



PRE-PACKAGED INSOLVENCY RESOLUTION PROCESS

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Introduction

CURRENT FINANCIAL STRESS RESOLUTION MECHANISMS

- ▶ A company in financial stress may seek for a resolution under the following options:

Formal court based enforcement system	Out-of-court options
CIRP under the IBC Code	The RBI's prudential framework for resolution of stressed assets
Scheme of compromise or arrangement (SoA) under the Companies Act, 2013	Informal thoughtful between a debtor and creditor, with /without help of a mediator

- ▶ Each of the resolution options has certain its own advantages as well as limitations
- ▶ The (Indian) Insolvency Law Sub-Committee chaired by Mr. Sahoo along with other advisors and industry participants issued the Report on Pre-packaged Insolvency Resolution Process on January 8, 2021
- ▶ The Report sets out a proposed framework for pre-packaged insolvency resolution in India within the structure of the Insolvency and Bankruptcy Code, 2016

What is Pre-pack?

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.

Pre-packs can be thought of as an amalgamation of the court-oriented process under IBC and the out of court debt restructuring involving lender banks and creditors.

The process under pre-pack insolvency envisages formation of a resolution plan to resolve the corporate debtor's stressed assets and debts, before the initiation of a formal provision bound court process before the NCLT.

Why Pre-pack?

The advantages of a pre-pack in terms of time and costs and minimal disruption to the debtor's business make it a helpful alternative for companies facing financial distress as a result of the COVID-19 pandemic as the time spent in the formal IBC process can be significantly reduced.

In addition to these advantages, it would also ease the burden on tribunals as a pre-pack would most likely require fewer filings and court time than a typical CIRP.

Considering the above, these are good reasons to bring pre-packs into the Indian insolvency framework for the COVID-19 era and beyond.

It is, however, important to keep in mind a few factors, including the inherent limitations of pre-packs, when designing a framework for pre-packs in India.

Need for pre pack



Ease the burden on NCLT/NCLAT as the substantial part of the proceeding is undertaken before the commencement of formal proceeding by the court.



Entails early detection of stress and timely restructuring of the CD

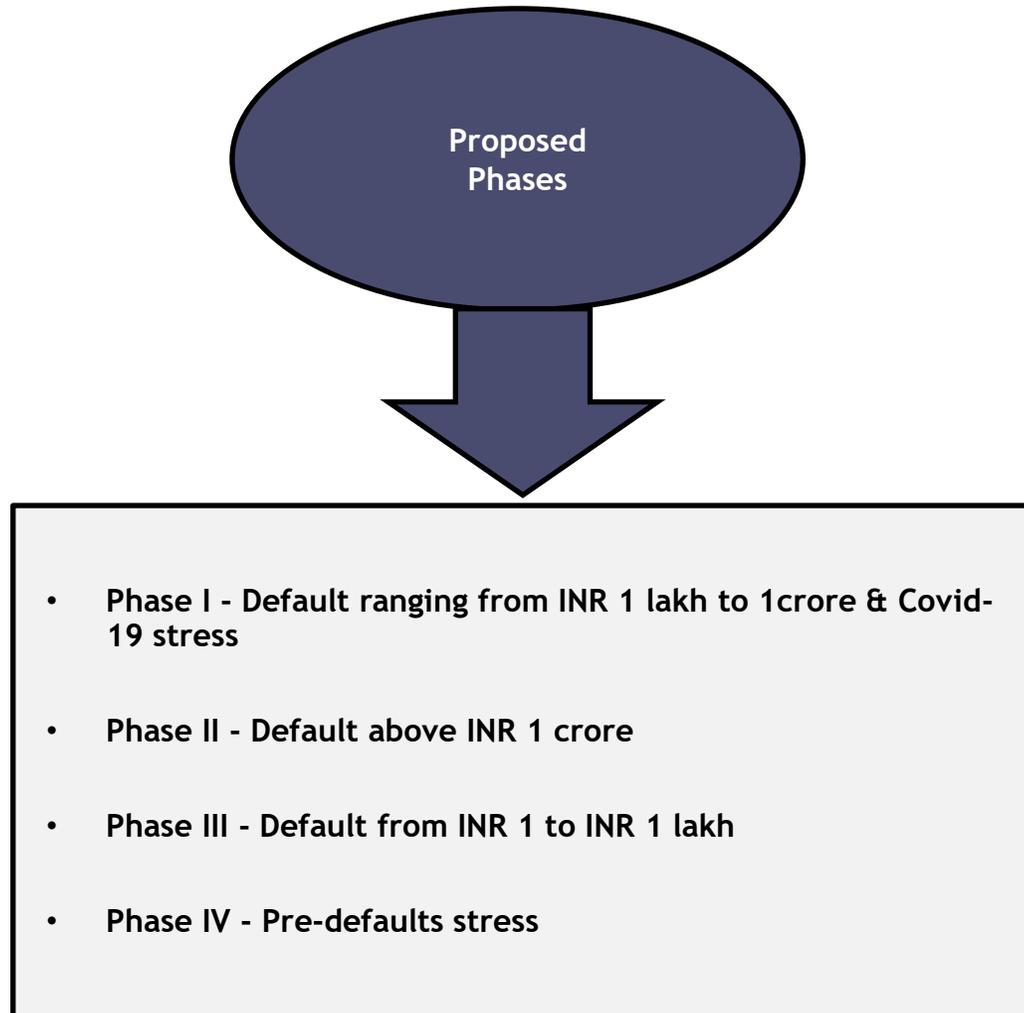


Balancing interests for both the financial and operational creditors which is lacking in CIRP

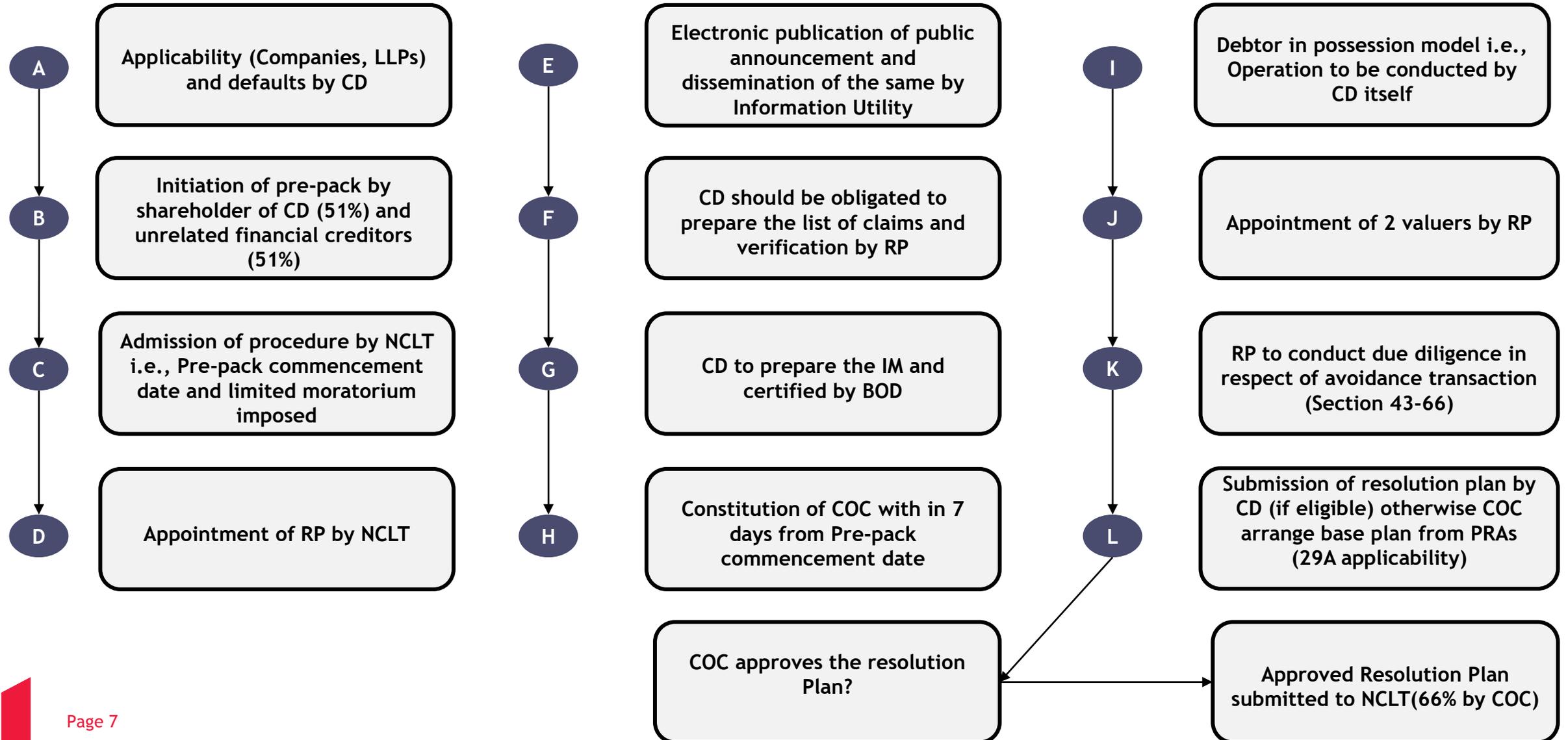


Speedy resolutions for distress companies and relatively smooth transfer of a business, allowing the business to continue uninterrupted

Phase Wise Implementation of Pre-pack



Framework for Pre-pack



Practical Overview

ZERO PERIOD



Phase - I

1. Informal discussions with stakeholders mainly with creditors
2. Private process of inviting bids (if required in case of Section 29A non-compliant promoter)
3. Bid evaluation by lenders
4. Investor Identification
5. Finalization of draft plan
6. Simple majority of shareholders (AGM/EGM)
7. Simple majority of unrelated FCs
8. Identification of RP
9. Application to AA

90 DAYS PERIOD



Phase - II

1. Limited Moratorium
2. Public Announcement (E-format) through Information Utility
3. Claim Verification by the RP
4. IM Finalization
5. Appointment of registered valuers by the RP
6. Avoidance transactions by the RP
7. Plan submission to creditors
8. Approval of the Plan / Liquidation / Closure

30 DAYS PERIOD



Phase - III

Approval of AA (Plan is binding on all stakeholders)

Comparative Analysis

SN	Points of Comparison	Category	Corporate Insolvency Resolution Process	Pre-pack
1	Objective		Resolution of the stress account through RP	Resolution of the stress account through RP
2	Applicability		Companies, LLPs, Companies governed by Special Act and Such other body incorporated as notified by Central Govt	Companies and LLPs (No clarity for those companies which are governed by Special Act)
3	Initiation of process		Either by FC, OC or CD	CD along with consent of majority (51%) of unrelated Financial Creditors
4	Interim moratorium		No	No
5	Peculiarity between creditors		Three class of creditors - Financial, Operational and others	Three class of creditors - Financial, Operational and others
6	Moratorium		After admission of case, moratorium under section 14 of the Code shall trigger	Limited moratorium shall be imposed on the CD from PCD excluding critical services
RP / Management Tasks				
7	Public announcement		IRP shall publish the Form-A in the newspaper for inviting claims from class of creditors (within three days from the appointment)	Electronic publication of public announcement and dissemination of the same by Information Utility
8	Committee of Creditors ("CoC")		Constitution of CoC is mandatory - Only the FCs should form a part of CoC (on or before first COC meeting)	Constitution of CoC is mandatory - Only the unrelated FCs should form a part of CoC (within seven days from PCD)
9	Information memorandum		To be prepared by RP and circulated to the CoC after receipt of confidentiality undertaking	To be prepared and certified by BOD or Chairman
10	Management of the CD		It is a responsibility of IRP/RP to run the CD as going concern to order to maximize the value of the assets of the CD	The management and operation of the CD to be carried out by existing management only (i.e. Debtor in Possession Model)

Un Common points between CIRP and Pre-pack

Comparative Analysis

SN	Points of Comparison	Category	Corporate Insolvency Resolution Process	Pre-pack
11	Valuation		To be carried out by two registered valuers - FV and LV	To be carried out by two registered valuers - FV and LV
12	Interim funding		CD can raise the interim funding with consent of CoC (66% voting) & such cost shall form part of IRPC	CD can raise the interim funding with consent of CoC members (66% voting)
13	Avoidance transactions		In the interest of value maximization, a typical formal insolvency process provides for claw back of value lost through avoidance transactions	Overlooking such transactions completely under pre-pack may not be in the best interest of the CD. The sub-committee, recommends application of normal provisions of IBC relating to avoidance transactions to pre-pack
14	Insolvency resolution process cost		Any cost incurred by the CD during the CIRP period in order to run the corporate debtor as going concern and which is unpaid shall form part of insolvency resolution process cost	Does not include the cost of running operation of the CD because affair of the CD during pre-packed period will be conducted by existing management only
15	Invitation of the resolution plan		RP shall publish the expression of interest in the newspaper and invites the PRAs to submit the resolution plan	First right of submission of the resolution plan is available with existing Section 29A complied promoters of the CD
16	Swiss challenge option		Not mandatory in nature i.e. if the CoC members suggest the RP to conduct the Swiss Challenge then the RP shall conduct the process with the help of bid process advisor	The sub-committee recommends that the pre-pack should start with a base resolution plan. The pre-pack should offer two optional approaches, namely, <ul style="list-style-type: none"> (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) of the Act Details of such design should be specified through Regulations

Comparative Analysis

SN	Points of Comparison	Category	Corporate Insolvency Resolution Process	Pre-pack
	Closure of the process			
17	Person eligible to submit the resolution plan		Section 29A of the Code, specified the person who are eligible to submit the RP	Section 29A of the Code, specified the person who are eligible to submit the resolution plan (no relaxation proposed under PPIRP)
18	Early closure / withdrawal of process		With the approval of 90% voting shares of the CoC	With approval of 66% voting share, present and voting in the CoC meeting
19	Voting threshold for accepting a resolution plan		The CoC may approve a RP by a vote of not less than 66% of voting shares of the FCs	66% of voting share, present and voting
20	Approval of CoC for certain actions - Section 28		The RP, during the CIRP, shall not take certain actions without the prior approval of the CoC i.e., no action shall be approved by the CoC unless approved by a vote of 66% of the voting shares	The RP, during the CIRP, shall not take certain actions without the prior approval of the CoC i.e., no action shall be approved by the CoC unless approved by a vote of 66% of the voting shares, present and voting in the CoC meeting
21	Voting process for accepting a resolution plan		The CoC may after considering the Feasibility and Viability of the compliant plan may vote upon a plan	Ordinarily, the CoC should vote upon a plan in the same manner as under a CIRP
22	Termination of process		No such concept is permissible under the Code	It may leads to Liquidation, with 75% of voting share of CoC
23	Significance on account of failure of process		No leeway - rejection of resolution plan for the non-compliance leads to liquidation of the CD	Closure



Un Common points between CIRP and Pre-pack

Comparative Analysis

SN	Points of Comparison	Category	Corporate Insolvency Resolution Process	Pre-pack
24	Clean slate post resolution		Yes	Yes
25	Sale of assets during moratorium		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	Advisable to allow sale of asset/group of assets with the approval of CoC (total % of admitted claim or other criteria not defined)
26	Role of National Company Law Tribunal		Relatively more	Relatively less
27	Timelines		180 days till approval of the RP and extension of period is available with consent of CoC	90 days for filing of resolution plan with NCLT + 30 days for AA to approve the plan
28	Freshening period		12 months between two CIRPs	Three Years between two PPIRPs

Pros and Cons - Pre-packaged Insolvency Resolution Process

Pros

Preservation:

- ▶ Pre-pack can save the day for potentially hostile firms, which detain default. Early action would generally lead to saving value
- ▶ News of insolvency or financial difficulty can result a reduction in the value if a business. The risk of value diminution can be avoided by completing a pre-pack

Less court interference:

- ▶ Where the debtor and the creditors have agreed to certain commercial agreements, the role of courts to 'interfere' in such commercial arrangements is reduced to a great extent

Binding nature / Cramdown:

- ▶ Unlike other kinds of out-of-court restructuring proceedings, a pre-pack operates within the fold of the statutory scheme, which makes the outcome legally binding on all stakeholders

Cons

Absence of regulatory umbrella:

- ▶ The regulatory and statutory exemptions that a company enjoys under the CIRP process would also be unavailable for such a process unless it acquires court approval

Absence of Transparency:

- ▶ Transparency would also be big hurdle since the existing management would be in-charge of isolating the assets to keep the company flooded and therefore, there would always be apprehensions regarding the correctness of the entire process. This may lead to creditors, especially unsecured, to approach the NCLT and filing cases against the corporate debtor

Regain power over the company:

- ▶ It is even argued that since the company is pushed into insolvency by its own management (be it operational mismanagement or bad business decisions), it is not sensible to allow the same management to alienate the assets of the company and this insolvency framework could turn out to be prejudicial to certain stakeholders

Contemplation for Discussion

SN	Committee Recommendations	Area for Discussions
1	Initiation of PPIRP by CD itself	<ul style="list-style-type: none"> ▶ Whether the lenders should initiate the background checks on the CD, in case the promoters are Section 29A non-compliant, before the initiation of the PPIRP or authorized the RP at Stage Zero?
2	Transaction with related parties <ul style="list-style-type: none"> ▶ Approval of the CoC is required during the PPIRP ▶ RP to file an application for avoidance transactions 	<ul style="list-style-type: none"> ▶ Whether or not related parties' transactions to be entered by CD during PPIRP should be provided before initiation of PPIRP? ▶ Can the related parties' transactions to be entered into forms a part of Information Memorandum?
3	CD to provide the list of claim	<ul style="list-style-type: none"> ▶ What mechanism to be followed for the purpose of Crystallization of major claims before the initiation of PPIRP?
4	Umbrella of Moratorium to CD only by the order of AA	<ul style="list-style-type: none"> ▶ What are the prospective grounds or technicalities basis which the Hon'ble NCLT will be granting or rejecting the moratorium? ▶ What are the challenges PPIRP is exposed to on account of absence of protection from prosecution under law? i.e., a pre-pack negotiation may trigger a slew of recoveries under various laws by dissenting creditors

Contemplation for Discussion

SN	Committee Recommendations	Area for Discussions
5	Clean slate post approval of the resolution plan by AA	<ul style="list-style-type: none"> ▶ Whether clean slate should be restricted only in case of change in ownership structure?
6	Termination of PPIRP including where no resolution plan are received or approved by Hon'ble NCLT	<ul style="list-style-type: none"> ▶ Whether liquidation is a better realization option than CIRP in case of Termination of PPIRP?
7	Timelines for completion of PPIRP	<ul style="list-style-type: none"> ▶ Whether substantial increase of bench capacity of NCLT will result in achievement of ambitious timeline of 90 days?
8	Proposed Swiss Challenge	<p>Recommended by the sub-committee:</p> <ul style="list-style-type: none"> ▶ Resolution Plan submitted by CD is placed for Swiss Challenge. If the H-1 bidder is: <ul style="list-style-type: none"> ▶ 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 ▶ Whether or not following the above-mentioned mechanism shall result in deriving maximum value from the PPIRP?

Contemplation for Discussion

SN	Committee Recommendations	Area for Discussions
9	Monitoring and implementation of the resolution plan	▶ Serious repercussion in case of default after approval of the Resolution Plan by AA

Key Abbreviations

Abbreviations	
%	Percentage
AA	Adjudicating Authority
Act / Code	Insolvency and Bankruptcy Code, 2016
CD	Corporate Debtor
CoC	Committee of Creditors
CIRP	Corporate Insolvency Resolution Process
FCs	Financial Creditors
FV	Fair Value
IBBI	Insolvency and Bankruptcy Board of India
IP	Insolvency Professional
IRPC	Insolvency Resolution Process Cost
IRP	Insolvency Resolution Professional
LV	Liquidation Value
NCLT	National Company Law Tribunal
Ocs	Operational Creditors

Key Abbreviations

Abbreviations	
PCD	Pre-Pack Commencement Date
PRAs	Potential Resolution Applicants
PPIRP / Pre-pack	Pre-packaged Insolvency Resolution Process
RP	Resolution Professional
RP	Resolution Plan

Business Restructuring Services and Resolution Advisory Team



BHRUGESH AMIN
Partner & IP
Business Restructuring



SUNDARESH BHATT
Partner & Leader, IP
Business Restructuring



SAMIR SHETH
Partner & Head
Deal Advisory Services



KIRAN CHONKAR
Partner
Resolution Advisory

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