

## Pre-pack Resolution Route Needs Incentives

An amendment to the Insolvency and Bankruptcy Code (“**IBC**”) recently received the President’s assent. It replaces an ordinance promulgated earlier this year, and provides for a pre-packaged insolvency resolution process (“**PIRP**”) for micro, small and medium enterprises (“**MSMEs**”). This comes in the backdrop of the financial stress caused by Covid-19 to MSMEs, and envisages a hybrid mechanism of negotiated debt restructuring, which, upon approval of the National Company Law Tribunal (“**NCLT**”), becomes binding on all stakeholders.

MSMEs account for about 30 per cent of the gross domestic product, employ over 110 million Indians, and are key to economic growth. A huge chunk of them are unregistered and don’t (especially in the micro-sector) have formal corporate structures; they raise debt funding on the strength of the personal assets of their founders and are dependent on the management skills of their founders.

Given that most MSMEs are informally organised, they may be averse to an insolvency resolution mechanism which displaces their founders. In addition, those facing financial distress may not be forthcoming to access the available mechanism on account of the complexity of the process, high costs involved, and social stigma surrounding the overlapping consequence of personal insolvency.

Aimed at causing minimal disruption to business and to ensure job preservation, the PIRP allows the existing management of the MSME to retain control of the firm during the PIRP, unlike the corporate insolvency resolution process (“**CIRP**”). However, certain fundamental decisions have to be approved by the Committee of Creditors (“**CoC**”) and the PIRP is monitored by a resolution professional (“**RP**”). If the existing management grossly mismanages the affairs of the MSME or commits any fraud, then, subject to approvals of the CoC and the NCLT, the management can be handed over to the RP.

The option to initiate a PIRP lies solely with the MSME itself. It is also the MSME that prepares and submits a base resolution plan for consideration, although such

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resolution plan may be subject to a Swiss-challenge from potential investors if it hampers the interests of operational creditors. The PIRP is tailored to be cost-efficient and provides for a strict timeline (90 days for approval of the resolution plan by the CoC and 30 days for approval by the NCLT) to complete the process.

While the PIRP is well intended, how much it can help resolve stress on corporate debtors in the MSME sector will come down to ironing the creases in its implementation and, if required, revisiting its design. The timeline for completion of the PIRP seems ambitious and will perhaps be its biggest challenge. Given the experience with the delays in CIRP - as highlighted by the Standing Committee on Finance recently in its report on the IBC - this could prove to be an uphill task.

Moreover, potential delays in the time taken in inviting and considering resolution plans (in case of a Swiss-challenge) and for approval of a resolution plan by the CoC cannot be discounted. The duplicity of the information required to be provided by the MSME and by the RP could also lead to delays.

MSMEs need to be incentivised to access the PIRP route. These incentives could have been in the form of reduced costs, a less complicated process, lack of fear of losing one's business and relaxation of eligibility conditions to submit the base resolution plan. Instead, the design of the PIRP is essentially similar to a CIRP with truncated timelines. The prudence of having adequate checks and balances cannot be undermined. However, by being over-prescriptive, the legislature and the regulator could deter MSMEs from exploring the PIRP route.

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