Bringing Pre-packs to India:
a discussion on the way forward

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Executive Summary

"Pre-packs", though yet to be born, have raised the expectations high. Reasons are obvious - the package is supposed to offer a lucrative combination of all the benefits of a 'reorganisation/resolution plan' as otherwise available only under formal insolvency proceedings with the added benefit of 'speed'.

Pre-pack framework, as studies show, is not always contained in the statutory machinery. One of the close examples is UK. There the pre-pack arrangement is guided by insolvency practice statement, rather than a legislative framework.

In the Indian context, with some unique features, our insolvency regime stands differently from other jurisdictions – say, section 29A, and more importantly, section 32A.

Also, we already have certain debt restructuring tools in vogue – schemes of arrangement, and the apex bank's framework for resolution of stressed framework. So, how do we welcome pre-packs, such that it serves the intended purpose? Surely enough, the pre-pack framework has to imbibe all the 'good things' which a formal insolvency framework has, and also offer something 'over and above' the existing options of debt restructuring.

The article sees these aspects and proposes what can be the optimal way of adopting pre-packs in India.

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Key areas of discussion

1. **Concept and variants of pre-packs as widely understood**
2. **Practices followed in jurisdictions like UK and US**
3. **Implementation of pre-packs in Indian context**

Background

With limited success run of informal insolvency procedures so far and certain limitations of typical formal set-up (say stretched timelines, costs, litigation, etc.), we may need to think of some 'middle-way' that can co-exist with the other options and still can reap the benefits of both formal and informal procedures, and minimise the cons associated with both. Further, with a suspension on insolvency proceedings (including self-filings)[1] for defaults occurring during the disruption period, certain debtor may feel the 'gap' to address their debt concerns.

"Pre-pack" is one such possible solution, which proposes a hybrid arrangement of out-of-court and formal proceedings, the role of latter being minimal. The nomenclature itself suggests that pre-packs are arrangements where the debtor *packages* a plan *before* initiation of formal insolvency proceedings, with the co-ordination and consent of creditors and presents it to the courts for the seal of approval. Note that here, we are not talking about typical 'schemes of compromises/arrangements" – 'pre-packs' are a little different from 'schemes', as we discuss later; though in principle, 'schemes' also combine formal and informal procedures.

While in India, we are yet to experiment with the concept, pre-packs have been quite common, rather in different forms, in the United Kingdom and the United States. In fact, as we see below, UK has been reviewing its pre-pack framework from time to time to address concerns arising out of the prevalent practices. In this article, we shall discuss the concept of pre-packs, and its viability and adoption in the Indian framework.

What are pre-packs and what are the possible variants?

The UNCITRAL Legislative Guide on Insolvency Law[2] uses the term '**expedited reorganization proceedings'** for pre-packs, as these proceedings follow the procedure of reorganization, but on an expedited basis, combining voluntary restructuring negotiations, where a plan is negotiated and agreed by the majority of affected creditors, with reorganization proceedings commenced under the insolvency law to obtain court confirmation of the plan in order to bind dissenting creditors. In *Orderly & Effective Insolvency Procedures*[3], the International Monetary Fund observes two variants of pre-packs in general – *first,* **prepackaged plans**, in which *both the negotiation and voting for the plan take place prior to commencement* of the rehabilitation procedure and court approval is sought immediately upon commencement, and *second*, **pre-negotiated plans**, in which the *plan can be negotiated prior to commencement but formal voting takes place once the proceedings have commenced*. The IMF provides that while the former approach will normally require the adoption of specific rules (either in the legislation or in the regulations), the latter will not.

[1] Vide Insolvency and Bankruptcy (Amendment) Ordinance, 2020. See our analysis here: http://vinodkothari.com/2020/06/implications-of-ibc-ordinance-2020-quick-round-up/
[2] https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf
[3] https://www.imf.org/external/pubs/ft/orderly/index.htm

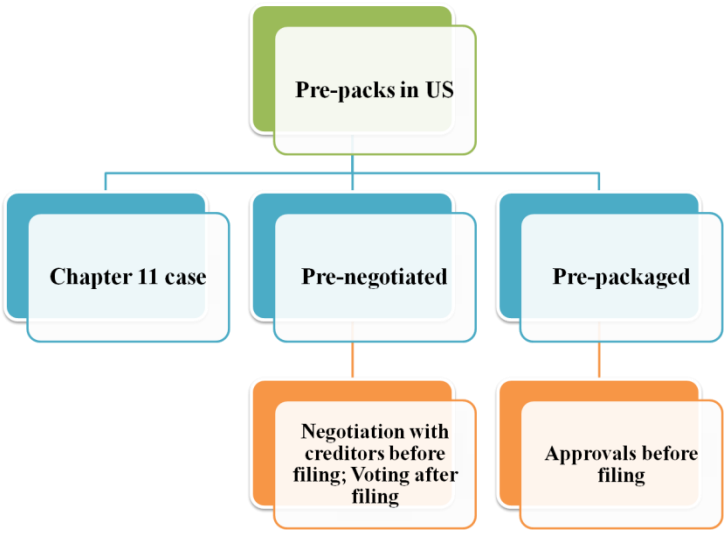
Statement of Insolvency Procedure – 16 (UK)[4] defines **'pre-packaged sale'** as , "an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator and the administrator effects the sale immediately on, or shortly after, appointment".

Similar variants are also used in foreign jurisdictions, as we see below.

Pre-packs in the US and the UK

United States

The regime of pre-packs was introduced in 1978 in the United States aiming for corporate rehabilitation, preservation of employment, and the improvement of community and stakeholders' interests[5]. Pre-packaged arrangements are facilitated under US Bankruptcy law (that is, Title 11 of the US Code) in Chapter 11. Section 1126 (b) of the US Bankruptcy Code provides that *"A holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan",* thereby recognizing pre-packs in its statue. So far as the mechanism for approval of plans is concerned, section 1126 (c) provides that the plan must be approved by the creditors[6] as well as shareholders[7]. Also, notably as per section 1126(f), a class that is not impaired under the plan and each holder of a claim or interest of such class, are conclusively presumed to have accepted the plan, and *solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required*.



See for a detailed account on how pre-packs work in US, in an article '*Pre-packaged Chapter 11 in the United States: An Overview*'[8]. The authors of the said article have descriptively dealt with the different types/modes of pre-pack, essentially based on the stage at which votes of the creditors/

[4] https://insolvency-practitioners.org.uk/uploads/documents/f30389ce35ed923c06b2879fecdb616a.pdf
[5] Source: Pre-packs: the rise of a new restructuring model, https://www.managementboek.nl/code/inkijkexemplaar/9789088632136/pre-packs-the-rise-of-a-new-restructuring-model-engels-victor-laplace-builhe.pdf
[6] Dual approval- 2/3rd of the value of debt + half the number of creditors whose claims have been allowed.
[7] Considered as approved upon assent by 2/3rd of total value
[8] Available here: https://globalrestructuringreview.com/benchmarking/the-art-of-the-pre-pack/1212023/pre-packaged-chapter-11-in-the-united-states-an-overview

shareholders are solicited and on the basis of the nature of arrangement. As the authors state, the insolvency process can be either a traditional Chapter 11 case, a pre-negotiated plan or a pre-packaged plan, as shown aside.

Pre-packs in US have been found to be successful and quick where there are lesser complexities; for instance, in *Re FullBeauty Brands, Inc,* in 2019[9].

United Kingdom

Unlike US, where pre-pack arrangement is borne out of statutory provisions, in UK, it has developed out of practice. The courts too, have supported the use of pre-packaged arrangements, on grounds of limiting judicial intervention in the economic and business decisions of the creditors/ resolution professionals. Such pre-packs would generally be accomplished through administration route, therefore, are also referred to as 'pre-pack administrations'.

In UK, pre-pack arrangements are generally in the form of a pre-packaged sale. An insolvency practitioner sells all or a part of assets of the company, where the preparatory work is undertaken before the appointment of the administrator. This process raised wide-spread concerns with respect to transparency and accountability, particularly in cases where sales were being made to 'connected parties' and where there was possible conflict of interests for the insolvency practitioners.

Thus, to address these concerns, a Statement of Insolvency Practice- 16 (SIP-16)[10] was issued in January, 2009, thereafter updated periodically. One signification step in the direction was *Graham Review into Pre-pack Administration*[11]. The SIP-16 was substantially overhauled (and is in its present form) in line with recommendations made in the *Graham Review*. The *Graham Review* sought to address several concerns relating to 'connected party sales' by way of certain measures, *inter alia*, independent opinion from pre-pack pool, viability review by the connected party, adherence to fundamental principles of marketing, independent valuations, etc.

The SIP also enjoins upon the insolvency practitioners to "differentiate clearly the roles that are associated with an administration that involves a pre-packaged sale, that is, the provision of advice to the company before any formal appointment and the functions and responsibilities of the administrator following appointment." The insolvency practitioner shall provide creditors with a SIP-16 statement, making requisite disclosures (as below) which would enable the creditors to conclude that pre-pack was appropriate and the administrator has acted with due regard for the creditors' interests.

Other Countries

While US and UK continue to be the major flag bearers of pre-pack arrangements, small steps have also been taken in other jurisdictions, *viz.* the Netherlands, Germany, France, Sweden, Italy etc.

See also a detailed article on pre-packs across jurisdictions – "*Pre-packaged Applications in business organisations: International Principles*" by S. Mkhondo & M. Pretorius.

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[9] See analysis of the case in an article, "Fast Fashion: The Case of FullBeauty Brands": https://globalrestructuringreview.com/benchmarking/the-art-of-the-pre-pack/1212024/fast-fashion-the-case-of-fullbeauty-brands

[10] https://insolvency-practitioners.org.uk/uploads/documents/f30389ce35ed923c06b2879fecdb616a.pdf

[11] *Graham Review into Pre-pack Administration: Report to the Rt Hon Vince Cable MP (June 2014)*

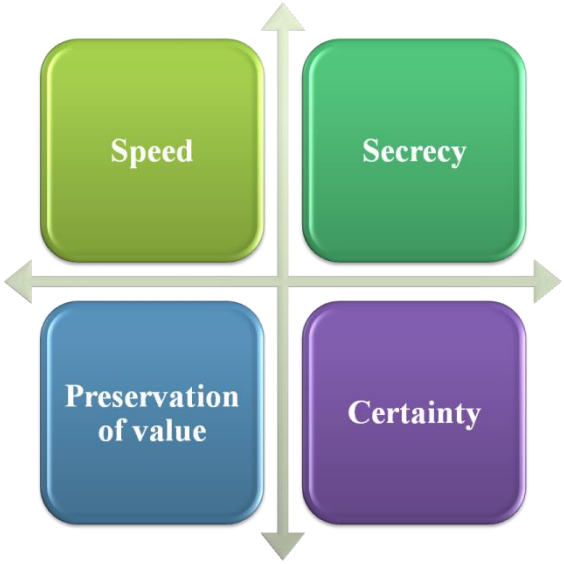
Bringing Pre-packs to India: Understanding the Economic Rationale

In general, pre-packs do have several advantages, including the following –

- Pre-packs are generally seen as **time**[12] **and cost saver,** for all.

- Pre-pack can save the day for **potentially ill firms**, which apprehend default. Early action would generally lead to saving value.

- As the court comes into picture at a considerably later stage, a great deal of **confidentiality** is ensured. It thus, helps to **prevent value destruction**.



- Where the debtor and the creditors (whose rights are sought to be altered) have agreed to certain **commercial agreements**, the role of courts to 'interfere' in such commercial arrangements is reduced to a great extent. Hence, there is a lot of **certainty** involved as against proceedings where the process of finding a patron begins after the court steps in.

In the Indian context, in order to reap the benefits as above, the framework of pre-pack has to blend with the existing insolvency framework, which has certain unique features, e.g., distinction between financial and operational creditors, ineligibility of certain persons to submit plans, ablution of offences on resolution, etc. Further, as every coin has two sides, pre-packs too, are vulnerable to potential abuse. For instance, pre-pack can be (mis)used to repackage 'broken' businesses and sending them back out into the market to take more credit before failing again. Essentially, it might involve 'serial' pre-packing which defies the purpose of being a rescue vehicle but becomes a debt-avoidance tactic[13]. Therefore, the system has to have such inbuilt immunity to prevent such misuse.

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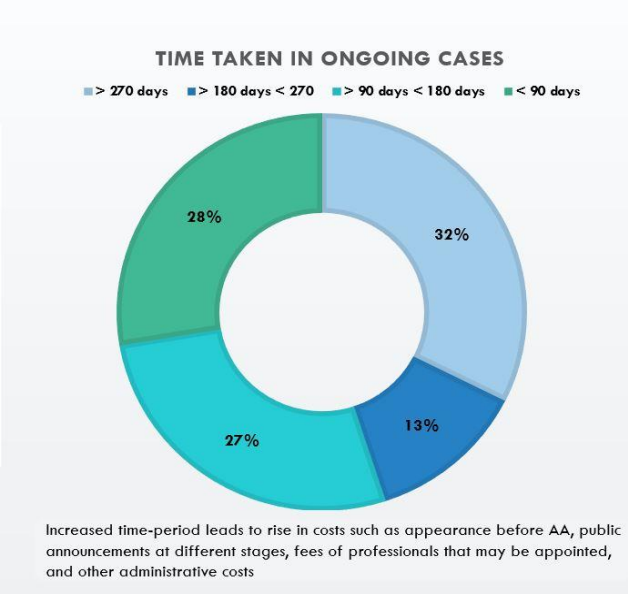
[12] "*The key attraction to the use of pre-packs is the speed with which the administration proceeds. With a buyer in place beforehand, it is not unusual for an insolvency practitioner to conclude the sale of the business on the same day that he or she is appointed as administrator*. This in turn prevents the erosion of goodwill and value in the business which can occur once word of the insolvency spreads. Moreover, funding the continued trading becomes the responsibility of the purchaser. This can allow a practitioner to conduct a going concern sale where it would not otherwise be possible, maximising the financial return for the company's creditors while simultaneously rescuing the business and preserving all or some of the employees' jobs." – See Report on the First Six Months' Operation of Statement of Insolvency Practice 16. The Insolvency Service, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/301183/sip16-first_six_months_2009.pdf

[13] See *Graham Review*, Para 7.83.



In order to address the concerns as above, **we need to understand the underlying economic rationale for introduction of pre-packs in India**, where we already have statutory/regulatory frameworks like schemes of arrangement, and inter-creditor arrangements, etc.

Murmurs of introducing pre-packs in India have always been there, however in an undertone. The Bankruptcy Law Reforms Committee[14] observed that *"the most important objective in designing a legal framework for dealing with firm failure is the need for speed"* and this context, also weighed the prospect of viability of pre-pack insolvencies in India. However, it was then opined that the Indian market, at that juncture, was not developed enough to allow out-of-court restructuring, without intervention of judiciary. Further, in the recent past, the need for *marrying* the statutory process for resolution of corporate insolvency under the Code, and the schemes of out-of-court debt restructuring mechanisms prescribed by RBI has also been felt[15].

While the Code has had a fairly positive effect on instilling credit discipline in the market, the frequent cases of liquidation is not what the Code aimed at. As on 31st December, 2019[16], over 25% of the cases admitted for insolvency have ended up in liquidation. Further, the exceeding breach of the time-limits provided under the Code have further lead to increased cost and time, which have proven to be burdensome for big companies under going insolvency process, rest aside the micro-small and medium enterprises.

Additionally, as the Government is also emphasising on rescue and protection of business due to recent COVID crisis and has suspended insolvency proceedings for defaults occurring during the disruption period[17], it is essential that stakeholders be guided towards an out-of-court settlement, with the benefits of the formal process.

So, why not schemes of arrangement or resolution framework of RBI? Why at all pre-packs are needed? Why should India look forward to pre-packs? The answers may lie in the design of the insolvency framework itself. The Code accords 'statutory' status to the resolution plans, where a section of creditors takes decisions which can bind rest of them. Further, a successful resolution absolves the new management from the past offences such that the corporate debtor can start

[14] https://www.ibbi.gov.in/uploads/resources/BLRCReportVol1_04112015.pdf
[15] Arun Jaitley, 'Speech by Shri Arun Jaitley, Hon'ble Union Minister of Finance and Corporate Affairs at the Conference on '*Insolvency and Bankruptcy Code, 2016: A Roadmap for the Next Two Years' at New Delhi on 18th December, 2018*'
[16] https://www.ibbi.gov.in/uploads/publication/62a9cc46d6a96690e4c8a3c9ee3ab862.pdf
[17] Insolvency and Bankruptcy (Amendment) Ordinance, 2020; see http://vinodkothari.com/2020/06/implications-of-ibc-ordinance-2020-quick-round-up/

afresh free from the bondage of past liabilities. Notably, the other modes of debt restructuring, *viz.* schemes of arrangement, and inter-creditor arrangement under RBI framework do have a statutory/regulatory force, however, do not harvest all the benefits, which a resolution plan does under the Code. For instance, a scheme would not absolve the company from past offences, and a scheme would not bind one class by decisions taken by another class. That's where the need of 'pre-pack' steps in. If one were to think of overhauling a corporate debtor, one would always prefer a 360^0 transformation – a company free of past liabilities and relieved of all kinds of debts has better chances of revival as compared to a company which seeks to progress towards financial rehabilitation with all the burdens of litigations, onerous contracts, debts, etc.

Pre-packs would facilitate the same in a lesser time and probably, at a lesser cost, and expectedly lessening the burden on NCLTs too. In our view, pre-packs should simply pre-arrange the resolution process to all extent possible and go to NCLT merely to seek the final seal of approval. All the provisions of the Code, as apply to the corporate debtor and all other parties during and after CIRP, should also apply *mutatis mutandis* to pre-packs. This would ensure that pre-packs bear the same fruits as the resolution plan.

Now, what if, the 'pre-packs' are designed differently? That is, say, if pre-packs do not bar ineligible persons, or do not absolve past offences, what can be the possible outcome? The answers to such questions can also be given with the rationale as explained above. We are of the view, if pre-packs do not imbibe the same deterrents, exemptions, and relaxations as the formal insolvency framework does, it will serve no better purpose than the extant schemes of arrangement, or other similar modes of debt restructuring, while the intent of our insolvency framework is to have a holistic revival mechanism for ailing businesses. Therefore , it would be futile to come up with a duplicative mechanism of pre-packs.

Should section 29A apply to pre-packs?

Note that the dilemma of applicability of s. 29A on prepacks will arise only when the account has been classified as NPA. Where the default is only *anticipated*, and no other clause of s. 29A is attracted, the prepack arrangement will anyway be free of s. 29A.

In case there is a default, note that the benefits under s. 32A are reliefs consequential to change in management. Hence, we see no reason why s. 29A should not be applied. In fact, applying s. 29A will bar continuation of wilful defaulters, etc. from being in the management of companies.

A possible counter-argument here is that, given certainty of ouster of present management, except where exceptions are available from s. 29A under s. 240A, the management may actually avoid a pre-pack arrangement. However, it seems obvious, that if the company has committed a default, there is no protection from insolvency filings either – sooner or later, the management may have to face the wrath of s. 29A.

Should only financial creditors be a party to pre-packs?

There can be two aspects involved here – (a) *first*, whether the pre-packs should involve all creditors or can be limited to a class of creditors, and (b) *secondly*, in any scenario, what should be the extent of rights resting with the creditors.

The machinery under the Code, for constitution of CoC and representation of the operational creditors has already been upheld by the Hon'ble SC in *Swiss Ribbons*. Pre-packs can follow the same format. Given that the pre-pack arrangement would be approved by the NCLT, it will have the same impact (binding nature) as the resolution plan. Hence, the prepacks can proceed on the same basis as the CIRP.

As regards decision-making by the creditors, the framework can follow the same rules as there in the Code. The creditors can take decision by 66% majority (in value). In order to address related party concerns, the related party creditor should not be allowed to participate and vote on the arrangements – such mechanism is already there under the Code.

Who should appoint RP?

Here, there would be an obvious conflict of interest between debtor and creditors. As the Code presently provides, in case of self-filing under s. 10, it is mandatory to recommend an RP.

Therefore, RP should be appointed by the debtor; however, the CoC should have the right to replace the RP on grounds of material irregularity.

Further, in view of often frequent power struggles between creditors and the insolvency professionals, it would be important to impose the same guidelines, as under the Code, governing the extent of involvement and influence of the creditors and their rights *vis-à-vis* the powers of the insolvency professionals, e.g. s. 28.

Should pre-pack arrangements involve shareholders?

Initiation of pre-pack arrangement should be with shareholder consent.

Can the pre-pack relate to all or a part of the undertaking/business of the company?

A pre-pack arrangement is nothing but a resolution plan. Hence all such restructuring measures as are available in case of a resolution plan should be available for a pre-pack arrangement. A pre-pack deal may not always contemplate sale of assets, there can be several other restructuring options, including assignment of debts, mergers, demergers, etc. – reg. 37 of the CIRP Regulations already provides an illustrative list of restructuring measures. Hence, sale of a part of assets of the debtor may be possible. For instance, in both UK and US, pre-packs provide for part-sales. As such, keeping in view the larger objective of resolution, sale of part assets may be allowed. Encumbered assets may be made a part of the plan, with a rider that the creditors assent to relinquishment is taken.

If there is a distribution under pre-pack arrangement, should that necessarily follow section 53?

Section 53 imbibes the concept of vertical comparison and liquidation value – hence, should be used a benchmark. The *Essar* ruling[18] has made it quite clear. While there can be voluntary compromises by the creditors, a creditor cannot be compelled to have a value lesser than the liquidation value. Hence, the pre-pack arrangement should adequately deal with the rights of dissenting creditors, as also there in s. 30(2) of the Code.

Needless to say, the contractual priorities within a class of creditors should be preserved in such arrangements too.

Will a sanctioned pre-pack arrangement entail the same benefits as available to a resolution plan?

Sanction of resolution plan by the NCLT under the Code, inter alia, has the following important benefits –

a) The sanctioned plan becomes binding on stakeholders involved in the plan. That is to say, it becomes a 'statutory contract', once it gets a seal of approval of the Tribunal.
b) Section 32A comes into play and absolves the corporate debtor from all the past offences, provided that if *the resolution plan results in change in management*.

In order to ensure that a prepack gives a benefit as tangible as a resolution plan, both the above benefits should be available under a prepack too. S. 32A is anyway conditional to change in management; hence the chances of abuse can be obviated.

How can we avoid the use of prepack as a 'repackaging' or 'debt-avoidance' tool?

In order to address the concern that pre-packs may become a debt-avoidance tool in the hands of related/connected parties, the framework can have sufficient safeguards in place – for instance, a pre-pack once contravened should enable the creditors to apply for formal insolvency proceedings/liquidation of the corporate debtor.

Also, akin to the concept of 'viability review' in UK, where the connected party writes a viability review of the 'new company', the Code provides for demonstration that the plan addresses the cause of default, it is feasible and viable, it has provisions for effective implementation and the resolution applicant has the capability to implement the plan[19]. The same should apply to a pre-pack arrangement as well. This acts as a record of the conduct of the management for future use and reference.

[18] See https://www.ibbi.gov.in/uploads/order/d46a64719856fa6a2805d731a0edaaa7.pdf. See also section 30 of the Code which clearly provides for application of s. 53 to resolution plans.
[19] See regulation 38(3) of the CIRP Regulations.

Proposed framework for Pre-packs in India

As we have tried to have possible answers to some of the important concerns, we have the following proposals for pre-packs in the Indian context. In our view, we can have both pre-negotiated and pre-packaged variants of pre-pack. The choice would largely depend on facts of each case. Say, where the negotiation stage reflects that the claims sought to be subdued under the arrangement are more/less concrete, the company can opt for pre-packaged plan; however, if it appears that there is a large base of creditors who can have varied claims, which may or may not be appropriately reflected in the books of the company, the company can explore pre-negotiated plan.

The steps to each variant can be summarily put as follows –

PRE-PACKAGED		**PRE-NEGOTIATED**	
May be preferable for: - small companies - small base of creditors - less litigated debts - certainty of creditor consensus, etc.		May be preferable for: - large companies - large and varied base of creditors - uncertainty of creditor consensus - several litigations, etc.	
1.	Can be initiated on default/anticipated default. Reasonable grounds[20] should exist.	***1.***	Can be initiated on default/anticipated default. Reasonable grounds should exist.
2.	Initiation by corporate debtor/proposal by creditor.	***2.***	Initiation by corporate debtor/proposal by creditor.
3.	CD appoints RP.	***3.***	CD appoints RP.
4.	**RP constitutes CoC (of financial creditors only).** - **Moratorium should begin from this date.** - **the debt owed to each creditor as appearing in the books of the CD can form a basis.**	***4.***	**CD, through involvement of RP, negotiates with creditors.**
5.	RP to perform all functions as envisaged under the Code, including market analysis, valuations, preparation of information memorandum, etc.	***5.***	RP to perform all functions as envisaged under the Code, including market analysis, valuations, preparation of information memorandum, etc.
6.	Invitation of pre-pack plans	***6.***	Invitation of pre-pack plans
7.	Submission of plans by applicants	***7.***	Submission of plans by applicants
8.	Examination of plans by RP, including s.	***8.***	Examination of plans by RP, including s.

[20] Here, the term 'reasonable grounds' may include persistent liquidity crunch, apprehensions about action by creditors w.r.t outstanding dues, or risk of loss of value due to operations during liquidity crisis

PRE-PACKAGED		PRE-NEGOTIATED	
	29A eligibility check, etc. (as usual under the Code).		29A eligibility check, etc. (as usual under the Code).
9.	**Consideration of prepack plans by CoC, on similar parameters as are there for resolution plans (priority, commercial viability, feasibility, etc.)**	***9.***	**Selection of the best plan by RP.**
10.	**Approval of CoC**	***10.***	Application to NCLT
11.	Application to NCLT	***11.***	Public announcement, **moratorium.**
12.	Public announcement	***12.***	Submission and verification of claims
13.	Submission and verification of claims	***13.***	**RP constitutes CoC (of financial creditors only).**
14.	Changes, if any, required under in the plan on account of claims received. Approval of CoC to modified plan.	***14.***	**Approval of CoC.**
15.	**Sanction of plan by NCLT.**	***15.***	**Sanction of plan by NCLT.**
16.	Implementation of plan in accordance with the procedures stated in the plan itself.	***16.***	Implementation of plan in accordance with the procedures stated in the plan itself.

Conclusion

Pre-packaged insolvency arrangements, by virtue of its nature, fits into the insolvency regime that the Government aims to achieve- a time-bound and value maximizing process. Further, the current situation makes it all the more apt to adopt pre-packs in India at this juncture.

As UNCITRAL Guide puts it – encouraging the use of such solutions need not stem from the fact that a country's formal insolvency system is poor, inefficient or unreliable, but rather from the advantages such solutions can offer as an adjunct to purely formal insolvency proceedings, which deliver fairness and certainty. Moreover, such solutions work best where there is the possibility that if the negotiation process cannot be started or breaks down, there can be swift and effective resort to the insolvency law.

Hence, while the existing mechanisms it is important to being into force a hybrid framework for corporate rescue that provides that benefits of the private restructuring as well the surety of a formal proceeding. Pre-packs take care of both these factors. Therefore, there is no reason why India should not look forward to such arrangements.

On the question whether there would be a need for amendments in the Code, it must be noted that in UK, the practice of pre-packs has been developed on the basis of practice, *sans* any statutory

framework (except SIP-16). However, in India, there might be a few amendments needed in the Code to incorporate certain enabling provisions.

See more of articles on Insolvency and Bankruptcy Code.

About the Author

Sikha Bansal is a Partner at Vinod Kothari & Company, and is engaged in matters relating to Insolvency and Bankruptcy Code. The author has also co-authored the book titled "Law relating to Insolvency and Bankruptcy Code 2016" [Taxmann], with Mr. Vinod Kothari, and has authored several articles on the subject.