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# WITNESS

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# Pre Packaged Insolvency: Issues, Prospects and Model Framework

■ **Varsha Banerjee & Akshat Singh**

“How did you go bankrupt?” Bill asked.

“Two ways,” Mike said. “Gradually and then suddenly.”

The dialogue above is from Ernest Hemingway’s 1926 novel, *The Sun Also Rises*. ‘Gradually and then suddenly’ might be one of the most profound insights into how corporate bankruptcy and insolvency manifests today. Market failure, genuine business decisions that go the wrong way or unforeseen events, the fell clutch of circumstance often renders the honest and genuine corporate debtor unable to pay off the debt. While sudden events may force a debtor to go bankrupt, the need of the hour is to protect those corporate debtors who can identify the early warning signs i.e. the gradual onset of financial distress. Early identification by the corporate debtor may enable it to take corrective steps in the form of restructuring or reorganization of debt so as to protect itself from going bankrupt and out of business. The concept of pre-packaged insolvency, which aims to enable and empower the corporate debtor to put its house back in order, may just be the right solution to protect and promote honest and genuine corporate debtors, assuring them in

true sense that insolvency proceedings are not meant to be adversarial in nature.

The advent of the Insolvency and Bankruptcy Code, 2016 has led to a transformative turnaround in the corporate distress resolution framework of India. It has given a new lease of life to a Corporate Debtor whose fate was earlier dependent upon a plethora of debt restructuring schemes introduced in the past, the failures of which often led the Corporate Debtor to enter its phase of final demise in the form of winding up of the Company. In this context, it would not be out of place to quote the Hon’ble Supreme Court in its *Swiss Ribbons* judgment where it remarked, “Earlier experiments, as we have seen, in terms of legislations having failed, ‘trial’ having led to repeated ‘errors’, ultimately led to the enactment of the Code.” The policy makers, having gained valuable insight from the past attempts at corporate restructuring and being wary of the repercussions of any big bang reform in the fiscal and economic paradigm of the country, chose wisely to enact and implement the I&B Code in a phased manner so as to make the transition of insolvency resolution framework in India swift, non-disruptive and transparent.

It has been two and a half years since the



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enactment of the Code and the story so far has been fairly successful. Taking the liberty to quote the Hon'ble Supreme Court in *Swiss Ribbons* again, "To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation.", and having seen the tremendous impact of the Insolvency and Bankruptcy Code since its inception, time is now ripe to initiate the next generation of insolvency reforms, prominent among which is the introduction of a pre-packaged insolvency resolution framework.

## THE CONCEPT

A Pre-packaged Insolvency Resolution is a scheme solicited by a proactive company before its formal insolvency. A proactive company proposes and negotiates a financial reorganization plan with its creditors in advance that takes effect after the nod of the Court.

Under the so-called 'pre-packaged' bankruptcy schemes, creditors and shareholders will approach a bankruptcy court with a pre-negotiated reorganization plan, as prevalent in countries such as the US and the UK. Under the pre-packaged scheme, creditors and shareholders would move the bankruptcy court with an agreed scheme so that it gets sanctity and becomes enforceable.

## ISSUES PLAGUING PRESENT INSOLVENCY FRAMEWORK

1. The present corporate insolvency resolution framework has failed to prevent prolonged and expensive legal battles involving the Corporate Debtor.



The moratorium provision envisaged under Section 14 of the Code has been successful to an extent when it comes to handling litigations involving the Corporate Debtor in different courts and tribunals of the country, however, the NCLT, with its nascent infrastructure, cannot handle the burden of litigations related to the resolution process of the Corporate Debtor. It is therefore, necessary that a pre-packaged insolvency framework is introduced within the confines of the existing I&B Code that addresses the issues arising out of proposed resolution plan for the Corporate Debtor. This can be ensured either through a "limited Moratorium" or a "Standstill Agreement" between the Creditors of the Corporate Debtor.

2. Though the CIRP proceedings are not intended to be adversarial in nature, it is seen that once a Corporate Debtor enters the CIRP there is a significant erosion of value, negative publicity and attrition of workmen and employees. This significantly affects the business

operations of the Corporate Debtor that is intended to be run as a 'going concern' by the appointed Resolution Professional. A pre-pack regime ensures that the promoters, stakeholders including the creditors enter into a negotiation phase that is devoid of litigations as observed in the current insolvency framework. An atmosphere devoid of litigation will ensure a much better chance of coming up with a negotiated Resolution Plan that ensures a better return for the investors alongside preserving and maximizing the value of assets of the Corporate Debtor. It will also ensure that the honest promoters who have defaulted due to market failure are not penalized.

3. It is also observed that the suspended board of management is non-cooperative post the commencement of insolvency proceedings. A debtor initiated pre-packaged insolvency framework will ensure that the management is cooperative with the financial creditors while formulating a resolution plan.

4. The present time line prescribed in the I&B Code intends to finish the CIRP of the Corporate Debtor within a period of (180+90) days. A pre packaged insolvency framework can significantly reduce this timeline for the resolution of the Corporate Debtor as the issues that may arise in the form of litigation are resolved during the pre-pack stage itself.

5. There is significant uncertainty involved in the current insolvency framework with regard to potential Resolution Applicants. It is seen that due to negative publicity associated with the insolvency proceedings of Corporate Debtor, disrupted business operations and liquidity crunch, many genuine investors are not interested in proposing a resolution framework for the Corporate Debtor. A pre-packaged insolvency framework will ensure that investors and creditors, including the connected parties get an opportunity to restructure and reorganize the Corporate Debtor before it enters the realms of insolvency proceedings under the Code.

6. A pre-packaged insolvency framework will also ensure a lower cost and faster approval process as most of the issues pertaining to the implementation of Resolution Plan are resolved during the pre-filing stage itself.

## MODEL PRE-PACKAGED INSOLVENCY FRAMEWORK FOR INDIA

**1. Recognition of Stress:** It is natural that the Corporate Debtor will be the most suited entity to identify the gradual onset of financial distress. It has been two and a half years since the commencement of IBC regime in India and having seen the stringent mechanism that is put in place during the corporate insolvency resolution process which in effect, suspends the existing board of management, the Corporate Debtors can be expected to be proactive and proficient in identifying the onset of financial distress in order to save itself from going into CIRP proceedings.

**2. Debtor enters into negotiations with prospective purchaser to decide**

**upon the sale/arrangement.** A form of “Limited Moratorium” / “Standstill Agreement” ensuring moratorium only on creditor-induced litigation kicks in. To have the legal sanction, it is necessary that the NCLT approves this “Limited Moratorium/Standstill Agreement” for a short span of 45-60 days and an application for the same may be approved or rejected by the NCLT within 7-10 days. To maximize the value of assets of the Company, the debtor should ensure that the proposed sale arrangement is discussed with genuine investors involving principles of open market mechanism. For this, the debtor may float a document similar to the present ‘Expression of Interest’ to attract genuine buyers.

**3. Appointment of Advisor/IP to verify that the proposed pre-pack sale is as per the Regulations framed by the IBBI. The appointment can be made through following methods:**

a. Debtor informs IBBI and the financial creditors that it is initiating the pre-pack process and chooses an “Insolvency Professional” from a list of Professionals maintained by the IBBI to conduct and supervise the negotiations preceding the sale/arrangements of the Corporate Debtor; OR

b. Debtor conducts a meeting of creditors in which the Advisor/IP is chosen through voting

**4. On being appointed, the IP will perform the following tasks:**



- conduct a meeting of stakeholders and verify/collate the claims

- conducting valuation by appointing independent valuers to ensure that the proposed pre-pack is not undervalued/overvalued/extortionate

- ensuring fair value to dissenting creditors

- Independent evaluation by a Pre-Pack Pool.

## 5. Appointment of Resolution

### Professional to effect the proposed pre-pack sale

- After the proposed sale/arrangement is negotiated, a Resolution Professional should be appointed to immediately give effect to the pre pack scheme following the approval of financial creditors and the NCLT.

- After ensuring compliance of the proposed pre-pack, the Resolution Professional should seek 66% approval of the Financial creditors of the Corporate Debtor prior to submitting the pre pack scheme for NCLT's approval. (Similar to Section 30 of IBC and Regulation 38 of CIRP Regulations, the NCLT will inspect the pre-pack negotiated sale/arrangement based on guidelines that need to be introduced by way of amendment to the IBC).

### ENSURING CHECKS AND BALANCES IN THE PREPACK FRAMEWORK

A pre-packaged insolvency framework in Indian context will require a significant amount of checks and balances to ensure that the framework is not misused by

delinquent and wilful defaulters from buying back the assets of the corporate debtor at steep discounts.

Pre-pack is essentially meant to be a "debtor-initiated" process that attempts to come up with a pre-negotiated reorganization plan involving the creditors and shareholders. In order to ensure that the process, despite including the promoters remains fair, open and transparent, need can be felt for a mechanism similar to a Pre Pack Pool.

The Graham Review into Pre-pack Administration in 2014 recommended the introduction of pre-pack pools to increase transparency and ensure accountability when the assets of the corporate debtor are sought to be bought by the promoter or by connected parties.

The intent of any insolvency framework in practice globally, is never to punish or prevent the honest but unlucky promoter to restart its business. Herein, a pool of independent business practitioners can step in to decide the commercial bona fide of the promoter or connected party, thereby streamlining the insolvency proceeding.

Given the fledgling phase of insolvency jurisprudence in India, independent scrutiny of connected party sales can only help in ironing out the wrinkles that often obstruct resolution proceedings.

In light of the above, the Insolvency Resolution Professional ("IRP") must be tasked with the duty of ensuring that sales to promoters and connected parties are transparent. [W](#)



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