency and Bankruptcy Code.
- The move comes soon after the end of a one-year suspension of insolvency initiation imposed by the government in light of the [Covid-19 pandemic](#). The government had last year also increased the minimum default threshold for insolvency proceedings from Rs 1 lakh to Rs 1 crore. We examine pre-packs and their impact on the insolvency resolution process.

What are pre-packs?

- A pre-pack is the resolution of the debt of a distressed company through an agreement between secured creditors and investors instead of a public bidding process. This system of insolvency proceedings has become an increasingly popular mechanism for insolvency resolution in the UK and Europe over the past decade. Under the pre-pack system, financial creditors will agree to terms with a potential investor and seek approval of the resolution plan from the National Company Law Tribunal (NCLT).
- The approval of a minimum of 66 per cent of financial creditors that are unrelated to the corporate debtor would be required before a resolution plan is submitted to the NCLT. Further NCLTs are also required to either accept or reject any application for a pre-pack insolvency proceeding before considering a petition for a Corporate Insolvency Resolution Process (CIRP)

What are the benefits of pre-packs over the Corporate Insolvency Resolution Process (CIRP)?

- One of the key criticisms of the CIRP has been the time taken for resolution. At the end of December 2020, over 86 per cent of the 1717 ongoing insolvency resolution proceedings had crossed the 270-day threshold. One of the key reasons behind delays in the CIRPs are prolonged litigations by erstwhile promoters and potential bidders.
- The pre-pack in contrast is limited to a maximum of 120 days with only 90 days available to the stakeholders to bring the resolution plan to the NCLT.
- Another key difference between pre-packs and CIRP is that the existing management retains control in the case of pre-packs while a resolution professional takes control of the debtor as a representative of financial creditors in the case of CIRP. Experts note that this allows for minimal disruption of operations relative to a CIRP.

What is the key motivation behind the introduction of the pre-pack?

- According to sources aware of developments, pre-packs are largely aimed at providing MSMEs with an opportunity to restructure their liabilities and start with a clean slate while still providing adequate protections so that the system is not misused by firms to avoid making payments to creditors.
- “Prepacks will help corporate debtors to enter into consensual restructuring with lenders and address the entire liability side of the company,” said Rajiv Chandak, partner at Deloitte India, noting that the government should consider setting up specific benches of the NCLT to deal with pre-pack resolution plans to ensure that they are implemented in a time-bound manner.

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- Pre-pack for MSMEs is a hybrid corporate rescue process, which blends elements and virtues of both formal and informal insolvency proceedings. A resolution plan is negotiated between debtor and its creditors before commencement of formal proceedings," the ministry said.
 - The initiative is based on a trust model and the amendments honour the honest MSME owners by trying to ensure that the resolution happens, and the company remains with them," the Ministry of Corporate Affairs said in a statement.
 - It is expected that the incorporation of pre-packaged insolvency resolution process will alleviate the distress faced by MSMEs due to the impact of the pandemic and the unique nature of their business, it added.
 - The government had suspended fresh insolvency proceedings for six months from March 25, 2020, when a nationwide lockdown was imposed to curb the spread of coronavirus infections. The suspension was extended twice by three months till December 24, 2020 and then March 24, 2021

Govt amends IBC, introduces pre-packaged resolution process for MSMEs

- The government on Sunday amended the Insolvency and Bankruptcy Code, 2016 by promulgating an Ordinance to provide pre-packaged resolution for micro, small and medium enterprises (MSMEs).
- The amendment allows the Centre to notify the minimum amount of default value, not more than Rs 1 crore, for pre-packaged insolvency resolution process.
- The Ordinance said MSMEs are critical for India's economy as they contribute significantly to its gross domestic product and provide employment to a sizeable population, and it is considered necessary to urgently address the specific requirements of MSMEs relating to the resolution of their insolvency due to the unique nature of their businesses and simpler corporate structures.
- It is considered expedient to provide an efficient alternative insolvency resolution process for corporate persons classified as micro, small and medium enterprises under the Insolvency and Bankruptcy Code, 2016, ensuring quicker, cost-effective and value maximising outcomes for all the stakeholders, in a manner which is least disruptive to the continuity of their businesses and which preserves jobs," it said.
- The IBC Amendment Ordinance, 2021 makes available the pre-packaged route to genuine and viable cases, to ensure least business disruption, Soumitra Majumdar, Partner at J Sagar Associates, told news agency PTI