Pre-Pack Insolvency: Adaptability to suit Indian context is the key

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The Indian Government is mulling upon the feasibility of "pre-packaged insolvency" schemes in the Indian context, borrowing a leaf from the schemes prevalent in the United States and the United Kingdom. The scheme if implemented shall segregate operation of insolvency law into three independent spheres, namely – pre-insolvency, CIRP and liquidation.

Pre-packaged insolvency is not a panacea, as many have claimed, and suffers from peculiar defects in jurisdictions where it is practised - such as lack of transparency, lower yields, under-the-hood marketing, related party concerns to name a few.

These defects, however, do not form the scope of this discussion paper, the author undertakes to prepare separate piece on these aspects, in the meanwhile, this discussion paper attempts to discuss the complexities of challenges presented by a pre-packaged insolvency in the context of Indian businesses, which have an atypical character of their own.

Before crafting a framework in this respect, the Government must be seized of the generic pit-falls as experienced by other jurisdictions as well as of those that find specific application in the Indian insolvency ecosystem. This discussion paper attempts to achieve the latter objective.

To begin with, CIRP and liquidation are essentially formal insolvency processes that consist of administration or administrative receivership; and generally begins at the instance of a creditor (financial or operational).

Whereas, "pre-packaged insolvency" begins at the instance of a debtor-in-duress, who signals to its lenders about the need for financial re-organization, which may include:

- sale of assets such as fixed assets, financial investments, investments in subsidiaries, etc.
- sale of business segments or Strategic Business Units (SBUs)
- negotiation of terms of debts
- foregoing of portions of debts
- transfer of entire business to a new owner
- change of management
- shareholder reorganization, etc.

A keen observer of the Banking sector shall surmise that:

- elements listed as above were to some extent part of the past restructuring mechanisms (CDR, SDR, BIFR, JLF) afforded by the RBI, except write-offs that remained in exclusive domain of Negotiated Settlements;

- lender-borrower agreements do contain provisions that empower lenders to afford all elements listed above, such powers of lenders gain legal sanction under provisions of the SARFAESI Act 2002 and RDDBFI Act 1993.

Yet, exercise of such powers are largely unheard of and there is good reason for it. In this respect one must learn from the experience of astounding implementation of the IBC, 2016. *Inter alia*, IBC owes its success in large part to the concerted efforts of the Legislature, the Government (Ministry of Finance and Ministry of Corporate Affairs), the Regulators (RBI and IBBI) and the Judiciary (the Hon'ble Supreme Court and the NCLT/NCLAT). It took a huge nudge and impetus from the RBI to push lenders to wholeheartedly explore avenues that IBC offered. In short, everyone contributed towards creation of an ecosystem that made the IBC to flourish.

In other words, an incentive mechanism was developed for the lenders to pursue the IBC route to resolve an insolvency. Also, it brought about a fundamental disposition in a lender's resolve to be amenable to suffer haircuts. This disposition, however, was rooted in the shroud of protection and recuse that IBC afforded on any lender.

Experience suggests that most successful resolutions under IBC have involved haircuts, thus, it is inconceivable for a pre-package insolvency to succeed without involving a haircut.

That precisely becomes a catch-22 situation as it is also highly inconceivable to get a lender to agree to a haircut without being afforded a sanctum or shroud of protection of the kind that IBC provided. A pre-package insolvency generally permits related parties to participate, which may grant sufficient reasons for a lender to shy away from it.

It is, therefore, essential that any legislation or regulation on pre-package insolvency recognizes this practical impediment and provides necessary tools or incentives for any lender to go down the path of pre-package insolvency; lest it shall merely become an ornamental piece of legislation or regulation. One way of achieving this is by making pre-insolvency package a mandatory step before initiation of S. 7 procedure, by creation of a pre-pack pool and by mandating compulsory appraisals by pre-pack pool.