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Pre-Packaged Insolvency Resolution Procedure and Its Probable Impact on MSMEs Sector

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Abstract

Insolvency and Bankruptcy code 2016 is a law for the resolution of Non-performing Assets. It covers all the business houses, including companies, limited liability partnerships, partnerships, proprietorship firms, and individuals. Since the law is very new, it is going through many amendments on it to make the resolution process business-friendly and straightforward. One of the recent amendments made in the Insolvency and Bankruptcy Code is the addition of provision of the Pre-packaged Insolvency Resolution Process. The Pre-packaged Insolvency Resolution Process is one of the processes out of the two broad resolution processes. The Pre-packaged insolvency resolution procedure was introduced in April 2021 to solve the problem of Non-performing Assets in the MSMEs Sector. This paper will explain the whole mechanism of the Pre-packaged insolvency resolution procedure and compare the process with the other one, which is the Corporate insolvency resolution procedure. The paper will also envisage the effect of the process in the resolution of NPA in the MSMEs Sector.

INDEX TERMS

Non-performing Assets (NPA), Insolvency and Bankruptcy Code (IBC), Pre-Packaged Insolvency resolution procedure, Corporate Insolvency Resolution Procedure, MSMEs

Introduction

The Insolvency and Bankruptcy Law came into existence in 2016 to make the resolution process more business-friendly. The critical feature distinguishing the insolvency and bankruptcy code from the previous regime is a market-based mechanism that tries to resolve the stressed assets within a given timeframe. Since its induction the code has been working better than other channels in terms of recovery. In the year 2019-20, it recovered 46.3% of the total amount involved. In the financial year 2020-2021, the recovery rate is 20.2%, which is declined due to the pandemic and suspension of new insolvency proceeding the Government.

Insolvency and Bankruptcy code consist of a well-established mechanism to resolve insolvency under which the corporate debtors are given a chance to rebuild their business. The procedure is known as the Corporate insolvency resolution process. As proceedings under corporate resolution process is entirely formal and time-consuming, the MSMEs face many issues in following the procedure. Other thing is that corporate insolvency resolution procedure only covers the case in which the minimum default is one crore, so in most cases, the

MSMEs are out of the bound of the Corporate resolution process.¹ Since the rate of NPA in the MSMEs sector is high, it is 9.2%, 10.2%, and 16.5% in micro, small and medium enterprises, respectively, for 2020. So to address the issues of Non-performing assets of the MSMEs sector, there is a need to form an insolvency resolution procedure that assists the MSMEs in resolving insolvency and bad debts. As we know that MSMEs are the backbone for the employment generation, their existence is essential, and the bad debts problem is a threat to the existence of MSMEs. The Central Government introduced the new insolvency resolution method: pre-packaged insolvency resolution process to make process of resolution of insolvency appropriate for the MSMEs sector. The pre-packaged resolution scheme is designed in a way which enables the MSMEs owner to keep the ownership with themselves during the resolution process it directly contributes in building trust among honest MSMEs.

OBJECTIVE

1. To study the procedure followed under the Pre-packaged Insolvency Resolution Process.
2. To study how the Pre-packaged insolvency process is convenient for the MSME sector.

- I. The pre-pack insolvency resolution process is a method for insolvency proceedings. The Insolvency and bankruptcy code was introduced in April 2021 to make the insolvency proceeding fast, cost-efficient, and effective in resolution with minimum disruption in the business proceedings without deteriorating the value of the business houses. The pre-packaged insolvency resolution process is a hybrid framework as it provides the opportunity for the stakeholders to resolve the NPA of the body corporate with minimum assistance of the State. It is an innovative corporate rescue method that offers an option to settle the insolvency either in formal (judicial) insolvency proceedings or informal (out of court) settlement. Let's understand the procedure of the Pre-packaged insolvency resolution process.

Eligibility criteria for the Pre-packaged process

A corporate debtor eligible to be called micro, small and medium enterprises under MSME Development Act, 2006 can apply for the pre-packaged scheme. The other condition for applying for this scheme of resolution is that the corporate debtor has involved in failure to honor the debt of more than Rs 10 lakh and is not barred from applying for the resolution plan under the IBC Act sec 29A. Other essential conditions are that the corporate debtor must not have undergone or completed pre-packaged scheme or corporate resolution scheme during the three-preceding year before the initiation date and is not ordered liquidated by an order by the Code.

STAGES IN PRE-PACKAGED INSOLVENCY PROCESS

Pre-initiation phase- Pre-initiation stage starts with seeking approval of creditors to file for applications to follow the resolution as per pre-packaged scheme. For getting the creditors' approval, the applicants need to serve notice at least five days before to convene the meeting of all unrelated corporate creditors or Unrelated operational creditors if there are no any unrelated creditors. The applicants need to enclose the list of all creditors and details regarding the amount due to each of them. The selection for the appointment of resolution professional is made from the list of eligible insolvency professional whom suggestions are made in the meeting of unrelated financial creditors and creditors having 10% value of debt. The appointment of resolution professional is approved by the creditors having atleast 66% of the total value of debt. The resolution profession appointed in the meeting of financial creditor and unrelated operational creditor shall be independent of the corporate debtor on whom the insolvency proceeding is going to be exercised. The terms of the appointment shall also be discussed in the meeting. It must include the fee payable to the resolution professional for performing duties in relation to the pre-initiation phase, fees payable to him, and expenses to be incurred in

¹ • India: NPA rate of MSME by segment 2020 | Statista

conducting insolvency proceedings under pre-packaged scheme and for management of corporate debtor. The last process is that the insolvency professionals appointed as resolution professionals are required to prepare the report in form P8 to confirm that the corporate debtor can be able to considered for a pre-packaged insolvency resolution process along with a base resolution plan. The application verifying the eligibility of corporate debtors for the pre-packaged insolvency process must have supporting documents such as a declaration by the majority of partners/directors of the Corporate debtors stating (a) that the within 90 days the Corporate Debtor shall file an application for initiation (b) that the resolution process is not being initiated to defraud any person, and (c) the name of resolution professional appointed and the special resolution by three-fourth of partners and directors of corporate debtors for filling of an application for initiating resolution process under pre-packaged scheme.

STAGE- 2nd Application for Initiation

Under this stage, the petition for the commencement insolvency resolution process under pre-packaged scheme is made to the adjudicating authority along with to the Insolvency bankruptcy board of India. The application for initiating the process starts with the filling of form 1 along with the following documents such as records of NPA, assent of insolvency profession selected to be appointed as resolution professional, in form number P1, acceptance of unrelated financial creditors for initiation in Form P4; Assent of the IP selected to act as AR, if any in Form P5, Directors/Partners declaration in Form P6, Members' Resolution or Partners' Resolution, Assent by corporate debtors regarding avoidance transaction(s) in Form P7, Report by resolution Professional in Form P8, financial statements of the last two financial years, Provisional financial statements for current financial year made up to the date of declaration under section 54A(2)(f), Udyam Registration Certificate, or testimony that corporate debtors is an MSME; Affidavit affirming that the corporate debtors is can submit resolution plan under section 29A of the Code to conduct PPIRP of corporate debtors, a fourteen days earlier updated statement of affairs, statement consisting the names and addresses of the members or partners of the corporate debtors, with details of their respective shareholdings, voucher as a proof that the application fee of ₹15,000 has been paid, proof that a copy of the application has been served to the IBBI and Document that records the authority of the applicant to make the application where the applicants is a member of partner of the corporate debtor.

For applying for approval from an adjudicating authority, the corporate debtor has to apply along with the supporting documents to Adjudicating authority. The adjudicating administration has to communicate about the completeness of an application to the applicants within 14 days of receipt of the application. The applicants have to furnish the incomplete portion within seven days of communication. If not completed within seven days, the adjudicating authority may reject on the ground of an incomplete application. Once the application is accepted, the pre-packaged insolvency resolution process commences from the date the application is accepted.

Post-initiation phase

The whole proceedings under the pre-packaged insolvency process is to be completed within 120 days from the commencement date. During the whole process of resolution of insolvency the management of affairs of company remains in the hand of Board of Director/the partner of corporate debtors; they are allowed to take all such steps which are essential for the benefits of the corporate debtor. The corporate debtor needs to submit the base resolution plan to the resolution professional and an updated list of claims of creditors and their security interests and guarantees in form no P10.

APPROVAL OF RESOLUTION PLAN

Under this stage, the group of creditors approves the base resolution plan. First, they evaluate the base resolution plan, and if they find that it does not adversely affect the interest of the operational creditors, then it is approved by the committee. If it impairs the operational creditors' interest, they invite the alternate resolution plan within 21 days. The base alternate resolution plan is then evaluated, and both plans' evaluation scores are compared. Then the best resolution plan shall be approved by the committee of creditors; if the plans are not satisfactory or there is any scope of improvement in technique, the improvement process keeps on going until the time for modification expires. If the committee does not approve it, the process terminates. Once the plan is approved, it is implemented by the resolution professional, and the directors/ partners of the corporate debtors are required to cooperate with them in doing so.

II. HOW THE PRE PACKAGED INSOLVENCY PROCESS IS BENEFICIAL FOR MSMEs

First and foremost, the pre-packaged insolvency process is made to cater to the insolvency proceedings of the MSMEs sector as it considers the minimum default of rupees 10 lakh. In case of the pre-packaged insolvency process, there are series of preliminary work before filling application to Adjudicating authority such as the special resolution of corporate debtors, approval of 66% of financial creditors, name of resolution professional, base resolution plan by debtors, and other formalities all these formalities need the continuous engagement of both the parties hence these to assist the MSMEs in keeping their command on the value of the Assets. The other provision that supports the MSMEs is that in the pre-packaged resolution scheme only the corporate debtor or its promoters/directors can initiate the insolvency process, which benefits in a way that it gives some more control to the debtor; hence it is beneficial for the needy MSMEs. In the case of a pre-packaged insolvency process, the corporate debtor can improve the Base resolution Plan with the approval of the committee of creditors, but the corporate debtor cannot do so in the case of the corporate resolution process.

This provision of improvement in the base resolution plan gives more control to the corporate debtor, which can be used beneficially to resolve insolvency. The management of whole affairs of the corporate debtor rests in the hands of corporate debtors unless fraud is involved; this also makes the entire resolution process more beneficial to the corporate debtor, as the debtor can take all possible steps to maintain the value of debtor. The other advantage of the Pre-packaged insolvency resolution process is that the time limit for completion of the process is 120 days; hence it provides speedy resolution, which safeguards the interest of debtors from loss caused due to reduction of value of assets over time and also from the poor impact of working disturbance due to the whole proceedings.

Conclusion

As we are well known of the fact that the MSMEs sector contributes near about 30% in nominal GDP with their network of 6.3 crore units and the share of MSME related products in total exports from India during 2018-19 was 48% along with that the MSME sector provides employment to near about 11 crore peoples. This proves that the MSME sector is very crucial for the Indian economy. The data of September 2021 shows that the level of NPA of the MSMEs sector is 18.5%, which is enormous and harms the existence of MSMEs. Since the MSME sector is so crucial to us hence the pre-packaged insolvency process is a need of time to save the MSME sector as a whole.

The pre-packaged insolvency process is really a simple, time-efficient method for resolving insolvency.

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