

Pre-Pack Insolvency Resolution Process (PPIRP) for Real Estate Developers: Challenges and Road Ahead



Aimed at providing an efficient alternative insolvency resolution process for MSMEs that could ensure quicker, cost-effective and value maximizing outcomes for all the stakeholders, in a manner which is least disruptive to the continuity of their businesses, and which preserves jobs, the President of India made the provision of Pre-Packaged Insolvency Resolution Process (PPIRP) for MSMEs through an ordinance on April 04, 2021. The Lok Sabha passed Insolvency and Bankruptcy Code (Amendment Bill) 2021 on July 26, which subsequently became the part of the IBC. In this article, author highlights various pros and cons of the PPIRP under the IBC regime and suggests some crucial reforms to make it a popular tool for resolution of MSME entities in India with a focus on Real Estate Sector.

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1. Introduction

Experience gained from implementation of the Insolvency and Bankruptcy Code, 2016 (IBC or the Code) including evolution of the ecosystem, stabilization of the processes and growing jurisprudence, has prepared the ground for new initiatives to further improve the effectiveness of the Code. The onset of Covid 2019 pandemic with the attendant derailment of economy and the stress to various industries particularly Micro Small and Medium Enterprises (MSMEs), also fueled the thought process of the Central government on making the IBC simpler and faster, at least for the smaller businesses. It was felt that a Pre-Packaged Insolvency Resolution Process (PPIRP) may be the need of the hour under the broad framework of the IBC as a newer and as an additional option for distressed corporates, as the normal CIRPs would not yield the desired outcomes.

Almost all the industries, particularly MSMEs were severely impacted by the Covid-19 caused lockdowns. The government, with an objective to resolve the problem and provide relief to the MSMEs, constituted a sub-committee of Insolvency Law Committee (ILC) vide order dated June 24, 2020 to prepare a detailed scheme for

implementing Pre-Pack and prearranged insolvency resolution process with the objective for aiding the existing insolvency framework by cutting costs and the reducing time taken in resolution process.¹ The PPRIP was expected to emerge as an innovative rehabilitation method for corporate debtors in MSME sector as it has good aspects of both informal (out of court) and formal (judicial) insolvency proceedings. The Sub-committee submitted its report to the Government on 31st October 2021 and public comments were invited on the report of the sub-committee from 8th to 22nd Jan 2022. The Central Government through the IBC (Amendment) Ordinance, 2021 dated April 04, 2021, introduced PPIRP for MSMEs under the Code.

2. PPIRP for MSMEs

MSMEs are critical for Indian economy and contribute significantly to the Gross Domestic Product (GDP) and provide employment to a sizeable population. According to Confederation of Indian Industries (CII), there are 63.4 million MSMEs in India which contribute around 6.11% of the manufacturing GDP, 24.63% of the GDP from services activities, and 33.4% of India's manufacturing output. The MSMEs provide employment to around 120 million persons and contribute about 45% of the overall exports from India.

Covid-19 pandemic has impacted their business operations and exposed many of them to financial stress. Resolution of these corporate lives requires different treatment, due to the unique nature of their businesses and simpler corporate structures. Therefore, it was considered expedient to provide an efficient alternative insolvency resolution process under the Code for MSMEs, that ensures quicker, cost-effective and value maximizing outcomes for all the stakeholders, in a manner which is least disruptive to the continuity of their businesses, and which preserves jobs².

¹ Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process, (<https://www.ibbi.gov.in/uploads/whatsnew/34f5c5b6fb00a97dc4ab752a798d9cc3.pdf>)

² Information brochure published by IBBI on Pre-Packaged Insolvency Resolution Process. (<https://www.businesstoday.in/latest/economy-politics/story/govt-amends-ibc-introduces-pre-packaged-resolution-process-for-msmes-292649-2021-04-05>)

3. Management of Corporate Debtor (CD) under PPIRP

Debtor-in-possession model is the preferred option for resolution of stressed corporates through Pre-Pack. This avoids inevitable shocks to the operations of the CD associated with CIRP where the control of the CD shifts from the management/promoters to the creditors i.e., creditor-in-possession model. During CIRP, the creditors' control and supervise the operations of the CD through Interim Resolution Professional (IRP) or Resolution Professional (RP). After, resolution, the CD is transferred to the Successful Resolution Applicant (SRA).

The debtor-in-possession model for pre-packs as recommended by the sub-committee makes the process simpler and its closure quicker, while helping the CD operate at its optimum level during the process.

Under Pre-Pack, the existing management/promoters continue to run the business and have a high possibility of retaining it through a Resolution Plan. This is necessary particularly when the business needs resolution and the market may not have many third parties interested in business of the CD. The debtor-in-possession model for pre-packs as recommended by the sub-committee makes the process simpler and its closure quicker, while helping the CD operate at its optimum level during the process. The CD shall also continue to be liable for all compliances, which are otherwise the responsibilities of the RP during a CIRP³.

4. Role of Resolution Professional in PPIRP

While the business is run by the existing management, the RP should ensure that the CD is managed during the process in a manner which is not detrimental to the interest of the creditors. RP should be entitled to attend the meetings of the Board of Directors of the CD as an observer, without any voting rights, for this purpose⁴. He must act independent to the CD and the creditors, in the

³ Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (<https://docslib.org/doc/2504581/pre-packaged-insolvency-resolution-process>)

⁴ Ibid (<https://docslib.org/doc/2504581/pre-packaged-insolvency-resolution-process>)

best interest of all stakeholders, while assisting the CD and creditors in negotiating and drafting the resolution plan. He should be responsible for collating and verifying the list of claims against the CD, constituting the CoC, and inviting resolution plans from prospective RAs, wherever required, in accordance with the laid down processes. He may file application before the AA as regards issues relating to conduct of the process, and not relating to the conduct of business of the CD.

The sub-committee considered the role of an Insolvency Professional (IP) during the pre-admission stage in negotiations and compliances. After deliberations, it concluded that the role of an RP in pre-admission stage and the manner of appointment of RP need not be defined and codified in the interest of flexibility. The stakeholders should have the liberty to use the services of an IP to help them in tasks prior to formal insolvency process. The sub-committee, therefore, recommended that the formal role of RP may begin with admission of the Pre-Pack, as it happens with CIRP⁵.

5. PPIRP for Real Estate Entities

PPIRP is ideally suited to several stressed real estate companies as the Pre-Pack process under Explanation I of Section 54K of the IBC permits the filing of an application by a stressed CD jointly with any other person. Hence the process facilitates early resolution of stressed real estate projects by the CD jointly with a financially stronger real estate company. Initial beneficiaries of PPIRP from Real Estate Sector are as follows:

(a) Loon Land Development Limited

NCLT, Principal Bench, New Delhi vide an order⁶ on November 29, 2021, admitted the PPIRP application filed by Loon Land Development Limited. The company joined hands with M3M Construction Private Limited to provide a viable Base Resolution Plan (BRP) which was duly approved by the financial creditors in Form P4. This was

probably the first case of a real estate entity availing the benefits of a PPIRP Process.

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(b) Krrish Realtech Private Limited

Krrish Realtech Private Limited submitted an application for PPIRP jointly with Skyline Propcon Private Ltd, however the said application was later withdrawn by Krrish Realtech Private Limited. The NCLT permitted the withdrawal vide an order⁷ February 22, 2022.

6. Challenges in Implementing Pre-Packs for Real Estate Entities

The present framework of PPIRP needs certain tweaking/modifications to enable smoother implementation of the process for real estate entities as explained below:

Assume X Ltd is a Real Estate company with 200 home buyers (financial creditors in a class) and is classified as an MSME as defined under Section 7(1) of the Micro, Small and Medium Enterprises (MSMEs) Development Act, 2006. X Ltd has committed a default more than ₹ 10.00 Lakhs⁸. It is also assumed that X Ltd meets all the eligibility conditions as defined under Section 54A (2) of the Code. It is also assumed that homebuyers are the only financial creditors. The steps involved in the Pre-Pack process and the challenges in implementation of the process in its present framework of the PPIRP are narrated below:

(a) First Step: The CD may seek the assistance of an IP and shall prepare a Base Resolution Plan (BRP) proposing a mechanism of resolving the stress so that the project can be completed. The said BRP must in principle be acceptable to the financial creditors. In case of a non-real estate entity, where a few banks are the financial creditors, it is possible

⁵ Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (<https://insolvencytracker.in/2021/01/10/resolution-professionals-have-a-limited-yet-crucial-role-in-pre-pack-scheme/>)

⁶ NCLT Principal Bench, New Delhi: Reference No. (IB)-(PP)-03(PB)-2021 dated November 29, 2021.

⁷ NCLT: Reference no. IB-PP-02/ND/2021 dated 22.02.2022

⁸ Gazette Notification no. S.O. 1543(E) dated 09.04.2021, the minimum amount of default for a PPIRP process is ₹ 10.00 Lacs. This Notification has been issued under proviso to Section 4 of the IBC.

for the promoters to get the buy-in on the BRP with a few modifications. However, obtaining buy-in of the BRP from a large group of unorganized home buyers is a herculean task.

(b) Second Step: Seeking approval of the name of the RP to be appointed in the process- Section 54A(2)(e) read with Regulation 14(4) of the PPIRP Regulation stipulates convening a meeting of the CoC (200 home buyers in the example given above) and seeking approval by a vote share of at least 66% by the unrelated financial creditors. The name of the RP is to be proposed by financial creditors who are not related parties of the CD and have not less than ten per cent of the value of the total financial debt. This exercise in itself can be challenging as narrated below:

(i) There could be circumstances where no single homebuyer has a ten or more percent of the value of the total financial debt due to which RP may have to be proposed by several creditors jointly. The Regulation is silent as to whether the RP can be proposed jointly by several financial creditors.

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(ii) A meeting of the unrelated financial creditor is to be convened just for seeking approval of the appointment of the RP. The financial creditors have to give the approval in Form P3. The CD has to call for a meeting of all the 200 home buyers wherein getting the vote of 66% or more from home buyers can itself be challenging. Whether provisions of Section 25A(3A) of the Code will be applicable in case say only 50% of the homebuyers vote on the proposal is a grey area and needs clarity.

(iii) It is important to note that the Authorized Representative (AR) can only be appointed post appointment of the RP, hence the CD has no choice but to convene the meeting of all the home buyers.

(c) Third Step: The CD has to convene second meeting of the unrelated financial creditors (200 home buyers in this case, not being related parties of the CD) for seeking approval by a vote of at least 66% for the filing of an application for initiating PPIRP as per extant provisions of Section 54A (3) read with Regulation 14 of the PPIRP Regulations. The approval of the unrelated financial creditors is to be obtained in Form P4. The need for calling the second meeting of the unrelated financial creditors arises, as the notice for calling the said meeting requires the applicant to attach Form P6 along with the said notice. It is pertinent to refer to Form P6 at this stage. Form P6 is the form for “Declaration by the Director” as per Section 54A(2)(f) of the Code. One of the requirements of Form P6 is that the applicant is required to specify the name of the RP appointed by the unrelated financial creditors. Hence RP has to be appointed prior to calling the said meeting. Therefore, two meetings of the CoC have to be compulsorily convened, (i) First meeting for approval of the name of the RP to be appointed and (ii) Second meeting for approval for filing of an application for initiating PPIRP. There is a lack of clarity in the Regulations with respect to the following:

(i) Whether the AR has to be appointed by the RP prior to convening the second meeting of the unrelated financial creditors or otherwise.

(ii) The primary duty of the RP under Section 54B i.e., before initiating PPIRP is to confirm that whether the CD meets the requirements as per Section 54A, and the BRP conforms to the requirements referred to in clause (c) of subsection (4) of Section 54A. Without the approval of the unrelated financial creditors for filing of an application for PPIRP, no meaningful duty can be undertaken by the RP. Therefore, more clarity needs to emerge about the duties of the RP prior to the initiation of pre-packaged insolvency resolution process.

The approval for “Appointment of the RP” and “Filing of an Application for Initiating PPIRP” should happen in the same meeting.

The present framework needs to be suitably modified to enable the following:

- (i) The approval for “Appointment of the RP” and “Filing of an Application for Initiating PPIRP” should happen in the same meeting.
- (ii) The Regulation can specifically provide that in case of class of creditors (like home buyers), the AR must be appointed prior to convening the meeting for the appointment of the RP, so that the process can be conducted smoothly.
- (iii) The provisions of Section 25A(3A) of the Code should be applicable for approval of “Appointment of the RP in Form P3” and “Filing of an Application for Initiating PPIRP in Form P4”.

7. Other Challenges in the Implementation of PPIRP

The framework for pre-packs as envisaged under the Code casts several responsibilities and obligations on the CD. It is prerequisite for the CD to come forward with clean hands, honest intent and purpose as it provides an opportunity to reorganise and resurrect its business with a potential haircut. The lack of trust between the CD and the financial creditors is the biggest challenge in making the PPIRP process a success. The PPIRP framework is designed to assist the promoters of MSMEs to overcome genuine business stress only. The other challenges in successful implementation of the PPIRP are detailed below:

- (i) PPIRP process can only start if the unrelated financial creditors with 66% or more votes approve for filing of an application to initiate PPIRP in Form P4. Hence getting this approval itself becomes a challenge, as the financial creditors would insist on improving the amount proposed for payment under the base resolution plan by the CD to the financial creditors. This is because creditors are generally under the impression that the CD is not honest, and more amounts can be obtained from management/promoters.

(ii) CD will normally propose impairment of the debts of financial creditors, since if the CD impairs the debts of operational creditors in the BRP, it is mandatory under Section 54K (4) of the Code for the CoC to invite resolution plans from prospective resolution applicants, i.e., a process of value maximisation has to be compulsorily undertaken. The FCs are very sceptical to approve a plan which proposed no haircut for the OCs but impairs the debts owed to the FCs.

(iii) The time period for approval of a resolution plan under PPIRP is only 90 days which is too short for a successful and a meaningful value maximisation process to be undertaken by the CoC. The financial creditors might feel that the prospective resolution applicants will not have the sufficient time to effectively participate in the value maximisation process. This might act as a deterrent where the value offered by the CD under a BRP is not to the satisfaction of the FCs. The timelines under PPIRP needs reconsideration as it is too optimistic and difficult to be implemented in practice.

(iv) The COC may decide during the PPIRP process to convert the said process into a CIRP process, this creates a fear for the CD that he might lose control over the CD.

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(v) If during the PPIRP process, avoidance transactions (i.e., preferential, undervalued, fraudulent etc) are observed by the RP, in all likelihood the CoC shall decide to vest the management of the CD under the RP. In this scenario, as per Section 54N(4) of the Code, in all likelihood the PPIRP process will be terminated and CD shall go for liquidation, this acts as a deterrent for the CD to initiate a PPIRP Process. Hence the Regulation must provide for a forensic audit to be conducted by the unrelated financial creditors prior to initiating a PPIRP process. Only after the CD gets a clean

forensic audit report, process should be initiated to overcome such uncertainties.

(vi) Maintaining the confidentiality of BRP and the terms of what constitutes a Significantly Better Resolution Plan (SBRP) is another challenge. This is because the BRP given by the CD cannot compete with a SBRP as per Section 54K (10) of the Code and the promoters shall lose control over the CD. Hence it is critical to maintain the confidentiality of the BRP and the terms of SBRP from the prospective resolution applicants.

8. Impediments in Making PPIRP a Popular Tool for Resolution

(a) Lack of awareness and knowledge about the PPIRP process: A CD being an MSME entity alone can initiate the process of PPIRP, hence it is crucial that the MSME entities are well versed with the nuances of a PPIRP process, its benefits and pitfalls. However, there is very little awareness amongst the MSME entities about the PPIRP, which acts as a major impediment in promoting this important tool for resolution of financial stress in MSME entities. There is therefore an urgent need to educate and

create awareness amongst MSME promoters through MSME industry associations about the PPIRP.

(b) Need for a policy framework: Most of the banks and financial institutions don't have an internal policy and framework in place to approve an application for PPIRP. As the approval for PPIRP process has to be given in Form P-4 at a preinitiation stage, it becomes difficult for the public sector banks and financial institutions to approve an application for PPIRP.

Indian Bank's Association (IBA) may take the initiative for creating a common policy framework for implementing the PPIRP process amongst its member banks. This shall go a long way in promoting PPIRP as a tool for resolution of financially stressed MSMEs.

MSME industry bodies and insolvency practitioners need to be consulted to understand their concerns as to why as the MSMEs have not actively considered the PPIRP process as a tool for resolution. Through a consultation process and with a little bit of tweaking, PPIRP can become the preferred tool for resolution of financially stressed MSME industry.

