

MSME insolvency gets pre-packaged resolution route



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MUMBAI/NEW DELHI : The Union government on Monday moved an ordinance to introduce pre-packaged insolvency resolution options for micro, small and medium enterprises, following global best practices.

The ordinance introduces a new chapter in the Insolvency and Bankruptcy Code to offer the pre-pack scheme to those defined as medium and small enterprises or MSMEs under the MSME Development Act. The scheme also covers businesses incorporated as partnerships, in addition to companies.

The scheme is available to entities that have neither undergone bankruptcy proceedings in the preceding three years nor are facing liquidation orders.

Pre-packs are a form of restructuring that allow creditors and debtors to work on an informal plan and then submit it for approval. The incumbent management typically retains control until the final deal..

The scheme disallows a business to avail of the scheme if the major shareholder is an undischarged insolvent or wilful defaulter. The most significant feature is that, unlike the general bankruptcy provisions, it allows the management of the defaulting small business to continue to be in control of operations.

Corporate debtors remaining in possession is a global best practice in such schemes. "Pre-pack gives you a platform where you can do a resolution as 'debtor in possession' rather than creditor in control under resolution professional. That's the major distinction. The company under debtor in possession is able to arrive at a solution. In IBC, the bulk of the litigation is by promoters, which creates roadblocks for resolution," said Ajay Shaw, partner, DSK Legal.

The ordinance refers to the increase in the minimum amount of default for initiation of the corporate insolvency resolution process to ₹1 crore introduced last year and the suspension of bankruptcy proceedings for one year in case of defaults during the period beginning 25 March 2020 as steps already taken to support small businesses

Businesses can voluntarily file for a pre-pack scheme by adopting a special resolution by the board or by a resolution by three-fourths of the partners. The scheme stipulates that though the control stays with the management (directors or partners), it has to "make every endeavour to protect and preserve the value of the property of the corporate debtor, and manage operations as a going concern."

The existing management of the defaulting small business is allowed to be in control of the affairs of the firm during the pre-pack resolution process as chances of new investors lining up for small businesses are fewer than those for large companies. Experts, however, said there will be fewer requests for pre-packs for MSMEs as they expect the chances of payment will be higher in cases where the loan amount is small, as opposed to higher loan amounts. That said, this will act as a test case for bigger borrowers, experts said.

"The government has cautiously introduced the pre-pack regime only for MSMEs, which is welcome. Depending on the success of the pre-pack regime, one can expect this to be made available for other corporate borrowers," said L. Viswanathan, partner at law firm Cyril Amarchand Mangaldas.

For the filing of an application for initiating a pre-packaged insolvency resolution process, the corporate debtor should obtain an approval from financial creditors representing not less than 66% in value of the financial debt. The ordinance said the process has to be completed in 120 days of the insolvency commencement.

"Getting the resolution plan accepted by the lenders is a process in itself as this requires the creditors to come together and approve a resolution plan. Quick resolution-oriented decision making by lenders will be key. Secondly, the process of getting the resolution plan approved from NCLT is saddled with the risk of getting embroiled in litigation. It is imperative that courts do not allow frivolous litigation on issues that are well-settled under the law—for example, the right of dissenting shareholders, and right of operational creditors including statutory dues—so long as the same is taken care of as part of the resolution plan," Shaw of DSK Legal added.