INSOLVENCY PROCEDURES – INVESTIGATING THE PRE-PACK PARADIGM IN INDIA†

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I. Introduction

Corporate rescue, as a precursor to insolvency resolution, enforcement against or liquidation of a company,[1] is a prominent feature of insolvency laws in many jurisdictions. Corporate rescue provides creditors[2] of a stressed debtor company[3] with the tools to formulate a plan to salvage the status of such debtor company and to make it a viable business again. This, in turn, benefits the creditors and allows them to recover their dues with minimum losses as the debtor services the debt timely.[4]

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† This article reflects the position of law as on 24 February 2019.

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1 The author will be restricting the scope of the article to debtors which are corporates.

2 The term 'creditors' has been used to refer to financial creditors such as banks and financial institutions and the term 'stakeholders' has been used to refer to all classes of stakeholders which have financial interests in the affairs of the company *vis-à-vis* employees of the debtor, crown debt creditors etc.

3 The term 'debtor company' has been used in this article to refer to a company which *inter alia* has been incorporated under the laws of its jurisdiction as a distinct legal entity, having perpetual succession and the power to enter into contracts under its own name, which has borrowed through various means and owes a debt to its creditors or has availed of credit or goods or services on deferred payment terms from other entities.

4 Following the global financial crisis, certain special regulatory concessions and asset classification benefits were allowed to banks and financial institutions to salvage genuine projects. These concessions were given by the Reserve Bank of India as incentives for timely and effective resolution / restructuring under the Reserve Bank of India's debt restructuring schemes. These guidelines and schemes were recently withdrawn by the Reserve Bank of India and a consolidated circular dated 12 February 2018 termed as 'Revised Framework for Resolution of Stressed Assets' was issued by the Reserve Bank of India for *inter alia* streamlining and consolidating the extant debt restructuring procedures and bringing them under the purview of *The Insolvency and Bankruptcy Code, 2016.*

Corporate rescue is critical where a company is facing inherent stress which could be the consequence of operational failure or business or financial failure, resulting in the debtor company's inability to service debts timely. Inherent stress may also arise when a company is unable to ensure that its assets are adequate to match its liabilities, which must however, be distinguished from isolated instances of asset-liability mismatch or default in repayment of debts that does not arise from the inadequacy of funds of the debtor company.

Pre-packaged administration of bankruptcy, or 'pre-packs' as commonly referred to, is a mode of corporate rescue which has not yet formally percolated into the Indian market.[5] A pre-packaged administration has been defined 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, his appointment'.[6] Black's Law Dictionary defines a 'pre-pack bankruptcy' as, 'Bankruptcy where the debtor agrees to terms reducing the time it takes to handle the business at hand.'[7]

In India, pre-packs could change the manner in which insolvency resolution is undertaken. The Indian economy is grappling with non-performing assets (NPA)[8] that banks and financial institutions are stranded with after having lent to large corporates who, due to

5 There exist views in the Indian insolvency sphere that introduction of pre-packs in India would prove beneficial for the stakeholders of a corporate debtor under distress. *See infra* n. 95.

6 Lorraine Conway, 'Pre-pack Administrations, House of Commons Library, Briefing Paper Number CBP5035' (2017) *House of Commons Library*, *at* http://researchbriefings.files.parliament.uk/documents/SN05035/SN05035.pdf (last visited 24 February 2019).

7 Black's Law Dictionary, Free Online Legal Dictionary 2nd Ed., *The Law Dictionary, at* https://thelawdictionary.org/prepackaged-bankruptcy/ (last visited 24 February 2019).

8 *See* Alekh Archana, 'Bankers meet to take stock of progress in NPA resolution' (2017) *Livemint, at* http://www.livemint.com/Industry/8eaqgJ0CO4Gpyuh5yyhrwJ/Bankers-meet-to-take-stock-of-progressin-NPA-resolution.html. (last visited 24 February 2019).

various reasons,[9] have not been able to service these loans. It takes an average of 4.3 years for a creditor to recover its debt in India as per the World Bank's Doing Business Report 2019 and India has been ranked 108 amongst 190 countries in terms of resolution of insolvency.[10] In a bid to clean up the balance sheet of the banks, the Reserve Bank of India (RBI) also identified certain large corporates which have contributed to the majority NPAs in a list sent to all banks having exposure to the named corporates. The banks were also mandated by the RBI to commence Corporate Insolvency Resolution Process (CIRP) under *The Insolvency and Bankruptcy Code, 2016* (IBC) and the rules and regulations thereunder against the named corporates, on their failure to meet certain set targets.[11]

In the above backdrop, the objective of this article is to explain the nature of a pre-pack and specifically analyse how a pre-pack regime would fare in the Indian insolvency market. This article also explores whether the implementation of pre-packs in India would necessitate an amendment in the existing insolvency regulatory framework and if yes, the extent of such amendment.

Part II of this article seeks to analyse the nature of pre-packs with an additional focus on their features, as a mode of corporate rescue in the United Kingdom (UK) and the United States of

9 Pallavi Chavan and Leonardo Gambacorta, 'Bank Lending and Loan Quality: The Case of India WPS (DEPR): 09 / 2016 RBI Working Paper Series' (2016) *Reserve Bank of India*, *at* https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=17400 (last visited 24 February 2019). The authors have set out the rationale of the procyclical nature of non-performing loans and analysed certain factors as to the reasons behind growth of non-performing loans in India.

10 World Bank Group, 'Doing Business Economy Profile 2017: India' (2019) *World Bank, at* http://www.doingbusiness.org/content/dam/doingBusiness/media/Profiles/Regional/DB2019/SA.pdf (last visited 24 February 2019).

11 *See* Reserve Bank of India, 'RBI identifies Accounts for Reference by Banks under the Insolvency and Bankruptcy Code (IBC)' (2017) *Reserve Bank of India, at* https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=40743 (last visited 24 February 2019).

America (US). Part III of this article sets out the present regulatory framework of insolvency resolution in India, pre-packs in the Indian insolvency regime and how pre-packs would fare in India. Part IV analyses essential aspects when considering pre-packs in India and contemplates certain key legislative considerations for pre-packs to be undertaken in India. Part V sets out a holistic overview of the benefits and disadvantages of a pre-pack. Part VI concludes the article.

II. The Nature of Pre-packs

A. Pre-packs vis-à-vis Restructuring

The term 'restructuring' is used frequently in the context of insolvency resolution. The terms 'corporate restructuring' and 'debt restructuring' have different connotations. As per Black's Law Dictionary, 'corporate restructuring' generally signifies: 'A fundamental and sometimes drastic change that will alter the relationships within a company or with other companies',[12] while 'debt restructuring' refers to, 'An agreement between creditors and the firms to reorganize liabilities to make it more feasible. It is done to avoid foreclosure or liquidations. It can involve forgiveness, rescheduling, and conversion into equity'.[13] There are various considerations while analysing the far-reaching impact of undertaking 'restructuring' of a troubled company.

In the above context, a pre-pack is a mode of restructuring which may involve any element or combination of the restructuring methods set out above, to be undertaken in respect of the debtor company. A pre-pack, however, is distinguished from the other modes of corporate rescue by the manner in which the debtor company is sought to be turned around and the timelines which are followed in relation to the

12 Black's Law Dictionary Free Online Legal Dictionary 2nd Ed., *The Law Dictionary*, *at* https://thelawdictionary.org/restructuring/ (last visited 24 February 2019).

13 Black's Law Dictionary Free Online Legal Dictionary 2nd Ed., *The Law Dictionary*, *at* https://thelawdictionary.org/debt-restructuring/ (last visited 24 February 2019).

process. In a pre-pack, a substantial portion of the restructuring of the affairs of the company takes place prior to the debtor company filing for insolvency.

B. What are Pre-packs?

Corporate rescue, as the term suggests, focuses on restoring the status of a flailing company. Pre-packs, largely perceived as a subset of corporate rescue, are typically employed to preserve the business of the debtor company, ie, its tradeable or enterprise value.[14] The purpose of a pre-pack is to strike a balance between safeguarding the interests of the creditors and maintaining the business and assets of the debtor company by facilitating a swift transition of such assets and business.

Certain key aspects of a pre-pack have been analysed with reference to US or UK laws, as applicable, in view of the maturity and evolved regime of pre-packs in the concerned jurisdictions. Set out below are the key aspects of a pre-pack.

1. Initiation of a Pre-pack

The essence of a pre-pack is that the terms of restructuring are formulated prior to the commencement of insolvency. When a pre-pack is undertaken prior to the occurrence of an event of default with a creditor, it is the debtor company which would be in a position to propose the commencement of a pre-pack. However, in a situation where the company has defaulted or has triggered a 'potential event of default' clause in its credit documents or even when a creditor becomes aware of the distress in the debtor company, he may seek to have the debt of the debtor company restructured as a pre-pack.

Whether the process is debtor driven or creditor driven is an important factor while analysing a pre-pack. In the event the debtor

14 *See infra* Paragraph B 6 of Part II below for analysis of enterprise value and Paragraph A of Part IV of this article for the concept of fair value in India.

company seeks to initiate the pre-pack, it would have to ensure that the necessary shareholders' resolutions and board resolutions have been passed. For a creditor to initiate a pre-pack, the crucial factor is the *inter se* understanding of all the creditors of the debtor company.[15]

The UK[16] and US[17] insolvency laws contemplate any stakeholder of a corporate debtor initiating a pre-pack in relation to the debtor company.

2. How Does a Pre-pack Work?

A pre-pack essentially involves restructuring of the debt of the company. The mode of restructuring that is undertaken pursuant to a pre-pack *vis-à-vis* the debtor company, would depend *inter alia* on the nature of activity or business that is primarily undertaken by such debtor company, the quantum and nature of debt that is incurred and subsisting, and the stage of distress that the debtor company is facing, thereby necessitating restructuring. This could also include corporate restructuring being considered as a part of such restructuring exercise. Once the mode of restructuring and the terms of the same have been finalised between the parties, the pre-pack is executed promptly as the company files for insolvency. Interestingly, under certain European laws, a pre-pack is effectuated on the same day as the appointment of the Insolvency Professional (IP) itself, ie, an immediate handover of the business to the incoming purchaser.[18]

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15 *See infra* paragraph B of Part IV of this article for an analysis on creditor control over the debtor company.

16 PricewaterhouseCoopers, 'Insolvency in brief: A guide to insolvency terminology and procedure' (2009) *PricewaterhouseCoopers, at* https://www.pwc.co.uk/assets/pdf/insolvency-in-brief.pdf (last visited on 24 February 2019).

17 Law 360, 'The Pros And Cons Of Prepackaged Bankruptcy' (2013) *Simpson Thacher & Bartlett LLP, at* https://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1647.pdf?sfvrsn=2 (last visited on 24 February 2019).

18 Adrian Cohen, 'A Guide to European Restructuring and Insolvency Procedures' (2015) *Clifford Chance*, *at* https://www.cliffordchance.com/briefings/2015/09/a_guide_to_europeanrestructuringandinsolvenc.html (last visited on 24 February 2019).

While 'pre-pack' as a concept under UK laws has been used more frequently in the context of sale of substantial business or assets of the debtor company to a new entity prior to the debtor company formally filing for insolvency,[19] the usage of a pre-pack bankruptcy under the US laws has a much wider connotation and entails formulation of the terms of bankruptcy of the company prior to the company filing for bankruptcy.[20]

In both scenarios, ie, in the UK and in the US, once a debtor company files for insolvency, the administrator or the court-appointed resolution professional effectuates the pre-pack immediately. In the UK, once the terms of a pre-pack are formulated, the debtor company is typically put under administration by approaching the court and an administrator is appointed in relation to the management of the business of the debtor company,[21] although the permission of a court is not required to initiate a pre-pack.[22]

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19 *Supra* n. 6.

20 Investopedia, 'Prepackaged Bankruptcy' (2017) *Investopedia, at* https://www.investopedia.com/terms/p/prepackagedbankruptcy.asp. (last visited on 24 February 2019). It stipulates while defining prepacked bankruptcy, 'A prepackaged bankruptcy is a plan for financial reorganization that a company prepares in cooperation with its creditors that will take effect once the company enters Chapter 11 (*of the US Bankruptcy Code*). This plan must be voted on by shareholders before the company files its petition for bankruptcy, and can result in shorter turnaround times. The idea behind a prepackaged bankruptcy plan is to shorten and simplify the bankruptcy process in order to save the company money in legal and accounting fees, as well as the amount of time spent in bankruptcy protection. A proactive company in distress will notify its creditors that wishes to negotiate terms of bankruptcy before it files for protection in court. These creditors — lenders, inventory suppliers, service providers, etc. — naturally do not like the distressed situation of the company, but will work with it to minimize time and expenses associated with bankruptcy reorganizations. The creditors are more apt to be amenable during the negotiations to rework terms since they will have a voice before the bankruptcy filing; the alternative would be a surprise and then a scramble to deal with the delinquent debtor with more uncertainty about how long the process will take.'

21 The procedure for administration of a company which is put under administration in the UK is regulated by Schedule B1 of *The Insolvency Act, 1986*. India follows a similar approach under the IBC which vests the control of the debtor company with an Insolvency Resolution Professional once an application for commencement of CIRP is accepted by the National Company Law Tribunal.

22 *Supra* n. 6.

Thus, what sets a pre-pack apart from other modes of restructuring is the promptness with which a restructuring plan is executed despite the company being subject to insolvency proceedings at the end of the restructuring.

3. Who Retains Control of the Debtor Company During Insolvency Outside of a Pre-pack?

Pre-packs under US laws are typically undertaken under Chapter 11 of *The US Bankruptcy Code, 2011 (US Bankruptcy Code).*[23] The US Bankruptcy Code, which provides for a Debtor-In-Possession (DIP) concept,[24] permits the debtor company to arrive at the terms of restructuring while remaining in possession of its assets. Chapter 11 of the US Bankruptcy Code vests with the (concerned) courts, the power to permit the debtor company to retain management of the company.[25]

The debtor company, however, remains subject to the oversight of the creditors' committee and the court. An automatic moratorium, not unlike section 14 of the IBC, is provided for under the US Bankruptcy laws, as well. Under the DIP status granted to the corporate debtor, the debtor is in charge of its day-to-day activities and the existing management of the debtor is not replaced by the control of a court-appointed administrator.

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23 *US Bankruptcy Code*, (United States).

24 *See* 'Bankruptcy Basics', *United States Courts*, *at* http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited 24 February 2019). One of the novel features of Chapter 11 under the US Bankruptcy Code is that, 'Upon filing a voluntary petition for relief under chapter 11 or, in an involuntary case, the entry of an order for relief, the debtor automatically assumes an additional identity as the "debtor in possession." 11 USC § 1101. The term refers to a debtor that keeps possession and control of its assets while undergoing a reorganization under chapter 11, without the appointment of a case trustee. A debtor will remain a debtor in possession until the debtor's plan of reorganization is confirmed, the debtor's case is dismissed or converted to chapter 7, or a chapter 11 trustee is appointed. The appointment or election of a trustee occurs only in a small number of cases. Generally, the debtor, as "debtor in possession" operates the business and performs many of the functions that a trustee performs in cases under other chapters. 11 USC § 1107(a).'

25 11 USC § 1107.

This is in contrast to the UK laws which require the management of the debtor company to vest in the administrator so appointed on filing for administration of the debtor company.[26] Some have even compared a pre-pack to a scheme of arrangement, which is contemplated under *The Insolvency Act, 1986 (Insolvency Act)* in the UK and a Chapter 11 filing under the US Bankruptcy Code.[27]

4. Appointment of an Insolvency Professional[28]

A pre-pack requires high level of skill and expertise in *inter alia* managing the affairs of the company and commercial aspects of insolvency resolution. Therefore, a qualified professional may be required to assist the debtor company in formulating and executing a pre-pack.

Under the UK laws, when a debtor company opts to go the pre-pack route, it typically appoints an IP who undertakes the operational aspects of finalising the pre-pack transaction. In the UK, apart from the Insolvency Act and the rules thereunder, the administrator is also required to adhere to guidance notes in the form of Statements of Insolvency Practice (SIP) issued by the Joint Insolvency Committee comprising representatives from recognised professional bodies and the Insolvency Service, which is the executive arm of the Department of Business Innovation and Skills.[29]

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26 *Supra* n. 21.

27 *See* Alastair Goldrein, 'Unwrapping English pre-packaged administrations: a guide to "pre-packs" in England' (2011) *Chadbourne & Parke LLP, at* https://www.lexology.com/library/detail.aspx?g=da1945a8-be91-4557-9028-48c5e8993a39 (last visited 24 February 2019).

28 *See infra* Paragraph B 3 of Part III for an analysis of the role of an IRP or IP in India, and also from a pre-pack perspective.

29 *See* Association of Business Recovery Professionals, 'Statements of Insolvency Practice - England & Wales' *at* https://www.r3.org.uk/what-we-do/publications/professional/statements-of-insolvency-practice/e-and-w (last visited 24 February 2019).

The SIP 16 mandates an IP to act professionally and with objectivity, with a view to maximise the interests of the creditors of a debtor company as a whole, given the high level of interest the public and the business community have in pre-packs and administrations.[30] As per SIP 16, IPs are required to bear in mind the responsibility that they have towards the company and the creditors prior to their appointment, in which case it would be mostly advisory in nature versus their duty in the eventuality they are appointed as administrators.[31]

The role that the administrator of the company (when appointed) plays in giving effect to a pre-pack arrangement is therefore crucial and the IP who later acts as the administrator has a dual role, prior to and post his engagement as an administrator. An IP has the responsibility of ensuring that the arrangement that the company is proposing is fair to each creditor and stakeholder, and is not carried out in a manner which is opaque or prejudicial to the interests of any stakeholder or class of stakeholders.[32]

An IP once appointed as the administrator, is required to act in the best interests of all the creditors and stakeholders. If an IP is found by the court to have acted improperly at any point during the course of the entire process, he may be made liable for misfeasance. If he is judged to have acted improperly by a professional body, he will be subject to that body's disciplinary proceedings.[33]

30 *See* Association of Business Recovery Professionals, 'Statement of Insolvency Practice - England & Wales' *at* https://www.r3.org.uk/what-we-do/publications/professional/statements-of-insolvency-practice/e-and-w/sip-16-list (last visited 24 February 2019).

31 *Ibid*.

32 *Supra* n. 30.

33 *Supra* n. 30.

5. Court Approval

Court involvement is a necessary prerequisite in a pre-pack, since the terms of restructuring are necessarily formulated by parties prior to there being a formal filing of insolvency. In this situation, while it is the creditors whose interests are primarily considered,[34] there exist interests of stakeholders of the debtor company which may not be taken into consideration while formulating such terms. Employees, vendors (in the Indian context, operational creditors), and statutory authorities are certain stakeholders which would be interested in ascertaining whether the terms of the pre-pack are beneficial to them as well. In such situations, having an adjudicating authority as a mode of grievance redressal is important to ensure that the stakeholders of the debtor company are not prejudiced due to the terms of the pre-pack.

Approval of the entire process by a neutral adjudicating body, which has to be satisfied that the terms of a pre-pack sale are indeed beneficial to the interests of all stakeholders concerned, would be important in building confidence in the functioning of pre-packs and would carry with them the seal of approval of the insolvency court as being above board, and confer legal sanctity on the arrangement.

6. Determination of the Enterprise Value of the Debtor Company

The enterprise value[35] of the debtor company serves as the benchmark, which the terms of a pre-pack are required to match at bare minimum, where a sale of business or management or assets is contemplated as a part of such pre-pack.

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34 *See infra* Paragraph B. of Part IV of this article for analysis of creditor control and how it is an important consideration while undertaking pre-packs, and also from an Indian perspective.

35 Black's Law Dictionary, Free Online Legal Dictionary 2nd Ed. *The Law Dictionary at* https://thelawdictionary.org/enterprise-value/. The Law Dictionary defines 'enterprise value' as, 'A firm's total capitalization defined as market value. Calculated as: Equity, added to debt, minus the non-critical asset value. To the firm's core business, these assets must be casual, non-essentials'. This term finds similarities under the IBC in the concept of fair value.

It is interesting to note that a like process of valuation of assets of a company under UK laws has not been prescribed.[36] Certain objections have been raised that the terms of a pre-pack may give a company an unfair market advantage by allowing the new company to leave behind its unwanted debts.[37] For the existence of a fair playing ground for competition, it is necessary while considering a pre-pack to ascertain the tangible value or the enterprise value of a debtor company to ensure that a balance is struck between corporate rescue of such company and to preclude a pre-pack from being used as a means to escape inconvenient debts in the books of a company.

7. Marketing the Assets of the Debtor Company

Wide marketing of the assets or business of the corporate debtor, calling for expressions of interest from parties interested in taking over the business or assets of the debtor company by inviting the bidders to quote their price for such assets would be crucial for a successful pre-pack. On arriving at a satisfactory price, the definitive documents are negotiated, consent from creditors is obtained and the terms of the pre-pack are effectuated.[38] The proceeds of the pre-pack are then used for repayment to the creditors while the actual company undergoes subsequent administration (or other insolvency processes prescribed under the insolvency laws).

In the event the sale of the business or assets of a debtor company is envisaged in a pre-pack, the SIP 16 in the UK requires that the assets of the debtor company, which are proposed to be sold, must be marketed widely to ensure that the debtor company obtains the best deal possible and to minimise the chances of a circuitous transfer of assets. Once a potential buyer is finalised, the debtor company files for administration and in majority of the cases, proposes the IP to act as the administrator.

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36 *Supra* n. 27.

37 *Supra* n. 6.

38 *See infra* Paragraph B. of Part IV of this article for an analysis on creditor control.

C. The Parties Involved

In a pre-pack, the debtor company is at the centre of the entire process, and may undergo a change in shareholding or its assets. The management of the debtor company, comprising the board of directors and other key managerial personnel, play a critical role in the pre-pack sale along with the shareholders, without whose approval it is unlikely that the debtor company will be able to undertake a pre-pack. This change in procedure is undertaken by the IP who is appointed by the company to formulate the terms of the pre-pack and oversee its execution.

The creditors of the debtor company are parties who are affected to a great extent given that the very nature of the entity, to whom they have lent substantial amounts of money, may undergo a change. Within the broad class of creditors, there may exist various sub-sets, *viz.* financial creditors such as banks and financial institutions funding the debtor company, operational creditors which are typically suppliers or vendors to the debtor company that are owed moneys on invoices and under trade contracts, secured creditors which have various forms of charge on the immovable or movable assets of the company or its shares, and unsecured creditors which have a right of recovery against the debtor company.

There are other crucial stakeholders in the debtor company, such as its employees and vendors without whom operations cannot continue, and the regulatory authorities of the jurisdiction, which, depending on the nature of activities or business of the debtor company, regulate and provide various licenses or approvals for the debtor company to undertake its business. Lastly, the government to which tax, cess and other charges are due also has an interest in the functioning of the debtor company.

III. Pre-packs in India

A. Insolvency in India Presently

The concept of insolvency rescue by creditors has been a part of Indian insolvency laws for more than a century. It has only attained formal recognition and importance from contemporary stakeholders

by the mandate of the fairly recent IBC. The IBC requires formation of a Committee of Creditors (CoC) for arriving at a resolution plan within the stipulated time period.[39] The Indian insolvency laws, prior to enforcement of the IBC, were formulated during the British regime and were not updated to align with contemporary insolvency resolution practices. The IBC consolidates the insolvency laws in relation to corporates and individuals both, and operates as the unified legislation to address insolvency of corporates and individuals.[40]

CIRP is the corporate rescue element of the IBC. The IBC provides for initiation of CIRP on admission, by the National Company Law Tribunal (NCLT), of an application either by or on behalf of a creditor or the corporate debtor. The resolution professional under the IBC is the equivalent of an administrator appointed under the UK model and all the affairs of the company vest in such resolution professional. The board of directors or the partners of the corporate debtor are stripped of all powers in relation to the management of the corporate debtor.[41] All creditors of the corporate debtor (including offshore lenders) are required to form a CoC under the IBC, and participate in collective decision-making for resolution of the financial stress of the corporate debtor.

Introduction of pre-packs as a formal mode of corporate rescue in India may be analysed now in the above backdrop.

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39 Section 12 of the IBC stipulates that a corporate insolvency resolution process must be completed within a period of 180 days from the date of admission of the insolvency application by the NCLT, which may extend the period by 90 days more at its discretion on an application by the insolvency resolution professional. The IBC also contemplates an additional year to be granted to a successful resolution applicant for obtaining the requisite regulatory approvals for implementation of the resolution plan proposed by it.

40 The IBC was notified by the Government of India on 28 May 2016. Certain sections of the IBC have been notified and are effective, specifically, the corporate insolvency resolution process. The bankruptcy provisions dealing with individuals are yet to be notified.

41 The IBC therefore responds to the question, 'Who retains control of the debtor company during insolvency?' by following the UK approach, ie, a creditor-favouring stance.

B. The Pre-pack Proposition

1. Are Pre-packs Required in India?

While the IBC has had a positive effect on promoters of defaulting companies in terms of repayment discipline,[42] liquidation is a grave threat perceived on failure of CIRP, and frequent instances of liquidation may not be a viable or desirable solution in the long run in terms of promoting the business community. This problem is aggravated further when it is the micro, small and medium enterprises which are mostly at the receiving end, due to a lack of investor interest in their assets during CIRP.[43] Time and costs, even for big companies undergoing CIRP, are huge factors which create an aversion towards CIRP.

While analysing the necessity of a pre-pack, one may also argue that prior to the pre-pack stage, the debtor company may enter into a leveraged buyout or management buyout for the purpose of transferring its assets or business to another entity. It may, however, be noted that such a buyout would not carry the seal of approval of a court[44] and would therefore, to that extent, be open to challenge by creditors if they were to object to such a transaction and require clawback,[45] which is a safeguard provided to creditors under the IBC.

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42 Anup Roy, 'Fearing insolvency proceedings, promoters line up to pay their dues' (2018) *Business Standard, at* https://www.business-standard.com/article/companies/fearing-insolvency-proceedings-promoters-line-up-to-pay-their-dues-118070301213_1.html (last visited 24 February 2019).

43 *See* Namrata Acharya, 'IBC proceedings: 78 liquidation orders, a handful of resolutions' (2018) *Business Standard, at* https://www.business-standard.com/article/economy-policy/ibc-proceedings-78-liquidation-orders-a-handful-of-resolutions-118042200726_1.html (last visited 24 February 2019).

44 Unless the same is undertaken as a court approved scheme such as a Scheme of Arrangement under *The Companies Act, 2013*.

45 Under section 44 of the IBC, the NCLT possesses the power to pass an order if approached by the resolution professional, declaring any transaction entered into by the debtor company prior to the insolvency commencement date as a preferential transaction, undervalued transaction or an avoidance transaction.

A risk of a clawback may not arise, however, if such a pre-pack is approved by the NCLT itself. By proposing mandatory NCLT approval for execution of a pre-pack, another advantage is that fears which investors, creditors and other stakeholders would have, about safeguarding their rights against the debtor company in recovery, would be allayed to a great extent and confirm the finality and binding nature of such transaction.

2. How Would a Pre-pack Work in India?

While the conventional definition of a pre-pack suggests that the sale of assets is concluded prior to the company officially filing for insolvency, a pre-pack in the Indian context may be broader in its usage to comprise various tools utilised in relation to the debtor company to revive it and rectify the financial stress that it is undergoing (similar to the term used in the US context).[46]

In the Indian context, change in management, sale of assets of the debtor company to another company, interim financing and refinancing, assignment of debt of the debtor company to asset reconstruction companies and turnaround funds are a few tools that a debtor company and creditors possess while undertaking the corporate rescue of such debtor company. These tools are also available to a bidder (resolution applicant) once a debtor company is subject to CIRP.

It would be interesting to blend the aspects of the IBC with such corporate rescue tools, prior to the debtor company undergoing CIRP itself.

It may be worth considering Project Sashakt, an initiative introduced by a Government panel headed by the Chairman, Punjab National

46 *See also* paragraph A. 2 of Part II which analyses the question, 'What Really is a Pre-pack?'

Bank, which was recently in the news due to its recommendations on handling stressed assets.[47] Project Sashakt suggests an approach of bringing together banks dealing with stressed assets by way of an inter-creditor agreement. The resolution approach to be adopted in respect of the assets is based on the size of the stressed asset.[48] For mid-sized assets, the lead bank is to be in charge of the resolution of the asset and the voting process in respect of resolution of the asset would be as under the IBC, being 66.66 per cent of majority vote share.[49] For larger stressed assets, the same are proposed to be auctioned to asset reconstruction companies and majority equity of the debtor company would then be transferred to sector-specific alternate investment funds, which would work under a unified asset management company to be set up by the banks. This would enable better price discovery and quicker turnaround of assets.[50] The timeline prescribed under Project Sashakt is 180 days, within which the resolution plan is expected to be formulated. Failing completion of the resolution in 180 days, the asset would be subject to CIRP under the IBC.[51]

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47 *See* Gopika Gopakumar, 'Mint Primer: What is Project Sashakt and how it will work' (2018) *LiveMint*, *at* https://www.livemint.com/Industry/xx5DASBD0xB9fgEPzKGwUO/Mint-Primer-What-is-Project-Sashakt-and-how-it-will-work.html (last visited 24 February 2019).

48 *See* Vishwanath Nair, 'Government Unveils Five-Point Plan 'Sashakt' To Tackle Bad Loans' (2018) *Bloomberg Quint*, *at* https://www.bloombergquint.com/business/government-unveils-five-point-plan-sashakt-to-tackle-bad-loans#gs.KQmVwtvY (last visited 24 February 2019).

49 *See* 'Project Sashakt: Banks give shape to inter-creditor pact for bad assets' (2018) *Economic Times*, *at* https://economictimes.indiatimes.com/industry/banking/finance/banking/banks-give-shape-to-inter-creditor-pact-for-bad-assets/articleshow/64877560.cms (last visited 24 February 2019).

50 Viral Acharya, 'Some Ways to Decisively Resolve Bank Stressed Assets' (2017) *Reserve Bank of India*, *at* https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1035 (last visited 24 February 2019). This approach may be reminiscent of a certain 'bad bank' which was discussed by the RBI Deputy Governor in the concerned speech.

51 *See supra* n. 48.

While Project Sashakt is a corporate rescue mechanism which is aimed at quicker recoveries to creditors, it is proposed to be a precursor to the IBC.[52] This is a large-scale initiative by the Central Government to manage stressed assets. A pre-pack in some ways would be similar to this scheme as it would contemplate corporate rescue prior to initiation of proceedings under the IBC.

Analysing the pre-pack in terms of Project Sashakt, the similarity in both is that the terms of the pre-pack would be formulated prior to the application for commencement of insolvency being filed against the debtor company. The differentiating factor is that on finalisation of the terms of the pre-pack, a CIRP application would be filed by the debtor company and the pre-pack plan promptly implemented as a resolution plan under the IBC.[53] Under Project Sashakt, however, a successful resolution of the debtor company precludes it from being subject to CIRP under the IBC.

The pre-pack process, therefore, would be similar to the IBC and work along the lines of a CIRP, with creditor involvement. However, being a less formal procedure, a pre-pack could be concluded on obtaining consent from creditors, without undergoing a 180-day process. This, of course, would depend greatly on the *inter se* understanding between creditors. In practice, it is not uncommon that negotiations of restructuring fail between a debtor company and its creditors due to lack of consensus between the creditors.

The majority vote concept of 66.66 per cent would aid in such situations. To give sanctity to a pre-pack, if the same is undertaken in compliance with all the procedures and processes prescribed, it could be the NCLT's sole discretion, whether or not to re-open a particular pre-pack on being approached by a dissenting creditor, and if the NCLT did seek to analyse a pre-pack, it may be restricted to a particular aspect or term.

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52 *See supra* n. 48.

53 *See infra* paragraph C of part IV of this article for analysis on viability of connected party pre-packs in India.

3. The Role of an IP

The UK insolvency laws differ from the Indian insolvency laws in the following way: while in the former, the debtor company appoints the IP prior to formally filing for insolvency, and such IP most likely is appointed as the administrator when the company files for insolvency,[54] in the present regulatory regime in the latter, the Insolvency Resolution Professional (IRP) is appointed only after an application for the commencement of the CIRP is admitted by the NCLT.

While the existing regulations in India governing IPs set out the code of conduct and their powers and responsibilities, these regulations apply once the IP has been appointed, ie, once the CIRP application against the corporate debtor has been filed and accepted by the NCLT.[55]

In the event that pre-packs as a mode of corporate rescue are formally recognised in India, the regulations may need to be amended to contemplate the scope of powers and responsibilities of an IP in a pre-pack transaction. Guidance from the SIP 16 may be sought since it contemplates the specificities of the role of an IP in a pre-pack.[56]

IV. Legislative Aspects of Pre-packs in India

Given the above background of the nature of pre-packs, certain specific issues set out below may be analysed from a legislative perspective to ascertain whether pre-packs would succeed in the Indian market.

54 *See supra* n. 30.

55 *See Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016*. Notification No. IBBI/2016-17/GN/REG003 dated 23 November 2016.

56 *Supra* n. 29.

A. Tradeable Value of the Company

The main responsibility of an IRP and subsequently the resolution professional is to ensure that the debtor company functions as a going concern during CIRP.[57] The approval of the CoC is required for the IRP or the resolution professional to undertake activities which affect the rights of the members of the CoC.[58] Therefore, any decision which may be arrived at by an IP for sale of either a part or whole of the assets of the debtor company under a pre-pack would be permitted to be executed only after the debtor company has filed for insolvency and with the approval of the CoC.

The disadvantage of a sale that is concluded under such circumstances, ie, where the debtor company has already entered into insolvency, is that the assets of the debtor company would depreciate given the insolvency proceedings.[59] For instance, a company whose assets are valued at INR 10 prior to the commencement of the insolvency proceedings may only have a tradeable value of INR 2 after the insolvency proceedings are concluded and the resolution plan for sale of the assets or business of the debtor company is approved by the CoC and the NCLT. It is the creditors who would ultimately bear the losses of a devalued sale since their dues will abate in substantial proportion. In the case of an unlisted company, while the tradeable value of the company may not fall in the case of insolvency, there would nonetheless be a general decline in the affairs of the company, since vendors would not desire to trade with a distressed company and fresh credit would not be forthcoming.

The IBC provides for calculation of the liquidation value of the debtor company. The liquidation value of a corporate debtor is defined under the IBC as the 'estimated realizable value of the assets

57 IBC, sections 20 and 25.

58 IBC, section 28.

59 Moneycontrol News, 'HCC's shares fall 7% after creditors file insolvency proceedings against Lavasa Corporation' (2018) *Money Control, at* https://www.moneycontrol.com/news/business/markets/hccs-shares-fall-7-after-creditors-file-insolvency-proceedings-against-lavasa-corporation-2901501.html (last visited 24 February 2019).

of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date.'[60] There is a fair amount of discussion surrounding how reliable the liquidation value of the company may be while assessing and formulating the resolution plan *vis-à-vis* the debtor company. Given that the liquidation value is essentially calculated at the insolvency commencement date,[61] there is a possibility that the figure so arrived at by the valuers may not reflect the actual value of the assets of the company, ie, its enterprise value.[62]

The IBC has been amended in view of the above and only the CoC members are permitted to have access to the liquidation value of the debtor company undergoing CIRP. Further, instead of the liquidation value, the resolution applicants are provided with the 'fair value' which is, 'the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion'.[63] While this would, to a great extent, help in ensuring that the value of the company does not depreciate, the damage to the brand value may have occurred due to the commencement of CIRP itself, not to mention the costs and the time taken for completion of CIRP.[64]

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60 *Insolvency and Bankruptcy Board of India (Insolvency Resolution of Corporate Persons) Regulations, 2016*, regulation 2(k).

61 The date of admission of an application for initiating corporate insolvency resolution process by the NCLT, which application is filed under sections 7, 9 or 10 of the IBC.

62 FE Bureau, 'Stressed asset valuation: Both fair and liquidation values to be considered' (2018) *Financial Express, at* https://www.financialexpress.com/economy/stressed-asset-valuation-both-fair-and-liquidation-values-to-be-considered/1057179/ (last visited 24 February 2019).

63 *Insolvency and Bankruptcy Board of India (Insolvency Resolution of Corporate Persons) Regulations, 2016*, regulation 2(hb).

64 'Insolvency and Bankruptcy Code: Here's why resolution must be strictly time-bound' (2017) *Financial Express, at* https://www.financialexpress.com/opinion/insolvency-and-bankruptcy-code-heres-why-resolution-must-be-strictly-time-bound/675643/ (last visited 24 February 2019): 'A very long CIRP period is likely to push the corporate towards liquidation while reducing its liquidation value. Further, a longer CIRP period means a larger number of firms under resolution process at a given point of time, which would impinge on economic growth.'

The proposition here is that for price discovery in terms of a pre-pack, the 'fair value' prescribed under the IBC may help the IPs, creditors and potential investors or counterparties to have a uniform criterion to evaluate the debtor company's tradeable value while formulating its terms. Thus, to that extent, extant laws will not have to be re-written to think of a new formula to calculate the enterprise value of a debtor company under a pre-pack.

B. Creditor Control

Creditors play a crucial role in any corporate rescue mechanism. In view of the maturity of insolvency laws in the US and the UK and the continuing reliance placed by Indian authorities thereon, it would be useful to understand the significance and extent of control which a creditor exercises in a pre-pack in the aforesaid jurisdictions and analyse the same in the Indian context *vis-à-vis* pre-packs.

1. The United Kingdom

In the UK, an interesting point arose basis the interpretation of the Insolvency Act in relation to an administrator's powers to sell the assets of the company in the period between his appointment and until a meeting of the creditors is to be called.[65] In fact, courts in England have at instances also considered whether pre-pack sales may be effectuated by an administrator soon after his appointment without seeking creditors' consent for concluding the transaction. Courts in the UK have held that administrators have sufficient discretion to manage the affairs of the company, including the discretion to refrain from taking into consideration the views of the creditors where deemed fit, for the purpose of ensuring smooth continuance of business of the debtor company.[66] This view has, to a great extent, been tempered by the SIP 16.[67]

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65 Re *Transbus International Limited*, [2004] EWHC 932 (Ch), para 12 and Re *T&D Industries Plc* [2000] 1 WLR 646.

66 *See* Re *Transbus International Limited*, [2004] EWHC 932 (Ch) and Re *T&D Industries Plc* [2000] 1 WLR 646.

67 *Supra* n. 29.

Where a proposal for sale of all or substantially all of the business of the debtor company is being contemplated, the creditors of the debtor company in most situations possess the contractual right to know of such proposal.[68] Such a transaction will have an impact on the capacity of the debtor company to continue functioning and therefore, also affect its ability to repay debts.

Where a transaction for divestment of the business of the debtor company is undertaken by it, and more specifically undertaken foreseeing the oncoming insolvency, the creditors should ideally have a definitive say in the transaction. The flipside, however, is that certain creditors or classes of creditors apprehend that such divestment is for avoiding the payment of their dues. Once the operational part of a company is divested to another company, then the creditors feel that they essentially have nothing to go after, in case the company undergoes liquidation. For this reason, creditors initiate independent legal recovery against the debtor company to prevent the transaction from going through. In such scenarios, actual transactions from which the debtor company could have benefited, also fall through.

In the past, anticipating creditor interference in the UK, companies would undertake pre-packs without entering into negotiations with their creditors.[69] Subsequently, the IP, once appointed as the administrator, would immediately conclude the transaction without taking creditor approval.[70] However, to ensure that no action prejudicial to the interests of the company is undertaken, the SIP 16 has been put in place, which requires the IP to comply with certain established standards of conduct and procedures.[71]

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68 Hugh Sims, 'Pre-packs: Recent law and practice' (2007) *Guildhall Chambers, at* http://www.guildhallchambers.co.uk/files/Pre-packs_RecentLaw&Practice_HS&PeterCranston.pdf (last visited 24 February 2019).

69 *See Re Transbus International Limited*, [2004] EWHC 932 (Ch) and *Re T&D Industries Plc* [2000] 1 WLR 646.

70 *See Re Transbus International Limited*, [2004] EWHC 932 (Ch) and *Re T&D Industries Plc* [2000] 1 WLR 646.

71 *Supra* n. 29.

2. The United States of America

As has been explained above, the US has a DIP mechanism available to debtor companies.

From a practical aspect, certain views exist in the US market as to when a voluntary filing under Chapter 11 may ultimately be of benefit to the debtor company. A debtor company, which has a certain class of lenders with a homogeneous type of debt, may benefit more from a pre-pack, given that prior negotiations on a bilateral basis will yield effective results for the debtor company.

When a debtor company has to negotiate with various classes of creditors, for instance, trade creditors, landlords, crown creditors, workmen or employees, the expectation that each class of creditor will have from the debtor company will vary widely, given the nature of the dues owed to them, and in such circumstances, even a pre-pack undertaken by the debtor company (with speediness of procedure as the primary consideration) may be rendered fruitless as the time spent in negotiating with the wide variety of creditors may amount to the same time which a conventional insolvency resolution process would take.[72]

3. India

As stated above, the IBC follows a more UK-centric approach to the management of the affairs of the debtor company once the application for commencement of its insolvency is admitted by the court.[73] It has been reiterated by the Supreme Court of India in its landmark judgment in the case of *Innoventive Industries* v. *ICICI Bank Ltd.*,[74] that the promoters of a debtor company under CIRP have no

72 *See* Douglas M Folley and Jame E Van Horn, 'Pre-packs on the Rise in Chapter 11 Bankruptcies: Prenegotiated Plans Can Accelerate Re-negotiations' (2008) *Bankruptcy Alternative, at* https://www.mcguirewoods.com/news-resources/publications/prepacks.pdf (last visited 24 February 2019).

73 IBC, section 17.

74 *Innoventive Industries* v. *ICICI Bank Ltd.* (2018) 1 SCC 407.

powers to take any decisions on behalf of the debtor company, or for management of the debtor company.[75]

In India, the appointed IRP is responsible to ensure that the interests of all the stakeholders of the debtor company are protected, and not just those of certain classes of creditors. This ensures that the resolution plan formulated is not prejudicial to a section or class of creditors of the debtor company.

A foreseeable problem that may arise in India, is where *inter se* creditor rights are concerned. Where there is a dissenting creditor in terms of a pre-pack, it would result in the failure of the pre-pack (absentia a formal procedure on democratic decision-making and enforcement of majority vote). It would therefore be a crucial consideration for a legislation contemplating pre-packs to clearly set out the provisions pertaining to the *inter se* treatment of creditors in terms of decision-making under a pre-pack.

A long-drawn process where parties end up negotiating terms for days on end would be counterproductive to the spirit of a pre-pack. Notwithstanding the aforesaid, in the event the principle of majority democratic vote is incorporated as a part of the pre-pack regime, whether the dissenting creditor would continue to have the right to seek initiation of CIRP under the IBC, *de hors* the pre-pack terms, would be a key consideration for legislators.

C. Connected Party Pre-packs

1. The United Kingdom

It is a fact that in the UK, it is usually the existing management which takes over the business or assets of the debtor company and commences business afresh. These arrangements are referred to as

75 In the above judgment, the apex court further clarified that the existing management of the debtor company does not possess the power to file an appeal against orders of the court pertaining to the debtor or to appear on behalf of the company in its proceedings as representatives of the debtor company.

connected party[76] pre-packs, giving the term 'phoenix' company to the resultant new entity with the 'fresh' management. It was estimated in the UK that in the period between 1 November 2015 to 1 November 2016, of the 1,689 cases that were referred for administration, 22 per cent of the cases were sought to be resolved under the pre-pack route and more than half of these, ie, 51 per cent of the cases were arrangements entered into with connected parties.[77]

It may be inferred from the above statistics that one of the strongest motives for a company's directors to undertake a pre-pack is to regain control of its business and/or assets, however, under a different identity. It is arguable that this roundabout manner of regaining control of the debtor company can result in circumvention of the insolvency laws. This particularly becomes an issue where a company is facing huge losses primarily due to promoter or managerial inefficiency.[78]

To regulate the sphere of connected party pre-packs, one of the recommendations of the Graham Committee set up to review the existing set of pre-pack laws in the UK, was to create a pool of independent business people to assess and give their opinion on whether the proposed arrangement of the debtor company would be viable and beneficial both to the rights of the creditors and the debtors.[79] The recommendation of the Graham Committee was carried

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76 The Insolvency Act, section 249 defines a connected party as:
'For the purposes of any provision in this Group of Parts, a person is connected with a company if—
(a) he is a director or shadow director of the company or an associate of such a director or shadow director, or
(b) he is an associate of the company,
and "associate" has the meaning given by section 435 in Part XVIII of this Act.'

77 'Pre-pack Pool: Annual Review', (2017) *Pre-pack Pool, at* https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf, page 7 (last visited 24 February 2019).

78 Amar Bhatti, 'Insolvency - Pre-packs' (2016) *LinkedIn*, *at* https://www.linkedin.com/pulse/insolvency-pre-packs-amar-m-bhatti (last visited 24 February 2019).

79 House of Commons, Business, Innovation and Skills Committee, 'The Insolvency Service' (2013) Sixth Report of Session 2012-13; Evidence 67, [HC 675], 6 February 2013.

out and subsequently a pre-pack pool, which is an independent body consisting of 'experienced business people who will offer an opinion on the purchase of a business and/or its assets by connected parties to a company where pre-packaged sale is proposed', was set up.[80]

2. India

The extent of involvement of connected parties in pre-packs may be worth analysing in the event legislative framework is introduced for regulating pre-packs in India.

Where CIRP is initiated against a debtor company which is party to an inter-company loan transaction, the lender company (which is the related party) will not have the right of representation, participation or voting in the CoC.[81]

From a resolution applicant's perspective, the IBC was specifically amended by *The Insolvency and Bankruptcy Code (Amendment) Act, 2018* (Amendment Act)[82] to *inter alia* address the issue of connected party involvement in CIRP of a debtor company. The Amendment Act under section 29A has effectively barred the existing management of the debtor company from taking any steps which would permit them to regain control over the assets of the debtor company.[83] The Amendment Act culminated due to cases of CIRP being undermined by the existing promoter group.[84]

80 *See supra* n. 78. In such scenarios, it would be counterproductive for a company to enter into a pre-pack given that there is no or very less assurance that the existing set of promoters will succeed in keeping the company afloat. This in turn might discourage suppliers of the debtor company from engaging in business with the phoenix company.

81 IBC, section 21(2).

82 The *Amendment Act* was passed by both houses of Parliament on 19 January 2018.

83 IBC, section 29A.

84 In *Edelweiss Asset Reconstruction Co. Ltd.* v. *Synergies Dooray Automative Ltd. & Ors.* CA (AT) Nos. 169 to 173-2017, by divesting assets of the debtor company to an associate company, the associate company of the debtor company was able to participate in the CoC as a majority creditor. The resolution plan which was ultimately formulated envisaged a 98 per cent haircut for the lenders of the debtor company.

Under the Amendment Act, as per section 29A, a connected person[85] is barred from proposing a resolution plan, ie, acting as a resolution applicant, if the applicant falls foul of the various criteria set out under section 29A. The most important criterion being that the resolution applicant 'has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under *The Banking Regulation Act, 1949* and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor.' There is a window provided for a connected person to act as a resolution applicant if the connected person makes payment of all overdue amounts with interest thereon and charges relating to NPA accounts before submission of the resolution plan.

Once the resolution plan is implemented, the existing management, including the promoters, are replaced and the debtor company is managed by the IRP. Further, under the Amendment Act, the terms of the resolution plan must not contemplate scenarios pursuant to which, during the tenure of the resolution period, the existing management of the debtor company may return to manage the debtor company. The management of the company during the implementation of the resolution plan should be vested with entities which are required to be completely unconnected from the existing management of the debtor company.[86]

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85 A "connected person" is –
'(i) any person who is the promoter or in the management or control of the resolution applicant; or
(ii) any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or
(iii) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii)'. By subsequent amendments, certain entities have been carved out and been permitted to participate as a resolution applicant during CIRP, to further the aim of the IBC.'

86 *See supra* n. 84.

3. Can Connected Party Pre-packs Be Considered in India?

Whether permitting existing management to retain control of a flailing company, specifically as permitted in the US, is desirable or not, is debatable. If the insolvency of the company was caused essentially due to mismanagement by the existing board, then permitting the existing management to continue controlling the debtor company would seem counterproductive. However, if the inability of the company to repay its debts can be attributed to external factors, such as sluggish growth in a particular sector of the economy and temporary cash flow mismatch, then allowing the existing management to continue overseeing the functioning of the company would be economical as the company would be in a better position to revive under its existing management.

There may be differing views on this subject while considering a connected party pre-pack, with arguments being made for both sides –on one hand, support for ensuring that all links which the existing management of the debtor company had with the debtor company are severed from it, and on the other hand, views that where the distress in the company is not caused by promoter or managerial causes but by financial risks or business risks, actually replacing the management of the company may be counterproductive.[87]

There exist certain arguments in support of the creditor-centric approach where the management of the affairs of the debtor company vests in the court-appointed administrators, citing that the 'historical link between the insolvency to the displacement of management is very strong'.[88] However, the argument for the existing management retaining control over the debtor company is also strong, primarily

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87 Andy Mukherjee, 'View: India turns a bad-loan tragedy into a bankruptcy farce' (2018) *Economic Times*, *at* s://economictimes.indiatimes.com/industry/banking/finance/banking/india-turns-a-bad-loan-tragedy-into-a-bankruptcy-farce/articleshow/63839265.cms (last visited 24 February 2019).

88 'Comparison of Chapter 11 of the United States Bankruptcy Code', *Jonesday at* https://www.jonesday.com/files/Publication/1ec093d4-66fb-42a6-8115-be0694c59443/Presentation/PublicationAttachment/e5b46572-7aeb-4c34-ab2e-bee2f8f3d3c2/Comparison%20of%20Chapter%2011%20(A4).pdf, page 13 (last visited 24 February 2019).

when a debtor company files for voluntary bankruptcy, as there is an added incentive for the debtor company to reorganise its business efficiently. This is because there is an extra layer of court protection to the creditors on the failure of the debtor company to repay its dues. There are, therefore, benefits to both approaches regarding in whom the control of a debtor company ultimately vests.

The present section 29A of the IBC, as amended from time to time, has tempered the erstwhile position of law which may have seemed harsh. However, given the strong stance that the Indian legislature has taken against connected party involvement in resolution of the corporate debtor, one may assume that connected party pre-packs may not be favoured in the event that pre-packs are formalised in India by the regulators, if not altogether prohibited along the lines of the present section 29A of the IBC.

D. Would the Law Require Reform for Pre-packs?

The introduction of pre-packs in India would require amendment to the extant insolvency laws. The IBC and its ancillary rules and regulations would require amendments to incorporate provisions which would not only enable but also regulate the sphere of pre-packs, depending on how much independence is considered to be vested in the parties to undertake and formulate the terms of a pre-pack.

Presently, in India, for a person or entity to be appointed as an IRP or resolution professional, such person or entity is required to meet certain qualifications and be registered as an IP with an insolvency professional agency, which in turn is registered with the Insolvency and Bankruptcy Board of India. These IPs or IP entities could serve a dual function just as the IPs in UK.

A specific set of regulations may also be required to regulate pre-packs. Some of the features that these regulations could contemplate have been set out below:

a) It would be the primary responsibility of the debtor company to mandatorily appoint an IP or IP entity prior to resolving to undertake a pre-pack.

b) The IP or IP entity would then undertake a detailed diligence of the debtor company and prepare an Information Memorandum (IM) which, just as in the case of CIRP, would be required to be kept strictly confidential. This IM would be permitted to be reviewed only by the creditors and bidders and subject to point (d).

c) It must be ensured that each creditor or stakeholder of the debtor company is notified of and made aware of the nature of the transaction being contemplated.

d) The most essential feature of a pre-pack would be for the IP or IP entity to ensure that adequate safeguards for maintaining confidentiality are in place, such as non-disclosure agreements and undertakings provided by potential bidders, and to ensure that participation of a creditor in the pre-pack does not jeopardise the process by the creditor commencing insolvency proceedings in the midst of a pre-pack.

e) As part of the terms of an understanding to undertake a pre-pack transaction, the parties may also be subjected to a 'stand-still period' where the creditors of the debtor company are restricted from independently initiating recovery against the debtor company during the subsistence of the pre-pack formulation process, which would undermine the entire process. The option of objecting to a pre-pack would always be available to the dissenting creditor at the time the company files for insolvency.

f) In continuation of point (c), it would be critical for the NCLT to satisfy itself that the interests of all stakeholders are considered prior to approving the pre-pack.

g) The decision to permit connected party pre-packs is open for debate. However, given the strong stance that the legislature has taken against involvement of connected persons in the insolvency resolution process of a debtor company, it seems likely that connected party pre-packs would be prohibited or strictly regulated in India.

h) In the event a sale of the business or assets of the debtor company is envisaged as a part of the pre-pack, the next step would be to seek potential acquirers or investors. The IP or IP entity, at this stage, may benefit from the involvement of the debtor company in this regard as the debtor company would be more adept at identifying the best terms and conditions at which the transaction may be concluded.

Delineating the finer provisions in relation to pre-packs will require considerable analysis of insolvency laws of other jurisdictions. Just as the introduction of a new legislation requires time to test how it fares, so will pre-packs be analysed adequately as it is yet uncharted territory.

V. To Pre-pack or Not to Pre-pack?

A. Benefits of a Pre-pack

Lenders add restrictive covenants to loan agreements that prevent a debtor company from alienating its assets (which are secured) or disposing of all or a majority of its business without creditor approval.[89] Therefore, the debtor company along with the IP are bound to ensure that all creditors' interests are considered to effectuate a meaningful pre-pack.

A pre-pack which does not consider the interests of a particular creditor will ultimately lead to a creditor independently initiating recovery actions against the corporate debtor, thereby rendering the entire exercise of a pre-pack futile.

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89 Typical restrictive clauses in a loan agreement include prohibition on:
(i) change in the management control of the debtor company (ie the power to direct the management and policies of the company);
(ii) effecting any change in the capital structure of the company;
(iii) undertaking any merger, consolidation, reorganisation, reconstruction or amalgamation;
(iv) amending or modifying the charter documents of the company;
(v) register or give effect to any transfer in the shareholding of the promoter below a prescribed threshold;
(vi) sale of any asset which is secured to or financed by the lender.

To therefore enable debtor companies to undertake pre-packs, the first question posed to administrators and legislators is: Will the Indian situation commercially benefit from pre-packs? There may be divergent views on this. While arguing against the advent of pre-packs, it may be said that a pre-pack is not required at the moment, given that the IBC provides for a fairly all-encompassing regime in order to identify and resolve insolvency. It may also be stated that a pre-pack may in fact not be desirable since it may permit the debtor company to divest its business and assets which, in all fairness, must be made available for creditor action and dealt with formally as per the prevalent insolvency laws of the land. It is essential, therefore, to evaluate both benefits and disadvantages of a pre-pack.

Pre-packs are undertaken typically with the following advantages in mind:

(1) A pre-pack provides the debtor company with a way to realise its assets and repay its outstanding dues.

(2) In the event a change in management of the debtor company is contemplated as a part of a pre-pack, the assets of the company are put to good use, albeit under a new management.

(3) A pre-pack reduces the strenuous and cumbersome exercise, which all involved parties are put through, during conventional restructuring or even liquidation of a company.

(4) The insolvency process is a costly procedure and the costs of the same are borne by the estate of the debtor company. It is from the assets of the debtor company that the insolvency costs are discharged. Valuation of assets and costs and fees of professionals and resolution professional costs sometimes tax an already burdened company to a great extent.[90] A pre-pack is a promising way of achieving a smooth transition of the assets of the company in a cost-effective manner.

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90 *See* Insolvency and Bankruptcy Board of India Circular number IBBI/IP/013/2018 'Fee and other Expenses incurred for CIRP' (2018) *Insolvency and Bankruptcy Board of India, at* http://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Jun/Circular%20on%20Fee%20and%20other%20Expenses%20incurred%20for%20CIRP%20[June%202018]_2018-06-18%2014:06:58.pdf (last visited 24 February 2019).

(5) Creditors have better prospects of expecting greater returns since the debtor company's tradeable value is not eroded by virtue of the insolvency proceedings as the assets are valued and sold at a price determined prior to the initiation of insolvency.

(6) Given the distressed status of the company, a pre-pack is characterised by the speedy procedure followed for concluding the terms of the proposed sale, which helps in addressing the stress in the company and effectuating company rescue before the value of the assets of the debtor degenerates or before creditors stake claim to it.

(7) Job protection for employees of the debtor company is one of the primary considerations for pre-packs where the long-drawn process of administration does not hamper the ongoing business of the company and poaching of resources by competitors of the debtor company can be curtailed to a great extent.[91] The UK also has laws which mandatorily require employees to be protected in the event of change of control, when a business or undertaking, or part of one, is transferred to a new employer.[92]

B. The Disadvantages of a Pre-pack

Given the inherent nature of pre-packs, it has faced strong opposition from certain quarters which have cited the manner in which pre-packs are concluded. Unsecured creditors typically contend that as opposed to the insolvency process as it currently stands, the process of entering into pre-pack arrangements is opaque,[93] may not consider the interests of the creditors and other stakeholders, and has an element of risk that the assets of the debtor company or its business

91 Association of Business Recovery Professionals, 'Pre-packaged Sales', *Rescue Recovery Renewal*, *at* https://www.r3.org.uk/media/documents/publications/press/Pre-packs_briefing.pdf (last visited 24 February 2019).

92 *The Transfer of Undertakings (Protection of Employees on Transfer of Undertakings) Regulations*, *2003* mandatorily requires protection of employees in the event of a business or undertaking, or part of one, is transferred to a new employer.

93 Louise Lang, 'Pre-pack administration: Pros and Cons', (2015) *The Gazette Official Public Record*, *at* https://www.thegazette.co.uk/insolvency/content/100359 (last visited 24 February 2019).

may be transferred to entities without keeping in mind the interests of the creditors or other stakeholders.

In the Indian scenario, it may also be argued that the interests of the unsecured creditors are usually not considered due to their low priority in the liquidation waterfall mechanism set out under the insolvency laws, and in case of pre-packs, such class of creditors has no opportunity to object to the transaction. Adequate remedies and recourse in relation to pre-packs to check the wide and uncontrolled use of pre-packs by debtor companies, as a means of avoiding the insolvency process, would need to be contemplated thereunder.

There exist some views that pre-pack arrangements may be entered into without taking into consideration the interests of all stakeholders. It is arguable that where the insolvency of a company has been brought upon the company by its own management (due to operational mismanagement of the existing promoters or management), permitting them to control the alienation of the assets *de hors* the statutory insolvency framework is highly prejudicial to the interest of all the stakeholders. The bidding for the assets or business of the debtor company may also pose a problem. This would fall within the IP's responsibility, who would ultimately be answerable to the insolvency court established under the insolvency laws of that particular jurisdiction. The IP would also have to ensure that the assets or business of the company are widely marketed notwithstanding its impending insolvency, hampering its prospects of continued functioning. Since the management of the debtor company presently remains with the company until admission of the CIRP application, the management in case of a pre-pack would continue to vest in the debtor company.

Finally, it must be highlighted that any action which is taken by the administrator must be with a view to: (i) ensuring that the company functions as a going concern and (ii) maximise value of the assets of the debtor company to ensure that the dues of the creditors do not get affected.[94]

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94 Bo Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar Publishing Cheltenham 2016).

VI. Conclusion

In view of the analysis undertaken in this article, corporate rescue and specifically pre-packs would prove useful since liquidation of borrowers seems far from a viable solution to cure the longstanding malaise of NPAs in India.

Corporate rescue, for this reason, is looked upon by many as the last resort before recovery proceedings are initiated. In such cases, the option may be considered by lenders of even big borrowers as a means to exit its exposure to turnaround entities (be it by divesting the debt or change of management of the debtor company) who actually possess the bandwidth to fund companies with intense capital requirements in certain sectors.

In the present situation of NPAs with which the financial sector is stranded, pre-packs may prove to be a useful tool to aid the IBC process. Such pre-pack transactions however, would have to be strictly within the four corners of a specifically formulated framework, be vetted thoroughly and approved by specialised adjudicatory bodies which may be set up under the aegis of the NCLT, which could substantially cut down the requirement of NCLT participation as well.

In fact, the Chairman, Insolvency and Bankruptcy Board of India and the NCLT President have expressed confidence that insolvency processes would soon mature and India may see the introduction of pre-packs.[95]

Pre-packs could thus prove helpful in a scenario where, despite availability of umpteen corporate rescue modes, creditors continue

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95 *See* Menaka Doshi, 'Who Among The 353 Resolution Professionals Can Manage 12 Large Insolvencies?' (2017) *Bloomberg Quint*, *at* https://www.bloombergquint.com/law-and-policy/2017/06/19/challenges-facing-insolvency-professionals-large-corporate-insolvencies-bankruptcies-nclt-ibbi-ms-sahoo-comments (last visited 24 February 2019) and KR Srivats, 'Time ripe to consider 'pre-packs' under insolvency: NCLT President' (2018) *The Hindu Business Line, at* https://www.thehindubusinessline.com/economy/time-ripe-to-consider-pre-packs-under-insolvency-nclt-president/article23650251.ece (last visited 24 February 2019).

to face a situation where they are expected to make high provisions against NPAs and also reconcile to face huge haircuts. Security enforcement and credit enhancement may seem adequate precautions to be taken at the time of sanction of big loans but these safeguards seem to prove inadequate in the long run on a large-scale, for the purpose of remedying the existing NPA problem and resolving the deep-rooted default culture.