

## **Pre-Packaged Insolvency Resolution Process under IBC 2016:- A unique mechanism for MSMEs**

The Government of India promulgated an ordinance on 4<sup>th</sup> April 2021 along with relevant Rules & Regulations for **Pre-Packaged Insolvency Resolution Process under IBC for Micro, Small and Medium Enterprises (MSMEs)**. There is great apprehension in the minds of all stakeholders whether it will be practically successful or remain on the papers only. An attempt is made to answer all this along with essential features of PPIRP as follows: -

### **1. A unique mechanism for MSMEs:**

- 1.1. The main feature of the new process, Pre-Packaged Insolvency Resolution Process (PPIRP), is that when a MSME unit defaults in payment of a debt of Rs 10.00 Lakhs or more, the existing promoter/management of the MSME unit is allowed to propose a **Base Resolution Plan** to the creditors and to NCLT to resolve their financial stress.
- 1.2. The existing management is also allowed to continue to manage the unit during the period of insolvency resolution. This is in contrast to the existing process of CIRP, whereas Management is transferred to IRP immediately on initiation of the process. In the new PPIRP, there is a change in strategy from a '**creditor-in-control model**' to a '**debtor-in-control model**' for insolvency resolution.

### **2. Advantage of PPIRP over CIRP**

- 2.1. PPIRP is designed to be completed in 120 days, including a period of 30 days provided for the A.A. to approve the resolution plan.
- 2.2. The cost of PPIRP process shall be borne by CD relieving CD of further spending money but control remains with him.
- 2.3. No litigation from CD is also expected as he is in control of business and process is done with his & FC's prior consent only.
- 2.4. CD shall prepare Base Resolution Plan as per business viability & underlying security to FC's and practically shall be with prior consent of FCs only.
- 2.5. The RP isn't required to run the unit & concentrate on Resolution Plan only, backbone of IBC proceedings.
- 2.6. Substantial benefit of Moratorium is also provided to reduce burden on RP/CD.
- 2.7. No impairment to operational creditors is allowed if Basic Resolution plan is to be implemented. However, in case Basic Resolution Plan has impairment, then it has to compulsorily compete in Public bidding.

- 2.8. Basic Resolution Plan may be required to compete with other plans and Swiss Challenge method is provided for maximisation of value.
- 2.9. Approved resolution plan shall be binding on all stakeholders such as Financial Creditors, Operational Creditors including I-Tax, GST dues etc and relieve the CD from all its pass defaults/ills.
- 2.10. The haircut, if any, as arisen out of approved plan is easily explainable by Bankers also being result of a plan approved by AA after due deliberation & as COC member, they have only limited say in it. Even otherwise, if PPIRP isn't undertaken, the CD was not in a position to pay & the whole debt was going to be an NPA and liquidation was not a viable economic solution.

### 3. Checks & Balances

What so ever be the good intention of Govt/Legislature, disgruntled management/Creditors shall be able to find lacunas in it & use it for own gain overriding the basic IBC 2016 objective of Resolution. In CIRP, many stakeholders started using it as recovery mechanism especially when the threshold limit was Rs. 1.00 Lakh only & many applications under section 10 were filled to get rid of I-Tax, PF, GST dues etc. The following Checks & Balances are built in it to **avoid abuse of PPIRP process**: -

- 3.1. The colling off period of 3 years is in built between two PPIRP to make PPIRP successful in one go & not allow disgruntled promoter to purpose PPIRP again & again. Please note application under section 7,9 & 10 can be made after colling off period of 1 year.
- 3.2. PUFEE (Preferential, Undervalued, Fraudulent, and Extortionate) transactions need to be examined by RP.
- 3.3. Time lines for Claims, Base Resolution Plan, Public Announcement, Registered Valuers, COC constitution & meetings, Information Memorandum, Avoidance transactions, Resolution Plan etc. are very tight and need to be completed within 90 days.
- 3.4. Time line for AA is also kept very tight being 14 days for the disposal of application & 30 days for the approval/rejection of plan.
- 3.5. All Section 29A clauses except clause c & h is applicable on all Prospective Resolution Applicants (PRA) or new investor.

#### **Will PPIRP be successful?**

The success of PPIRP depends on collective efforts of all & is analyzed stakeholder wise as follows: -

4. **Financial Creditors** mainly Banks are the most important Stakeholders in whole PPIRP and following is expected from them: -

- 4.1. Bankers need to find early sign of sickness and initiate PPIRP. In fact, Bankers must come out with policy of going for PPIRP for SMC-2 classified accounts. Either RBI or IBA can come up for such Schemes.
  - 4.2. Base Resolution Plan is known beforehand, they can always venture for better Resolution Plan without any cost as all PPIRP cost is to be paid by CD.
  - 4.3. The alternative mechanism of Restructuring is practically temporary in nature and further erode business value alongwith primary & collateral securities with the efflux of time.
  - 4.4. The alternative mechanism of SARFASI/DRT etc. is also similarly time consuming. The recovery amount under SARFASI/DRT etc. if compared with amount as received in PPIRP after discounting shall always be on higher side.
  - 4.5. The alternative mechanism of CIRP under section 7 application in IBC 2016 involves liability in terms of additional cost of payment of CIRP expenses. It is lengthy & generally does not attract many RAs. Many a times, it is painful also as CIRP cost is to be borne by FCs only.
  - 4.6. Bank's start charging **higher interest rate of interest** immediately on downgrading of an account. However, for PPIRP accounts, **no such higher rate be charged & at the most 'Right to recompense'** say after 3-5 years may be in asked in Base Resolution Plan.
  - 4.7. Banks need to look beyond the **HAIR CUT** amount and compare the expected realization with underlying **SECURITIES**.
  - 4.8. If planned properly, banks can always **proceed against Personal Guarantors** to Corporate Debtor for haircut amount as per business viability only.
  - 4.9. FCs must be prepared to **accept haircut and may impose similar haircut for OC's and ask promoter to transfer equity to them in same proportion as a matter of just and equity**.
  - 4.10. Banks must foresee it as their **economic contribution of keeping MSME alive** by absorbing haircut if any.
5. **Corporate Debtors/Promoters** are other important Stakeholders in the whole PPIRP and need to contribute as follows: -
- 5.1. Must **obtain Udyam Registration (MSME Registration)** which is very simple online process to be effectively eligible to start the PPIRP process. Please note out of 6.3 Crore MSMEs only 26.42 Lakhs MSMEs are registered only.

- 5.2. The benefits given by Govt/RBI during second wave of Covid-19 should simply be treated as **temporary breather** only. PPIRP must be considered at an early stage to avoid big default later on.
- 5.3. Must plan for **diluting their holding by bringing in investor as their partner or transferring equity with buy back clause** after 3-5 years in favor of FC as part of Basic Resolution Plan.
- 5.4. If they have indulged in any **PUFF transaction**, they must be willing to **return money** - a hard nut to break.
- 5.5. The Base Resolution Plan as prepared in advance must have **informal approval of at least 2/3<sup>rd</sup> COC members**.
- 5.6. The Base Resolution Plan is subject to Swiss Challenge if desired by COC then Corporate Debtor/Promoter **must be willing to improve it**.
6. **Resolution Professional** is also a very important Pillar for success of PPIRP like "Behind every great man there is a great woman". He is expected to work with due diligence & foresightedness as follows: -
  - 6.1. Must be able to blend the formal and informal resolution processes, informal up to a point, formal thereafter.
  - 6.2. Must have **acumanship** to fill **divergent expectations of FC and CD/Promoter** to keep MSME alive for the benefit of all stakeholders.
  - 6.3. Plan affairs in **preference for existing promoter** keeping in mind in-built provisions of Swiss challenge also.
  - 6.4. Act as **catalyst** for all work assigned to Management of CD under PPIRP like Application preparation & filing, preparation of provisional Financials, Claims, Ascertaining Classes of Creditors, Information Memorandum, Observe Board Meetings etc for prompt compliances.
  - 6.5. Must have infrastructure & in-depth experience to adhere challenging timelines and legal compliances before AA/IBBI/Agency/COC.
  - 6.6. Must act in most transparent & fair manner as per objectives of IBC 2016 keeping in mind interest of all stakeholders especially Creditors & maximise the asset valuation either from existing Promoters or PRA at reasonable fees.
7. **Government & Statutory Authorities** is the most effective pillar in whole eco system to bring success to PPIRP & enhance India's rating in world ranking index & following is expected from them: -

- 7.1. **Time lines prescribed for Courts** shall expected to be held **directory in nature** in due course as per CIRP experience. It has been seen that during CIRP, admission time prescribed is 14 days but it takes months or a year for admission, Resolution Plan or Avoidance applications also takes months or year to adjudicate. Hopefully with **augmentation of proposed infrastructure, the time taken at NCLT/NCLAT shall reduce a lot.**
- 7.2. At present, PPIRP provisions are **applicable to MSME Corporates & LLP** which only constitutes 30% of total MSME. Wishfully it shall be **made applicable to NON-MSME, Partnerships & Individuals also** after success in MSME so that benefit to the balance 70% is also extended.
- 7.3. A lot of concessions during 2<sup>nd</sup> wave of Covid-19 have been given by Banks/Govt which shall result in not downgrading MSME accounts. This **period be used for initiation of PPIRP** because no downgrading of account shall take place during this period. In fact, RBI/IBA **must come out otherwise also with circulars for not downgrading the MSME's opting for PPIRP till approval of resolution or scraping of PPIRP.** Here it is pertinent to note that **RBI/SIDBI has given concessions** to MSME during 2<sup>nd</sup> wave of Covid-19 in terms of moratorium on payment of instalments and interest on term loans, relaxations in the drawing power margins for working capital loans, reassessment of working capital cycles, all without any downgrade in the asset classification of an asset and Rs. 3-Lakh Crore Credit Guarantee scheme, etc.
8. **Conclusion: IBBI has taken great initiative by adding new Chapter III-A in IBC code 2016 as on 4<sup>th</sup> April 2021 alongwith notification of relevant Regulations & Rules as on 9<sup>th</sup> April 2021 naming it as Pre-Packaged Insolvency Resolution Process.** Hopefully, all stakeholders shall also make it more successful with their above stated contributions and **help India to improve its international rating as happened on introduction of IBC & GST in the year 2017.**

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