PRE-PACKAGED INSOLVENCY REGULATION: WHAT CAN INDIA LEARN FROM THE UNITED KINGDOM AND THE UNITED STATES?

M.P. RAM MOHAN[*] & VISHAKHA RAJ[**]

Pre-packaging allows a distressed company to negotiate a plan with its creditors and a purchaser before entering formal insolvency proceedings. By allowing the terms of a plan to be negotiated before formal proceedings, pre-packs provide a quick and discreet way of completing the insolvency resolution process. The speed and confidentiality offered by pre-packs have made them prevalent in the United Kingdom and the United States; however, these advantages come with trade-offs. Creditors' voting rights under the regular insolvency resolution process are circumvented by the pre-pack process. The US has two pre-pack processes, one that requires creditor approval and another that does not. In the UK and the US, there has been opposition to regulating pre-packs that do not need creditor approval because reforms that increase creditor participation will reduce the speed associated with such pre-packs. In India, pre-packs have not evolved through the present insolvency regime as it does not allow for the assets of a debtor to be sold without its creditors' approval. The Insolvency and Bankruptcy Board of India is considering introducing pre-packs in India and faces unique challenges because of some of the features of India's insolvency regime. Insolvency law in India places limitations on the participation of a company's directors and promoters in insolvency proceedings and also has broad avoidance provisions which can complicate the implementation of pre-packs. This Paper discusses these challenges and uses the experience of the UK and the US to suggest a framework for the introduction of pre-packaged insolvency in India. After evaluating the pre-pack regimes in the UK and the US, we conclude that it would be optimal for India to retain creditor protections and require creditor approvals in its pre-pack regime. This would ensure that pre-packs can be discreetly implemented and also avoids the disenfranchisement of creditors.

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[*] Associate Professor, Strategy Area, Indian Institute of Management Ahmedabad. Email: mprmohan@iima.ac.in.

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INTRODUCTION

The Insolvency and Bankruptcy Board of India ("IBBI") is in the process of introducing a pre-packaging regime in India.[1] In October 2020, the IBBI published a report containing its design for a pre-packaging regime for India ("MCI Pre-pack Report").[2] In a pre-packaged ("pre-pack") insolvency, a troubled company and its creditors negotiate the terms of an insolvency resolution plan prior to the commencement of the formal insolvency process.[3] The negotiated resolution plan is then implemented soon after the formal proceedings begin; it often involves the sale of all or a substantial portion of the company's business.[4] Pre-pack insolvency seems to be a natural step in the evolution of insolvency regimes. Many countries, including the United Kingdom ("UK")[5] and the United States ("US"),[6] allow pre-pack insolvencies. While it is difficult to determine the exact point at which pre-pack negotiations begin, they are normally carried out when the corporate debtor is under some financial or economic distress and prior to the formal insolvency filing.[7]

Pre-packs offer unique advantages when compared to the regular insolvency resolution process. Most of these advantages stem from a pre-pack's ability to reduce the time spent by a company in formal insolvency proceedings. This is done by negotiating the terms of a plan before an insolvency application is filed.[8] This may seem counterintuitive because one of the key functions of modern insolvency law is to give creditors a space to bargain and come to an agreement about the future of a

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[1] *See Special insolvency resolution framework for MSMEs at advanced stage: IBBI chief*, ECON. TIMES (July 26, 2020, 2:55 PM), https://economictimes.indiatimes.com/small-biz/sme-sector/special-insolvency-resolution-framework-for-msmes-at-advanced-stage-ibbi-chief/articleshow/77180706.cms; Ministry of Corporate Affairs, Notice (Notified on Apr. 16, 2019) (India) (inviting comments from stakeholders with regard to instituting a Pre-Packaged Insolvency Resolution), https://ibbi.gov.in/webfront/Notice%20for%20inviting%20public%20comments%20on%20Code.pdf. *See also* FE Bureau, *Pre-packaged insolvency resolution: Govt seeks stakeholder comments*, FIN. EXPRESS (Apr. 17, 2019, 2:03 AM), https://www.financialexpress.com/economy/pre-packaged-insolvency-resolution-govt-seeks-stakeholder-comments/1550354/; Paul Williams, *Pre-packaged insolvency: Process should help achieve overarching objectives of the IBC*, FIN. EXPRESS (May 8, 2019, 3:13 AM), https://www.financialexpress.com/opinion/pre-packaged-insolvency-process-should-help-achieve-the-overarching-objectives-of-the-ibc/1571593/.

[2] MINISTRY OF CORPORATE AFFAIRS, REPORT OF THE SUB-COMMITTEE OF THE INSOLVENCY LAW COMMITTEE ON PRE-PACKAGED INSOLVENCY RESOLUTION PROCESS (Issued on October 31, 2020) (India) [hereinafter MCI PRE-PACK REPORT].

[3] *See* VANESSA FINCH & DAVID MILMAN, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 372–73 (3d ed. 2017).

[4] *See id.*

[5] *See* VENESSA FINCH, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 453 (2d ed. 2009) [hereinafter FINCH, CORPORATE INSOLVENCY LAW].

[6] *See* 11 U.S.C. § 1125(g) (2018).

[7] FINCH & MILMAN, *supra* note 3, at 371.

[8] *See* LORRAINE CONWAY & ALI SHALCHI, HOUSE OF COMMONS LIBR., BRIEFING PAPER NO. 5035, PRE-PACK ADMINISTRATIONS 3 (Oct. 27, 2020), https://commonslibrary.parliament.uk/research-briefings/sn05035/ (highlighting pre-pack negotiations occur "prior to the appointment of the administrator").

distressed company.[9] However, the costs of solely relying on the traditional insolvency resolution process are now coming to the forefront of discussions. Longer and more public insolvency proceedings are likely to spook the market and reduce the value of the company. It also becomes more difficult to raise finances when a company is undergoing a formal insolvency resolution process, making day-to-day activities and trading uncertain.[10] Shorter insolvency proceedings through pre-packs help preserve employment and the value of the firm.[11] In October 2020, the UK Government published its *Pre-pack Sales in Administration Report* (the "Pre-pack Sales Report"), which confirmed the unique benefits offered by pre-pack insolvency.[12] Pre-packs helped retain employment and the value of the business compared to regular insolvency proceedings.[13] The clandestine nature of pre-packs[14] also allows a company to retain its reputation with its suppliers, customers, and investors.[15] Through their speed and confidentiality, pre-packs effectively reduce the indirect costs associated with the insolvency resolution process.[16]

While the advantages of a pre-pack make it an attractive option for distressed companies, they often are effectuated without creditors' approval and disenfranchise unsecured creditors.[17] In such cases, the company's unsecured creditors are usually left without any notice of the company's distress until the formal insolvency

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[9] *See* BO XIE, COMPARATIVE INSOLVENCY LAW: THE PRE-PACK APPROACH IN CORPORATE RESCUE 8–9 (2016) (positing the traditional notion of insolvency law is for creditors to "free[ly] agree on forms of enforcement of their claims on insolvency [and] collectivist arrangements rather than procedures of individual action or partial collectivism"); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 861–62 (1982).

[10] *See* Sofia Ellina, *Administration and CVA in Corporate Insolvency Law: Pursuing the Optimum Outcome*, 30 INT'L CO. & COM. L. REV. 180, 189–90 (2019) (asserting, although administration has its drawbacks, it is the best option to rescue a company).

[11] *See* TERESA GRAHAM, GRAHAM REVIEW INTO PRE-PACK ADMINISTRATION: REPORT TO THE RT HON VINCE CABLE MP 26 (June 2014) (UK) [hereinafter GRAHAM REPORT], https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration#:~:text=The%20report%20was%20carried%20out,Government%20response%20to%20the%20Review (remarking a pre-pack is the best option for resolving insolvency issues); FINCH, CORPORATE INSOLVENCY LAW, *supra* note 5, at 456–57 ("[P]re-pack[s] . . . provid[e] a way to retain key employees who might leave the company if not confident that a sale can be agreed in the short to medium term. . . ."); Peter Walton, *Pre-packin' in the UK*, 18 INT'L INSOLVENCY REV. 85, 92 (2009) (supporting how pre-packs can be the best option for all stakeholders involved).

[12] *See generally* THE INSOLVENCY *SERVICE*, PRE-PACK SALES IN ADMINISTRATION REPORT (Oct. 8, 2020) (UK) [hereinafter PRE-PACK SALES REPORT], https://www.gov.uk/government/publications/pre-pack-sales-in-administration/pre-pack-sales-in-administration-report ("The Attraction of the pre-pack sale as a business rescue tool is the speed of the transaction, which helps preserve the value of the business and save jobs, whilst avoiding the costs of trading a business in administration.").

[13] *See id.*

[14] *See* XIE, *supra* note 9, at 147; *see also* FINCH & MILMAN, *supra* note 3, at 404.

[15] *See* Brian L. Betker, *An Empirical Examination of Prepackaged Bankruptcy*, 24 FIN. MGMT. 3, 7–8 (1995) (explaining how pre-packs reduce indirect costs of financial distress); *see also* XIE, *supra* note 9, at 96–97; FINCH & MILMAN, *supra* note 3, at 375.

[16] *See* Betker, *supra* note 15, at 7–8.

[17] FINCH & MILMAN, *supra* note 3, at 371, 387; *see also* Betker, *supra* note 15, at 8; Walton, *supra* note 11, at 87.

proceedings are filed.[18] This effectively removes their ability to participate in the negotiations that result in the sale of the company's assets.[19] Though pre-packs often pay suppliers the full amount of their claim (mainly to avoid negotiations with them),[20] these suppliers continue their commercial relationship with the company without notice of its distress and increase their exposure.[21] Pre-packs do away with the open bargaining process that is facilitated by regular insolvency proceedings. Creditors who were not a part of pre-pack negotiations have limited influence over a pre-pack, even after formal proceedings commence. This is because the insolvency professional who participates in pre-pack negotiations by advising the debtor or creditors[22] is appointed as the resolution professional after the formal insolvency proceedings are filed.[23] Such an arrangement ensures that the terms of the negotiated pre-pack translate into a formal and binding resolution plan under the relevant insolvency law.[24] While this practice is beneficial to those privy to pre-pack negotiations, it reduces the independence usually expected of the resolution professional.[25]

The UK and US have employed different approaches to regulating pre-packs and the challenges to fairness and transparency that they pose. The nature and extent of these difficulties differ based on the type of pre-pack regime in place. In the UK, a pre-pack can be completed without creditor approval or even consultation.[26] The pre-pack's ability to circumvent creditors' procedural voting rights make unsecured creditors vulnerable stakeholders in the process.[27] In the US, pre-packs can be effectuated through two routes; one requires creditor approval and the other does

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[18] *See* Betker, *supra* note 15, at 5; Walton, *supra* note 11, at 87.

[19] *See* FINCH & MILMAN, *supra* note 3, at 387.

[20] *See id.* at 372.

[21] *See id.* at 379; Walton, *supra* note 11, at 87 (suggesting a supplier may be unprotected if the distressed company continues ordering goods on credit).

[22] *See generally* XIE, *supra* note 9, at 100–10.

[23] *See* FINCH & MILMAN, *supra* note 3, at 397; *see also* Walton, *supra* note 11, at 90–92.

[24] *See* XIE, *supra* note 9, at 78 (explaining when the company has no funding and the deal to sell the business has already been well arranged, administrators will likely view the pre-packaged deal as the best option for creditors).

[25] *See id.* ("It is arguable that the framework of pre-packs is likely to reduce the role of the administrator. . . ."); FINCH & MILMAN, *supra* note 3, at 397 ("[In a pre-pack case,] [t]he administrator's duty to act in the interest of all creditors has been bypassed and it is no answer to this to say that the IP can take an unbiased view of the pre-pack to assess whether it serves all interests fairly. . . ."); Mark Wellard & Peter Walton, *A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be Made to Justify the Ends?*, 21 INT'L INSOLVENCY REV. 143, 147 (2012) ("One obvious threat to the objectivity of a pre-packing administrator is where the administrator has advised either or both the company and any secured creditor in the planning stage of the pre-pack."); SANDRA FRISBY, A PRELIMINARY ANALYSIS OF PRE-PACKAGED ADMINISTRATIONS 65 (Ass'n. of Bus. Recovery Pros. 2007) (illustrating pre-packs "favour secured creditors at the expense of unsecured creditors").

[26] FINCH & MILMAN, *supra* note 3, at 377; Walton, *supra* note 11, at 87 ("The pre-packaged deal will have been carried out without [unsecured creditors'] knowledge or consent.").

[27] *See* Walton, *supra* note 11, at 87 (expressing unsecured creditors' rights to vote on proposals are "illusory" in the context of UK pre-packs); Wellard & Walton, *supra* note 25, at 157.

not.[28] Studying these pre-pack regimes will help prepare India for the challenges its pre-pack regime is likely to face and inform the design of its pre-pack law.

India's interest in introducing pre-packs puts it in a unique position. Since pre-packs are not prevalent in the status quo in India, lawmakers can substantially direct how pre-packs will evolve and operate. India also has the benefit of the UK's and US's experiences with pre-packs and has a range of measures from which it can piece together the framework of its pre-pack regime. India's insolvency law has distinct features, some of which make the insolvency regime conducive to pre-packs, while others make the introduction of pre-packs more challenging. For example, the prohibition of promotors' and directors' participation in the insolvency resolution process and its broad avoidance provisions are two challenges posed by Indian insolvency law. Part I of this Paper discusses these two issues in detail after providing a comparative overview of the insolvency regimes in India, the UK, and the US. Part II evaluates the implementation of pre-pack insolvency in the UK and US, using three themes—the route to pre-packaging, modes of regulation, and judicial involvement. In Part III, insights from Part II are used to recommend the optimal route for the introduction of pre-packs in India. Part III engages with the recommended pre-pack design for India as contained in the MCI Pre-pack Report. Additionally, Part III focuses on identifying important safeguards to ensure the Indian pre-pack regime remains fair and transparent while facilitating the time bound completion of the insolvency resolution process.

I. A COMPARATIVE OVERVIEW OF INSOLVENCY LAWS IN THE UK, THE US, AND INDIA

A. The Indian Insolvency Regime—A Brief Overview

The Insolvency and Bankruptcy Code, 2016[29] (the "IBC") contains India's insolvency regime. The objectives of the IBC are enumerated in its preamble.[30] The IBC aims to maximize the value of the debtor's assets, promote entrepreneurship and the availability of credit, and balance the interests of all the stakeholders involved in the resolution process.[31] The IBC also enshrines the objective of completing the insolvency resolution process in a time bound manner[32]—pre-packs would help further this objective of the IBC. The IBC has some similarities with the UK and US insolvency regimes but also has notable differences. The following discussion examines features of the IBC that are unique to the Indian insolvency regime, and then compares the insolvency laws of the three jurisdictions. Since insolvency laws in the UK and US shaped their experiences with pre-packs and the regulatory

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[28] *See* XIE, *supra* note 9, at vii, 208 (explaining the two US practices of pre-packaged bankruptcy filings and section 363(b) pre-plan sales differ, in that the latter may deny creditor participation in the process).

[29] The Insolvency and Bankruptcy Code, 2016 (India).

[30] *See id.* pmbl.

[31] *Id.*

[32] *Id.*

challenges associated with them, comparing the insolvency laws of these two jurisdictions with those of India will shed light on the types of challenges India is likely to face after introducing pre-packs. It will also help identify any preemptive steps that can be taken to mitigate these challenges.

The IBC divides a corporate debtor's creditors into financial creditors and operational creditors; this demarcation has an important bearing on who decides the future of the corporate debtor.[33] Only financial creditors, or those who disbursed money to the debtor for a consideration of the time value of money, constitute the Committee of Creditors (the "CoC").[34] The CoC evaluates and approves resolution plans submitted for the reorganization of the corporate debtor.[35] Members of the CoC cast votes in proportion to the debts owed to them by the corporate debtor, and a plan needs to be approved by at least sixty-six percent of the CoC's votes.[36] The National Company Law Tribunal (the "NCLT") is the adjudicating authority under the IBC.[37] The NCLT is in charge of approving resolution plans and ensuring that they are compliant with the IBC and other laws.[38] Persons aggrieved by the decision of the NCLT can approach the National Company Law Appellate Tribunal (the "NCLAT").[39] Appeals against NCLAT decisions lie with the Supreme Court of India.[40]

Operational creditors comprise persons such as employees and trade creditors.[41] These are persons whose relationships with the corporate debtor are based on the provision of goods or services.[42] Operational and financial creditors are both allowed to file an insolvency application against a company if they are owed a sum exceeding 10,000,000 INR (equivalent to approximately 137,000 USD).[43] However, a corporate debtor needs to be given ten days' notice to repay the operational debt and has the ability to dispute an operational debt.[44] This is different from the procedure applied

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[33] *See id.* § 21 (delineating who is considered a financial creditor versus an operational creditor for the purpose of forming the committee of creditors).

[34] *Id.* ("The committee of creditors shall comprise all financial creditors of the corporate debtor. . . ."); *see also id.* § 5(7)–(8) (defining "financial creditor" and "financial debt").

[35] *See id.* § 30(4).

[36] *Id.* §§ 5(28), 30(4) (stating the voting share of a financial creditor is based on the proportion of financial debt owed to that creditor in relation to the total financial debt owed by the corporate debtor).

[37] *Id.* § 5(1).

[38] *See id.* §§ 30(6), 31.

[39] *Id.* § 61(1).

[40] *See* The Companies Act, 2013, § 423 (India).

[41] *See* The Insolvency and Bankruptcy Code § 5(20)–(21) (defining "operational creditor" and "operational debt").

[42] *See id.*

[43] *See id.* § 4; Ministry of Corporate Affairs, S.O. 1205(E) (Notified on Mar. 24, 2020) (India). For the currency conversion as of March 2021, see Xe Currency Converter: INR to USD, Xe.com (Mar. 31, 2021), https://www.xe.com/currencyconverter/convert/?Amount=10000000&From=INR&To=USD [https://perma.cc/PA5U-WV8A].

[44] *See* The Insolvency and Bankruptcy Code §§ 8–9 (outlining the insolvency resolution process for operational creditors).

when an application is filed by a financial creditor. The NCLT is bound to admit the application of a financial creditor provided that a default has occurred.[45]

Operational creditors are granted certain protections under the IBC in lieu of the right to vote on resolution plans. Resolution plans are required to provide operational creditors with the amount they would have gotten in the event of a liquidation or the amount they would have gotten if the money distributed under the plan were distributed as per the hierarchy of the liquidation waterfall, whichever of the two is higher.[46] Additionally, regulation 38 of the Insolvency Resolution Regulations requires payments under the plan to operational creditors to be made in priority over payments to financial creditors.[47] Having traversed these important features of the IBC, we now turn to the insolvency laws of the UK and US. The differences between the insolvency laws of India, the UK, and the US need to be identified to fully appreciate the extent to which insights from their experiences with pre-packs can be applied to India.

B. Key Comparisons Between the Insolvency Regimes of the UK, the US, and India

The substantial insolvency laws of the UK and US are contained in the Insolvency Act 1986[48] and title 11 of the United States Code[49] (the "US Bankruptcy Code"), respectively. Chapter 11 of the US Bankruptcy Code governs corporate reorganizations and is the counter part of the corporate insolvency resolution process under the IBC. Chapter 11 contains one of the two pre-pack routes in the US;[50] the other is contained in section 363(b) of the US Bankruptcy Code.[51] The UK Insolvency Act provides for three routes to formal rescue, which include company voluntary agreements ("CVAs"), administrative receivership, and administration.[52] Most pre-packs in the UK are effectuated through administration, which is governed by schedule B1 of the Insolvency Act.[53]

There are some important similarities between the insolvency laws of India and the UK. These include similarities in the treatment of shareholders during the insolvency process and the role of the resolution professional. In India and England, shareholders' claims are not considered during a company's insolvency resolution

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[45] *Id.* § 7; *see also* Innoventive Indus. Ltd. v. ICICI Bank, (2018) 1 SCC 407, 410–11 (India) ("In the case of a corporate debtor who commits a default of a financial debt, the adjudicating authority has merely to see . . . evidence produced by the financial creditor to satisfy itself that a default has occurred.").

[46] The Insolvency and Bankruptcy Code § 30(2)(b).

[47] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 38.

[48] Insolvency Act 1986, c. 45 (UK).

[49] 11 U.S.C. §§ 101–1532 (2018).

[50] *See generally id.* § 1121 (stating a "debtor may file a plan with a petition commencing a voluntary case").

[51] *See generally id.* § 363(b) (defining the parameters for the sale of property of the estate)

[52] *See* Insolvency Act 1986 pts. I–III.

[53] *See generally id.* sch. B1. *See, e.g., In re* Transbus Int'l Ltd. [2004] EWHC (Ch) 932, [12] (UK); *see also* FRISBY, *supra* note 25, at 15–16; XIE, *supra* note 9, at 26; FINCH & MILMAN, *supra* note 3, at 375.

process and administration respectively.[54] This is different from the position in the US where shareholders are subordinate to creditors but remain an interested party nonetheless.[55] In the US, a chapter 11 reorganization plan needs to be approved by two-thirds of shareholders in addition to being approved by creditors.[56] Under chapter 11, a bankruptcy trustee (who is roughly analogous to the administrator in the UK and the resolution professional under the IBC)[57] need not be appointed in every chapter 11 case.[58] A bankruptcy trustee is also not a pre-requisite for a section 363 pre-pack.[59] Section 363 sales can be initiated by either the debtor or the bankruptcy trustee, if one is appointed.[60] However, in the UK and India, administrators and resolution professionals are a mandatory and indispensable part of the administration and insolvency resolution processes, respectively.[61] Unlike schedule B1 and section 363(b), the IBC does not empower a resolution professional to sell the assets of a corporate debtor without the authorization of creditors.[62] The resolution professional has the power to manage the affairs of the company and has "control and custody" over the debtor's assets, but this does not extend to disposing of them.[63] This limitation is the key reason for why India has not seen the spontaneous evolution of pre-packs.

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[54] Shareholder approval is deemed to be given under section 30(2) of the IBC. The Insolvency and Bankruptcy Code, 2016, § 30(2) (India). For the English and US positions, see XIE, *supra* note 9, at 182.

[55] XIE, *supra* note 9, at 182.

[56] *See id.*

[57] *See* Himani Singh, *Pre-packaged Insolvency in India: Lessons from USA and UK*, HARV. BANKR. ROUNDTABLE (Apr. 28, 2020), https://blogs.harvard.edu/bankruptcyroundtable/tag/himani-singh/ ("[Resolution professionals] in [the] Indian insolvency regime, have more in common with the administrators in UK. However, in case of Pre-packs, it would be more fruitful to align the role of [a resolution professional] with that of a US trustee.").

[58] *See Chapter 11—Bankruptcy Basics*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Mar. 7, 2021) (explaining only a small number of chapter 11 cases involve the appointment or election of a trustee).

[59] *See id.*; *see also* 11 U.S.C. § 363(b)(1) (2018); Alfonso Nocilla, *Asset Sales and Secured Creditor Control in Restructuring: A Comparison of the US, UK, and Canadian Models*, 26 INT'L INSOLVENCY REV. 60, 72 (2017) ("Under Section 363 of the Code, *the debtor or its trustee* may sell its assets outside the ordinary course of business." (emphasis added)).

[60] *See* Nocilla, *supra* note 59, at 75 ("[T]here is no need to appoint a trustee for a 363 sale. [T]he debtor often remains in possession, continuing to manage its own operations and conducting the sale process."); XIE, *supra* note 9, at 205.

[61] *See* Vinod Kothari & Sikha Bansal, *Role of Insolvency Professionals in Corporate Insolvency Resolution Process*, *in* IBC: USHERING IN A NEW ERA 62, 65–66 (Megha Mittal ed., 2019) (explaining the resolution process under IBC is similar to that of the UK Insolvency Act 1986, at least in regard to the role of the insolvency professional and the administrator, respectively).

[62] *See id.* at 69 (explaining section 18 of the IBC requires a resolution professional to take control and custody of a debtor's assets but does not allow them discretion to dispose of said assets); Insolvency and Bankruptcy Board of India (Insolvency Resolution for Corporate Persons) Regulations, 2016, Reg. 29 (stating the resolution professional can sell unencumbered assets of the corporate debtor outside the ordinary course of business only with majority creditor approval, but such a sale is also only permitted if the book value of the assets being sold do not exceed ten percent of the value of the claims admitted against the corporate debtor).

[63] *See* Kothari & Bansal, *supra* note 61, at 69 ("[T]he words 'control and custody' shall not be misinterpreted to mean taking control and custody of the assets for the purpose of disposal thereof. . . .").

While substantial similarities exist between the Indian and UK insolvency regimes, there are also important differences. Under the IBC regime, the NCLT (the adjudicating authority) plays an active role in overseeing insolvency proceedings and approving the insolvency resolution plan after it has been accepted by the CoC.[64] This is different from the largely deferential trend in the UK where courts seldom interfere with commercial decisions of an administrator.[65] Additionally, in the UK, it is possible for an administrator to be appointed out of court, after which, the administration process is then implemented and completed without court supervision.[66] The role played by the NCLT in India is similar to that of the bankruptcy court (under the US Bankruptcy Code), which needs to approve chapter 11 reorganization plans.[67] Under section 30 of the IBC, there are statutory requirements that an insolvency resolution plan must adhere to in order to be confirmed by the NCLT.[68] This process of plan confirmation under section 30 has been compared to section 1129 of the US Bankruptcy Code, which also contains a checklist of conditions a plan must meet before a bankruptcy court can confirm it.[69]

Thus, India's insolvency law bears important similarities to the US and UK insolvency laws but is also identifiably different from each of them, for instance, in its approach to dividing creditors into operational and financial creditors.[70] The Indian insolvency regime is thus capable of adopting either jurisdiction's approach to pre-pack regimes or even a mixture of the features of both regimes. An important difference between the Indian regime and those in the UK and US is the IBC's prohibition on related parties of a company buying their company's assets through the insolvency resolution process.[71] The prevalence of pre-pack sales to connected parties (directors, shadow directors, and promoters) in the UK and US casts doubts on whether the IBC can maintain its strict policy against connected party sales after pre-packs are introduced. This issue, along with the effect of the IBC's broad avoidance provisions, are discussed below.

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[64] *See id.* at 70–71.

[65] *See* Adam Plainer & Corinne Ball, *Comparison of Chapter 11 of the United States Bankruptcy Code and the System of Administration in the United Kingdom*, JONES DAY GOULDENS, https://www.jonesday.com/files/Publication/b0c886bd-6721-4c66-9213db7f01ddb55f/Presentation/PublicationAttachment/96b1ebf1-2203-4577-bff4-8baf89f4e0d1/Comparison%20of%20Chapter%2011.pdf (last visited Mar. 7, 2021) (noting administration occurs with almost no court supervision).

[66] *See id.*

[67] *See* 11 U.S.C. § 1128(a) (2018).

[68] *See generally* The Insolvency and Bankruptcy Code, 2016, § 30 (India).

[69] *See* C. Scott Pryor, *Good News for Secureds in India: Supreme Court Confirms Priority of Secured Claims (and More)*, 39 AM. BANKR. INST. J., Mar. 2020 at 26, 26 (expressing the criteria for confirmation under section 30 of the IBC are similar to those of section 1129 of the US Bankruptcy Code).

[70] *See id.* (explaining equitable treatment of creditors under the IBC depends on whether they are a part of the secured or unsecured classes *and* the financial or operational classes).

[71] *See* The Insolvency and Bankruptcy Code § 29A; *see also* Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Regs. 2B, 37(8) (providing persons ineligible to submit a resolution plan under section 29A of the IBC cannot participate in a scheme of arrangement of the company following a liquidation order or purchase secured assets from creditors through the liquidation process).

C. Challenges to Introducing Pre-packs in India

1. The IBC's treatment of the incumbent management's participation in the insolvency resolution process

When the IBC was first introduced and brought into force in 2016, there was no prohibition on promoters being resolution applicants.[72] The 2016 law defined a resolution applicant as "any person" who submits a resolution plan with respect to a corporate debtor.[73] Section 29A was added through the first amendment to the IBC in 2018.[74] The rationale behind this amendment was that unscrupulous persons were using the IBC to regain control of companies they had mismanaged and brought to the stage of insolvency.[75] However, this approach runs into the problem of excluding all promoters and directors from proposing resolution plans, irrespective of whether their management was responsible for the downfall of a company. A 2014 study in the UK revealed most pre-packs involved companies that failed due to market conditions, such as an increase in the cost of raw materials and changes in currency exchange rates.[76] Thus, sales to connected parties can be justified not only because they are often the only ones who are willing to purchase the business as a whole, but also because they are not always responsible for a company's distress.

The 2015 Bankruptcy Law Reforms Committee's Report (the "BLRC Report")[77] containing the design of the IBC originally encouraged promoters to buy back their distressed corporation and have a second chance at running them.[78] The report also distinguished between the malfeasance of a promoter and business failure.[79] Though the distinction was made in the context of a promoter's personal liability for business

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[72] *See* Vishwanath Nair, *IBBI Bars Promoters From Buying Back Companies Through Liquidation*, BLOOMBERG QUINT (Jan. 7, 2020, 8:56 PM), https://www.bloombergquint.com/business/ibbi-bars-promoters-from-buying-back-companies-through-liquidation ("The Insolvency and Bankruptcy Board of India has amended the norms governing liquidation of a company under the Insolvency and Bankruptcy Code, 2016 and barred [connected parties] from participating in the process at any level.").

[73] *See* The Insolvency and Bankruptcy Code § 5(25) n.1 (showing, prior to its amendment in 2018, section 5(25) defined "resolution applicant" as "any person who submits a resolution plan to the resolution professional").

[74] Insolvency and Bankruptcy Code (Amendment) Act, 2018, § 5 (India).

[75] Insolvency and Bankruptcy Code (Amendment) Bill, 2017, Bill No. 280 of 2017, Statement of Objects and Reasons (Nov. 23, 2017) (India) ("Concerns have been raised that persons who, with their misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution process, and gain or regain control of the corporate debtor.").

[76] *See* PETER WALTON & CHRIS UMFREVILE, PRE-PACK EMPIRICAL RESEARCH: CHARACTERISTIC AND OUTCOME ANALYSIS OF PRE-PACK ADMINISTRATION 14–15, 57 (Univ. of Wolverhampton 2014), https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration#:~:text=The%20report%20was%20carried%20out,Government%20response%20to%20the%20Review. This report was prepared to assist the Graham Review of pre-packs in 2014.

[77] TK VISWANATHAN ET AL., THE REPORT OF THE BANKRUPTCY LAW REFORMS COMMITTEE—VOLUME I: RATIONALE AND DESIGN (2015) [hereinafter BLRC REPORT], https://ibbi.gov.in/BLRCReportVol1_04112015.pdf.

[78] *See id.* at 14.

[79] *Id.* at 22–23.

failure,[80] it can also be applied to giving them a second chance at running their business as well. The BLRC Report further stated some ventures are bound to fail, and this failure cannot be attributed to any malfeasance.[81] The limited liability corporation encourages some amount of risk taking; this is an integral part of any business.[82] Sometimes, these risks do not pay off. However, this in itself does not mean that the promoters and directors involved warrant any legal censure.[83]

a. Prohibition of connected party participation in the insolvency resolution process

India's current position on the incumbent management's and promoters' participation in the insolvency resolution process is very different from what was envisioned by the BLRC Report. Section 29A of the IBC prohibits promoters and managers of companies (connected parties) that have non-performing assets from being resolution applicants, which effectively prohibits the promoters and directors of a company undergoing the insolvency resolution process from submitting a resolution plan.[84] The IBC's current position on the issue not only differs from the IBC's original position in 2016, but also from the approach of the UK and US. In the US, a corporate debtor is encouraged to submit plans for its own reorganization.[85] Once an insolvency application is filed under chapter 11, the corporate debtor has the exclusive right to submit a plan for a period of the 120 days after the order of relief.[86] Further, the US debtor-in-possession bankruptcy regime[87] allows the incumbent management of the company to retain control over the corporate debtor, rather than be replaced by persons like the resolution professional or administrator (as in India and the UK).[88] India and the UK have a creditor-in-possession regime[89] and there are some limitations on connected party participation in the UK as well. Under the UK Insolvency Act, directors of companies that have gone through liquidation are prevented from being on the board of another company that has the

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[80] *Id.*

[81] *See id.* at 23.

[82] *See id.* ("Historically, limited liability corporations were created with the objective of taking risk.").

[83] *See id.* ("Since exploration benefits society through risk taking, it is important to protect the concept of limited liability, which bankruptcy law must aim to do.").

[84] *See* The Insolvency and Bankruptcy Code, 2016, § 29A (India).

[85] *See generally Chapter 11—Bankruptcy Basics*, *supra* note 58 (detailing the steps involved in the US chapter 11 bankruptcy process).

[86] 11 U.S.C. § 1121(b) (2018) ("[O]nly the debtor may file a plan until after 120 days after the date of the order for relief under [chapter 11.]").

[87] *See id.* § 1107 (codifying the rights, powers, and duties of a debtor in possession); *see also Chapter 11—Bankruptcy Basics*, *supra* note 58.

[88] *See* Nocilla, *supra* note 59, at 71 (explaining the differences between the chapter 11 process in the US and administration in the UK); *see also* Kothari & Bansal, *supra* note 61, at 65–66.

[89] *See* Kothari & Bansal, *supra* note 61, at 65–67 (noting both India and the UK have adopted the creditor-in-possession regime).

same or similar name.[90] However, this prohibition applies to a very specific form of pre-pack sale and has not significantly affected pre-pack sales to connected parties, which comprise two-thirds of pre-pack sales.[91]

Under the IBC's regulations, connected parties are also prohibited from participating in a compromise or agreement involving the distressed company after a liquidation order is passed under the IBC.[92] Even if a secured creditor wants to realize the value of their security without relinquishing it to the liquidation estate, they are barred from selling their secured interest to a promoter or the incumbent management.[93] Under the present IBC regime, a pre-pack sale to a connected party would be prohibited even if it has the sanction of all the secured and unsecured creditors by virtue of the statutory provisions of the IBC.[94] The case of *Chitra Sharma v. Union of India*,[95] decided by the Supreme Court of India, can be used to animate the Indian insolvency regime's stance on promoters participating in the resolution of their distressed companies.

In *Chitra Sharma*, the Supreme Court did not allow the corporate debtor to enter into a master restructuring agreement ("MRA") that was acceptable to all of its creditors.[96] Under the MRA, the company would have had to sell some of its assets in order to complete ongoing projects.[97] The court's decision was informed by two considerations, both of which operate independently. One of these considerations was the addition of homebuyers to the category of "financial creditors" under the IBC through an amendment in 2018.[98] Since this amendment was made after the insolvency resolution process had commenced, homebuyers had not participated in it.[99] Accordingly, the court ordered for the resolution process to be started afresh, thus ensuring the homebuyers would also be able to exercise their newly recognized right to vote in the CoC.[100] However, the decision to include homebuyers and restart the time period allotted to complete the resolution process was made using article 142 of the Constitution of India, which allows the court to render complete justice.[101]

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[90] Insolvency Act 1986, c. 45, § 216 (UK); *see also* Wellard & Walton, *supra* note 25, at 155 ("The provisions . . . provide that a director of a company that has gone into insolvent liquidation cannot be involved in the management of a second company using the same or similar name to that of the failed company for a 5-year period.").

[91] *See* Wellard & Walton, *supra* note 25, at 155–56.

[92] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Reg. 2B.

[93] *Id.* Reg. 37(8) ("A secured creditor shall not sell or transfer an asset, which is subject to security interest, to any person, who is not eligible . . . to submit a resolution plan. . . .").

[94] *See generally* The Insolvency and Bankruptcy Code, 2016, § 29A (India).

[95] Chitra Sharma v. Union of India, (2018) 18 SCC 575 (India).

[96] *See id.* at 597–601, ¶¶ 36–37.

[97] *See id.* at 597, ¶ 36.

[98] *See id.* at 606, ¶¶ 47.1–47.2.

[99] *See id.* at 606, ¶ 47.1 ("When the [insolvency resolution process] was initiated . . . the homebuyers did not have the status of financial creditors under the provisions of the IBC.").

[100] *Id.* at 606, ¶ 47.2 (holding, in light of the amendment of the IBC, the insolvency resolution process "should be revived and CoC reconstituted as per the amended provisions to include the homebuyers").

[101] *Id.* ("In the facts of the present case, recourse to the power under Article 142 would be warranted to render complete justice.").

The other consideration that influenced the court's decision was the statutory mandate contained in section 29A of the IBC.

The Court referred to section 29A of the IBC and explained that it prohibits the promoters of corporate debtors from submitting insolvency resolution plans.[102] Thus, in *Chitra Sharma*, the Supreme Court refused to allow restructuring through a scheme of arrangement that was agreeable to all of its creditors (except homebuyers), even if it meant the corporate debtor could continue its projects.[103] The court's reasoning as to why section 29A prohibited the implementation of the MRA was independent of its concern for homebuyers.[104] Thus, this precedent will apply to any agreement that is entered into between promoters and the creditors of a corporate debtor in the context of an insolvency resolution plan. The IBC's (and the Supreme Court's) position on an incumbent management's participation in the process of restructuring is unequivocal.[105]

Interestingly, the current Indian approach to connected party sales may be justified based on the UK's experiences with them. Most pre-pack sales in the UK are in the form of sales to connected parties or persons who are directors, shadow directors, or associates of the company.[106] In the UK, this practice (also known as phoenixing)[107] has been especially criticized in the context of pre-packs.[108] Phoenix transactions allow connected parties to use information to which only they are privy in order to negotiate a better deal for themselves.[109] For instance, it would be in the interest of purchasing directors, or parties connected to them who are purchasers, that the firm is sold at a lower consideration.[110] This would reduce the amount of money available for distribution to secured creditors.[111] A corollary to this criticism is that promoters are allowed to "shed their creditors" and carry on with a their new business, irrespective of whether or not they have engaged in any actual course correction.[112]

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[102] *Id.* at 597–601, ¶¶ 36–38; *see also* The Insolvency and Bankruptcy Code, 2016, § 29A (India).

[103] *Chitra Sharma*, 18 SCC at 597–601, ¶¶ 36–38.

[104] *Compare id.*, *with id.* at 606, ¶¶ 47.1–47.2.

[105] *See id.* at 598, ¶ 37 ("[A]ccepting the proposal . . . would cause serious prejudice to the discipline of the IBC and would set at naught the salutary provisions of the statute.").

[106] *Cf.* GRAHAM REPORT, *supra* note 11, at 38 (stating it is often the case that the only party willing to make a superior offer, or any offer at all, is a "connected party").

[107] *See* Wellard & Walton, *supra* note 25, at 170.

[108] *See id.* at 153–56.

[109] *See* XIE, *supra* note 9, at 94; *see also* Wellard & Walton, *supra* note 25, at 153–56; Eugenio Vaccari, *English Pre-packaged Corporate Rescue Procedures: Is There a Case for Propping Industry Self-regulation and Industry-led Measures Such as The Pre-Pack Pool?*, 31 INT'L CO. & COM. L. REV. 170, 181 (2020).

[110] *See* XIE, *supra* note 9, at 94 ("When the directors of troubled companies are interested in a management buy-out, they have a vested interested in the insolvency process with a view to paying a lower price for the business."); FINCH & MILMAN, *supra* note 3, at 405 ("A . . . major fear for the unsecured creditor is that if there is a transition from informal rescue to a pre-pack, the pre-packaged sale will be at undervalue to a party related to the current directors.").

[111] *See* FINCH & MILMAN, *supra* note 3, at 379–80.

[112] XIE, *supra* note 9, at 94.

b. Justifications for connected party sales

Sales to connected parties invite more scrutiny in the context of pre-packs because the speed and secrecy of the process do not allow creditors to fully evaluate the plan.[113] Further, pre-packs are normally executed without the creditors' vote of approval.[114] Creditors, thus, do not have a means to check decisions of the management that have been taken in their own self-interest when the sale is executed through a pre-pack. The Graham Committee Report (the "Graham Report"), commissioned by the Secretary of State for Business, found that pre-pack sales to related parties had thrice the odds of failing as compared to sales to unconnected parties.[115] Despite this, the Graham Report did not recommend banning pre-packs,[116] and the UK Government seems to agree with this position for now. The UK Insolvency Act gives the Secretary of State the power to frame regulations for the sale of a company's assets to connected parties.[117] This includes the ability to require the administrator to get the court's or creditors' approval before affecting such a sale and extends to prohibiting these sales altogether.[118] Originally, this power to regulate was to be used before May 2020, and for this reason, has been referred to as a sunset provision.[119] In June 2020, the UK Government amended the Insolvency Act to extend the sunset period to June 2021.[120] The Pre-pack Sales Report has suggested how this regulatory power may be used,[121] which marks a shift away from relying on voluntary regulations and towards mandating these regulations. These suggestions are discussed later in the Paper.

The unique benefits of pre-pack sales to connected parties as identified by the Graham Report are similar to those in the BLRC Report. The Graham Report noted that when a corporation is experiencing financial difficulties due to an industrial slow down, it is unlikely that other companies in the industry will be willing to purchase the business of the corporate debtor as a whole.[122] In such cases, the incumbent management is often the only stakeholder willing to purchase the business of the company.[123] In these situations, sales to connected parties are usually the only option in order to preserve the company's business.[124] More generally, there may be some

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[113] *See* Sandra Frisby, *Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?*, 64 CURRENT LEGAL PROBS. 349, 379 (2011); *see also* Walton, *supra* note 11, at 87.

[114] *See* Walton, *supra* note 11, at 87 (noting creditors are often excluded from the decision-making process).

[115] *See* GRAHAM REPORT, *supra* note 11, at 3, 51.

[116] *Id.* at 54.

[117] Insolvency Act 1986, c. 45, sch. B1, ¶ 60A(1)(b) (UK) ("The Secretary of State may by regulations make provisions for . . . imposing requirements or conditions in relation to, the disposal, hiring out or sale of property of a company by the administrator to a connected person in circumstances specified in the regulations.").

[118] *See id.*

[119] Corporate Insolvency and Governance Act 2020, c. 12, § 8(1) (UK) (noting paragraph 60A of schedule BI to the Insolvency Act expired in May 2020).

[120] *Id.* § 8(2) (substituting in a new sunset provision for paragraph 60A).

[121] *See generally* PRE-PACK SALES REPORT, *supra* note 12.

[122] *See* GRAHAM REPORT, *supra* note 11, at 38; *see also* XIE, *supra* note 9, at 94.

[123] *See* GRAHAM REPORT, *supra* note 11, at 38.

[124] *See* XIE, *supra* note 9, at 94; GRAHAM REPORT, *supra* note 11, at 38.

business failures that cannot be attributed to the management of the company;[125] thus, not all insolvency applications are a result of bad management practices. In such circumstances, it would be quite harsh to deprive promoters and directors of a second chance at running their company.[126]

c. Revaluating section 29A

It is difficult to imagine a pre-pack negotiation that can be carried out without the cooperation of the incumbent management.[127] Even if the resultant sale is not to a related party, the directors or promoters of a company will have to be involved in the negotiation process as representatives of the corporate debtor.[128] Under the normal insolvency procedure of the IBC, the insolvency professional replaces the company's directors and liaises with the CoC during the resolution process.[129] Since pre-pack negotiations are carried out before the insolvency application is filed, there is no insolvency professional to replace the office holders of the company during these negotiations.[130] Once a resolution professional is appointed, it becomes difficult to maintain the secrecy of the insolvency resolution process.[131]

It has been suggested that a resolution professional can be voluntarily appointed in the pre-pack process to ensure all dealings happen at a fair price.[132] While this may resolve the issue of fairness in connected party sales, it still does not ensure the incumbent management will not influence the resolution professional or that they do not participate in the resolution process. A similar suggestion was also made in the UK; it was suggested pre-pack negotiations must only be between insolvency professionals.[133] However, this proved to be impracticable as it is difficult to define when exactly negotiations become pre-pack negotiations.[134] Further, if pre-pack

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[125] *See* GRAHAM REPORT, *supra* note 11, at 82 fig.E4 (displaying the statistics for companies' causes of failure).

[126] *See* XIE, *supra* note 9, at 94; Singh, *supra* note 57, at 10–11.

[127] *See* Singh, *supra* note 57, at 11 (opining section 29A "acts as a major obstacle" to the pre-pack process).

[128] *Cf.* XIE, *supra* note 9, at 61 (noting directors have a duty to cooperate with the administrator in the UK administration process).

[129] The Insolvency and Bankruptcy Code, 2016, §§ 17(1)(b), 23(2) (India) (stating the powers of the board of directors are suspended during the insolvency resolution process, and these powers are exercised by the interim resolution professional and then transferred to the resolution professional); *see also* Singh, *supra* note 57, at 3.

[130] *See* CONWAY & SHALCHI, *supra* note 8, at 3; Walton, *supra* note 11, at 97; XIE, *supra* note 9, at 74–75 (explaining how directors of the company and their advisors participate in negotiations with creditors before the formal insolvency process commences in the UK).

[131] *Cf.* GRAHAM REPORT, *supra* note 11, at 23 ("One of the main arguments used in support of pre-packing is that the secrecy preserves value in a business.").

[132] *See* Singh, *supra* note 57, at 15 ("A voluntarily appointed IRP along with the Pre-pack pool can efficiently ensure that all business transactions during the Pre-pack process are at arm's length, in the interest of all the creditors and stakeholders and compliant with IBC.").

[133] *See* Vanessa Finch, *Pre-Packaged Administrations and the Construction of Propriety*, 11 J. OF CORP. L. STUD. 1, 21 (2011) [hereinafter Finch, *Pre-Packaged Administrations*].

[134] *Id.*

negotiations are restricted to insolvency professionals, they will be unnecessarily constricted.[135]

Chitra Sharma has shown, even in India, secured creditors are willing to negotiate with the incumbent management to reorganize the business.[136] The fact that an amendment had to be passed to prevent secured creditors from selling their securities to the incumbent management shows that connected party sales were opted for by the corporate debtor's management and its secured creditors.[137] A pre-pack regime retaining these restrictions would limit the incentives of the secured creditors and the incumbent management to cooperating during pre-pack negotiations. Creditors who believe that pre-pack negotiations will not allow them to negotiate a deal with the parties they choose (such as promoters and directors) may prefer to simply trigger the insolvency process and take the normal route to insolvency proceedings. Skepticism about all connected party participation in the insolvency process will unnecessarily complicate pre-pack negotiations in India. Accordingly, the IBC needs to cautiously embrace the participation of the incumbent management and promoters of a company in the insolvency resolution process in order to reap the full benefits of a pre-pack regime.

Interestingly, the members of the committee that drafted the MCI Pre-pack Report were not able to agree on whether the prohibition on promoter participation under section 29A ought to be relaxed.[138] While four out of the seven committee members recommended retaining section 29A as it was, three of the members (in the minority) were in favor of relaxing it.[139] The rationale of the members in the minority is similar to that which is discussed above. Importantly, the MCI Pre-pack Report suggests pre-packs should be initiated through the corporate debtor.[140] This would require approval from a simple majority of its shareholders.[141] In order for this mode of pre-packaging to be used, it would require the promoters (if they are shareholders) of the corporate debtor to be on board as well.[142] The Report has mentioned that in the status quo, only 6.6% of corporate insolvency resolutions have been initiated by the corporate debtor through this route.[143] One of the key reasons for this, as explained in the Report, is the unwillingness of the corporate debtor's management to initiate the resolution process if they are barred from proposing a plan under

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[135] *See id.* (noting that restricting pre-pack negotiations to only insolvency professionals would increase the cost and reduce the speed of a reorganization).

[136] *See generally* Chitra Sharma v. Union of India, (2018) 18 SCC 575 (India).

[137] *See id.* at 601–02, ¶¶ 38–39.

[138] *See* MCI PRE-PACK REPORT, *supra* note 2, at 50–52.

[139] *See id.* (explaining the majority members submitted against relaxation in an effort to retain the basic features of the Code, while the minority members advocated for partial relaxation because other restructuring frameworks do not prohibit such participation).

[140] *See id.* at 35–37 (stating pre-packs should be initiated through the corporate debtor since "[t]he [corporate debtor] understands the company, its stress, and the possibility of its resolution better").

[141] *See id.* at 37–38.

[142] *See id.*

[143] *See id.* at 36–37.

section 29A.[144] Essentially, promoters do not want to subject the corporation to a process by which they will lose control of it.

This incentive structure will continue to exist even in the context of a pre-pack. If board of directors and shareholder approval is necessary before the formal portion of the pre-pack process commences, then those prohibited from submitting plans under section 29A may be unwilling to cooperate in this process. The Report mentions that a few members of the sub-committee proposed section 29A should be relaxed in the context of pre-packs.[145] This would go a long way in allowing pre-packs to be used by companies that need it. If a promoter's plan is not acceptable, creditors retain the right to reject it through their power to vote. Creditors would also have the option to seek out other potential resolution applicants in the negotiation stage of the pre-pack. As discussed in the Report, there may also be instances where the promoters are not to be solely blamed for a corporation's distress.[146] More importantly, if the percentage of corporate-debtor-initiated insolvency resolutions is under seven percent in the status quo,[147] this is likely to be replicated in the context of pre-packs too. Skepticism about all connected party participation in the insolvency process will unnecessarily complicate pre-pack negotiations in India. Accordingly, the IBC needs to cautiously embrace the participation of the incumbent management and promoters of a company in the insolvency resolution process in order to reap the full benefits of a pre-pack regime.

2. Limiting the reach of the IBC's avoidance provisions

Section 43 of chapter III of the IBC defines preferential transactions, and section 44 allows for their avoidance.[148] Preferential transactions are transactions between a corporate debtor and its creditor, surety, or guarantor involving the payment of an antecedent debt or any other liability.[149] In order for a transaction to be considered preferential in nature, it must put the person to whom the transfer was made in a better position than they would have been prior to the transfer in the event of a liquidation.[150] The definition of a preferential transaction under section 43 is largely similar to the one contained in section 239 of the UK Insolvency Act.[151]

Section 43 states that if such a transfer is made to a related party two years prior to the commencement of the resolution process and to any other party one year prior to the commencement of the resolution process, the transfer is deemed to have been

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[144] *See id.*
[145] *See id.* at 50.
[146] *Id.* at 51.
[147] This figure dropped to 3.2% in 2019 to 2020. *See id.* at 36–37.
[148] The Insolvency and Bankruptcy Code, 2016, §§ 43–44 (India).
[149] *Id.* § 43.
[150] *Id.* § 43(2)(b).
[151] *Compare id.* § 43, *with* Insolvency Act 1986, c. 45, § 239 (UK).

preferential.[152] Section 45 defines undervalued transactions as those in which a transfer is made as a gift or at a consideration that is significantly less than the value of the thing that is being transferred.[153] The wording of the definition of an undervalued transaction under the IBC is also similar to that of the UK's.[154] However, an undervalued transaction in the UK cannot be avoided if it is made in good faith; no such exception is provided under the IBC.[155]

In *Anuj Jain v. Axis Bank Ltd.*, it was held that chapter III (which deals with liquidation) would also be applicable to chapter II, which contains the insolvency resolution process.[156] Even if a company is not likely to go into liquidation, *Anuj Jain* would allow a transaction to be avoided by a resolution professional after the resolution process has commenced.[157] The bare text of the IBC states that a resolution professional or liquidator can ask for an order under the IBC's avoidance provisions.[158] From the bare text, it is unclear whether a resolution professional's power to ask for these orders are referred to in the context of CoC approved liquidations or whether they can be used immediately after the resolution process begins.[159] *Anuj Jain* has given a clear mandate that sections 43 and 45 (dealing with preferential and undervalued transactions, respectively) in chapter III of the IBC apply to the resolution processes in chapter II.[160] Thus, a resolution professional will be allowed to avoid transactions even if the company is not heading towards liquidation.

In the UK, avoidance provisions do not come in the way of pre-packs because the actual transaction takes place during the formal insolvency proceedings, prior to which there are only negotiated arrangements in place.[161] Thus, a pre-pack cannot be challenged for being a preferential transaction or an undervalued one.[162] Under the IBC, the word "transaction" has a broad and inclusive definition and extends to any "agreement or arrangement in writing for the transfer of assets, or funds, goods or services, from or to the corporate debtor."[163] The definition under section 43 uses the word "transfer" and not "transaction," whereas the definition under section 45 uses

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[152] The Insolvency and Bankruptcy Code § 43(4); *see also* Anuj Jain v. Axis Bank Ltd., (2020) 8 SCC 401, 437, ¶ 13.1 (holding the "look-back period" was the two years prior to the commencement of the insolvency process).

[153] The Insolvency and Bankruptcy Code § 45(2).

[154] *Compare id.*, *with* Insolvency Act 1986 § 238(4) (defining an undervalued transaction as "a gift to a person . . . on terms that provide for the company to receive no consideration" or a transaction where the value of the consideration received by the company "is significantly less than the value . . . of consideration provided by the company").

[155] *See* Insolvency Act 1986 § 238(5); *see also* The Insolvency and Bankruptcy Code § 45.

[156] *See Anuj Jain*, 8 SCC at 460–61, ¶¶ 19.2–19.3.

[157] *See id.* at 458, ¶ 18.7.1 (explaining there was not a strong likelihood of the debtor going into liquidation).

[158] *See* The Insolvency and Bankruptcy Code §§ 44, 47.

[159] *See id.*

[160] *Anuj Jain*, 8 SCC at 460–61, ¶¶ 19.2–19.3.

[161] *See* XIE, *supra* note 9, at 124–25.

[162] *See id.*

[163] The Insolvency and Bankruptcy Code § 3(33).

both "transfer" and "transaction."[164] Transfers are defined inclusively,[165] but their meaning is not as broad as that of a transaction. A transfer includes sales, mortgages, gifts, etc.[166] Unfortunately, this does not provide much clarity as the section headings of the IBC's avoidance provisions refer to "preferential transactions" and "undervalued transactions;"[167] these phrases have been used elsewhere in the IBC as well.[168]

Thus, there is the possibility these sections can be used to set aside any pre-pack negotiation prior to the insolvency application as preferential or undervalued based on the existence of written negotiations. This problem is compounded by the fact these sections operate without any regard for the intention behind these transactions.[169] There is thus a strong case for the application of sections 43 and 45 to pre-pack negotiations, even if the arrangements were reached to ensure that the successful preservation of the debtor's assets. Before deciding on the more substantial features of India's pre-pack regime, lawmakers will have to ensure that the application of section 29A and interpretation of sections 43 and 45 do not jeopardize the stability of pre-packs. The next Part will discuss the options available to India for the introduction and regulation of pre-packs by drawing from the experiences of the UK and US.

II. IMPLEMENTATION OF PRE-PACKS IN THE UK AND THE US

A. Choosing a Route to Pre-packs

Pre-packs have been neither explicitly mentioned in the insolvency regime of the UK nor the US. Yet, both these regimes have seen pre-packs become an important and prevalent method of effecting business sales of distressed corporations. In the UK, there are no statutory regulations that specifically refer to pre-packs. Pre-packs in the UK evolved through the use of the administrator's power to sell a company's assets without creditors' approval.[170] A similar type of pre-pack emerged through the creative and unprecedented use of section 363(b) of the US Bankruptcy Code.[171] Chapter 11 of the US Bankruptcy Code takes a different approach. Without defining pre-packs, chapter 11 provides a route to pre-packaging.[172] The introduction of chapter 11 pre-packs in the US was thus legislatively sanctioned and controlled. The regulatory implications (or more accurately, challenges) of pre-packs that emerge

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[164] *See id.* §§ 43, 45.

[165] *See id.* §§ 3(34) ("'[T]ransfer' includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer right, title, possession or lien. . . .").

[166] *Id.*

[167] *Id.* §§ 43, 45.

[168] *See id.* §§ 29A, 44, 47.

[169] *See* Anuj Jain v. Axis Bank Ltd., (2020) 8 SCC 401, 488, ¶ 32.1.

[170] *See* Adam Gallagher et al., *Pre-Pack Sales in the U.K.: Smoke Without Fire*, 28 AM. BANKR. INST. J., May 2009 at 38, 38–39 (describing the legal standing of pre-pack administrations in the UK).

[171] *See* 11 U.S.C. § 363(b) (2018).

[172] *See id.* § 1126(b).

from existing legislation and pre-packs that are deliberately introduced are very different and will be the subject of the following discussion. Given the diverse practices that can constitute a pre-pack, it is important that India chooses the most optimal route for their introduction. A comparison between the US and UK will make for apt guidance on this issue as both of these regimes contain different routes to the introduction of pre-packs.

1. Evolution of pre-packs in the UK

The UK insolvency regime is contained in the Insolvency Act 1986.[173] The Act provides for three routes to formal rescue, which include CVAs, administrative receivership, and administration.[174] Administrative receivership is declining in its use after the Enterprise Act 2002,[175] which only allowed creditors to appoint administrative receivers if they held a charge that was created prior to September 2003.[176] Thus, administrative receivership has largely been replaced with administration. This was a manifestation of the rescue-oriented nature of the Enterprise Act 2002.[177] The UK has seen a rise of pre-pack sales after the Enterprise Act's introduction of a more streamlined administration procedure including out-of-court appointment of administrators.[178] A study published in 2007 found that thirty-five percent of business sales were through pre-packs;[179] the same study also suggests that the actual percentage may be higher, somewhere between fifty to eighty percent.[180]

The UK began its paradigm shift from a collection and distribution oriented insolvency regime to a rescue oriented one after the publication of the Cork Report.[181] The Review Committee on Insolvency Law and Practice inquired into the UK's insolvency laws and recommended changes. On the basis of these recommendations, the UK Insolvency Act 1986 (currently in force) was drafted.[182] Pre-packs were a result of the shift towards a rescue culture in the UK.[183] More specifically, pre-packs emerged from the desire to stabilize CVAs in the context of insolvency.[184] The problem posed by the regular CVA method was that a single

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[173] Insolvency Act 1986, c. 45 (UK).

[174] *See id.* pts. I–III.

[175] *See* Enterprise Act 2002, c. 40, § 250 (UK); *see also* FINCH, CORPORATE INSOLVENCY LAW, *supra* note 5, at 327–28 ("[T]he Enterprise Act 2002 took away the floating charge holder's right to appoint an administrative receiver and, in doing so, largely replaced receivership with administration.").

[176] *See* FINCH, CORPORATE INSOLVENCY LAW, *supra* note 5, at 359–60.

[177] *See id.* at 254–55.

[178] *See generally In re* Transbus Int'l Ltd. [2004] EWHC (Ch) 932, [10] (UK); *see also* FINCH, CORPORATE INSOLVENCY LAW, *supra* note 5, at 458; FRISBY, *supra* note 25, at 15–16.

[179] *See* FRISBY, *supra* note 25, at 15–16.

[180] *Id.*

[181] *See* KENNETH CORK, REPORT OF THE REVIEW COMMITTEE ON INSOLVENCY LAW AND PRACTICE, 1982, Cmnd. 8558 (UK) [hereinafter CORK REPORT]; *see also* XIE, *supra* note 9, at 35.

[182] *See* CORK REPORT, *supra* note 181; FINCH, CORPORATE INSOLVENCY LAW, *supra* note 5, at 16–17.

[183] *See* XIE, *supra* note 9, at 35.

[184] *Id.* at 40.

creditor could ruin these efforts by filing a winding up petition.[185] The pre-pack essentially combines the formality and the protections of insolvency (such as the moratorium) with the flexibility of the CVA in the UK.[186]

a. Pre-packs as sales during administration

In a typical administration, the administrator has to present proposals for the reorganization of the company within eight weeks from the commencement of administration proceedings.[187] These proposals are voted upon and approved by the company's creditors through a simple majority.[188] All of these procedures happen under the protection of a moratorium on recovering securities and starting or maintaining legal proceedings against the debtor.[189] Anyone who wishes to pursue a remedy against a company undergoing administration needs the permission of the administrator or the court.[190] Schedule B1 prevents an administrator's proposal from affecting the rights of a secured creditor to enforce their security.[191] Accordingly, it is mostly the unsecured creditors who vote on the proposals to the extent of their debt.[192] Secured creditors also vote on the proposals, but only to the extent that their debt is not covered by their security.[193] A proposal is approved once a majority of creditors vote in its favor.[194] Pre-pack sales are made possible in the UK through the powers granted to the administrator. Schedule B1 also allows the administrator to exercise powers granted to it under schedule 1 of the Insolvency Act.[195] One of the powers conferred by schedule 1 is the ability to sell the debtor's property either through auction or private sale.[196] This power can be exercised without the authorization of creditors or the court's approval.[197] Pre-pack sales in administration have evolved through this route.

Unlike the process in a regular administration, most of the negotiations and decision-making in a pre-pack happens in the pre-formal stage (before the

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[185] *See id.*; FINCH & MILMAN, *supra* note 3, at 366–67.

[186] FRISBY, *supra* note 25, at 18–19.

[187] *See* Insolvency Act 1986, c. 45, sch. B1, ¶¶ 4, 49(5)(b) (UK).

[188] *See* The Insolvency (England and Wales) Rules 2016, SI 2016/1024, ¶ 15.34 (UK).

[189] *See* Insolvency Act 1986 sch. B1, ¶ 42.

[190] *See id.* ¶ 43.

[191] *Id.* ¶ 73 ("An administrator's statement of proposals under paragraph 49 may not include any action which . . . affects the rights of a secured creditor of the company to enforce his security.").

[192] *See* XIE, *supra* note 9, at 62.

[193] *See id.*

[194] *See id.* at 70.

[195] Insolvency Act 1986 sch. B1, ¶ 60 ("The administrator of a company has the powers specified in Schedule 1 to this Act.").

[196] *Id.* sch. 1, ¶ 2.

[197] *See In re* Transbus Int'l Ltd. [2004] EWHC (Ch) 932, [12] (UK) ("[A]dministrators are permitted to sell the assets of the company in advance of their proposals being approved by creditors. . . ."); *see also In re* Hellas Telecomms. (Luxembourg) II SCA, [2009] EWHC (Ch) 3199, [9] (UK).

administrator is officially appointed).[198] In a regular administration, the management has to function under the supervision of the administrator and cannot do anything that would conflict with the functions of the administrator.[199] In a pre-pack, the management of the distressed company is actively involved in finding new sources of funds, negotiating with existing creditors, and marketing a plan to potential buyers for the purchase of the company's business.[200] Pre-packs allow the management of the company more control over the insolvency resolution process. This change in the framework of decision-making has significant implications for the management's incentives to choose which method of administration they want to pursue. Unsurprisingly, the incumbent management is more incentivized to enter into pre-pack negotiations than they are to simply file a formal administration application without a pre-pack in place.[201]

During the pre-formal stage, the promoters, directors, shareholders, and creditors of the distressed company can hire insolvency professionals to help rescue the company.[202] These insolvency professionals need not be insolvency practitioners who can fulfil the statutory role of the administrator.[203] However, they are empowered to negotiate resolution plans that will be given effect in a statutory insolvency procedure.[204] Since these professionals are not office holders (unlike administrators), they are free to protect the interests of their client over those of other claimants of the company.[205]

Once a pre-pack is negotiated, there is a bias to conform to these negotiations even after an administrator has been appointed and the formal administration process has commenced.[206] This strong bias towards implementing the terms of a pre-pack exists largely because the resolution professional who helped negotiate the pre-pack is appointed as the administrator.[207] Further, it is often difficult to secure adequate funds in order to maintain a company's relationship with its suppliers and customers by the time administration proceedings have been filed.[208] Thus, while the

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[198] *See* FINCH & MILMAN, *supra* note 3, at 371, 397; *see also* XIE, *supra* note 9, at 35, 73; Walton, *supra* note 11, at 86.

[199] *See* XIE, *supra* note 9, at 61 ("[Directors] cannot exercise management powers which could interfere with the exercise of the administrator's duties and competences.").

[200] *See id.* at 93–94 ("Work at [the pre-formal negotiation] stage normally includes: seeking further funding for the company; consulting with the major creditors as regards their support to the likely options; and marketing the business and negotiating with prospective purchasers.").

[201] *See id.* at 94.

[202] *See id.* at 74–75.

[203] *See id.* at 75.

[204] *See id.* at 75, 92.

[205] *See id.* at 75.

[206] *See id.* at 78 ("[A]ny action or decision being taken during the negotiations stage could produce an initial set-up, and establish a single way forward with a strong bias towards the achievement of what was agreed in the pre-pack deal."); *see also* FINCH & MILMAN, *supra* note 3, at 397.

[207] *See* XIE, *supra* note 9, at 78; *see also* Wellard & Walton, *supra* note 25, at 147.

[208] *See* XIE, *supra* note 9, at 78 ("When the administrator is officially appointed, the condition facing the company may well be that . . . no or insufficient funding is available to keep the company trading."); *see also* Ellina, *supra* note 10, at 189–90 ("When it comes to CVAs, it is very difficult to obtain funding because of the fact that banks are concerned about 'throwing good money after bad.'").

administrator could potentially take the insolvency proceedings in a different direction than the pre-pack negotiations, they are more likely to stick with the plan they helped negotiate.[209] Therefore, pre-packs bypass creditors' voting rights and often keep them in the dark until after the sale is completed.[210] General creditors tend not to get as good a deal since the company's assets are usually undervalued when sold.[211] However, they are not empowered to do anything about this. Suing a company that has just come out of the insolvency resolution process is not a viable option; it is also difficult to prove malpractice against directors and insolvency professionals.[212]

2. Pre-pack routes in the US

Chapter 11 of the US Bankruptcy Code contains the law governing corporate reorganizations and includes a route to pre-packaging under section 1126(b).[213] Chapter 11 lays down rules for negotiating a plan and soliciting votes from creditors before a bankruptcy petition is filed.[214] The chapter 11 pre-pack route, thus, largely retains the informational and participation rights of creditors that would be granted to them in a regular insolvency proceeding. The key difference between a regular chapter 11 reorganization and a chapter 11 pre-pack is that, in the latter, creditors' votes are solicited before a bankruptcy petition is filed.[215] Another route to pre-packaging under the US Bankruptcy Code is section 363(b), through which the assets of a company undergoing chapter 11 reorganization proceedings can be sold without creditor approval.[216] A company involved in chapter 11 proceedings can, thus, proceed to execute a pre-pack sale under section 363(b) for its entire business.[217] For the sake of convenience, this Paper will refer to the statutory route to pre-packs under chapter 11 as "chapter 11 pre-packs," in order to differentiate them from section 363(b) sales.

a. Section 363(b) sales in the US

The loose counterpart of administration sales in the UK is the section 363(b) sale under the US Bankruptcy Code.[218] Section 363(b) allows a US bankruptcy trustee (analogous to an administrator) to sell, lease, or otherwise dispose of the property of

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[209] *See* Wellard & Walton, *supra* note 25, at 147.
[210] *See id.*; *see also* XIE, *supra* note 9, at 84; Finch, *Pre-Packaged Administrations*, *supra* note 133, at 7–8.
[211] *See* Wellard & Walton, *supra* note 25, at 153–54.
[212] *See* FINCH & MILMAN, *supra* note 3, at 379.
[213] 11 U.S.C. § 1126(b) (2018).
[214] *See generally id.* §§ 1123, 1126.
[215] *See id.* § 1126(b).
[216] *Id.* § 363(b).
[217] *See, e.g., In re* Gen. Motors Corp., 407 B.R. 463, 489–90 (Bankr. S.D.N.Y. 2009) (explaining section 363(b) permits the sale of the entirety of a debtor's business).
[218] *See* 11 U.S.C. § 363(b).

a corporate debtor once they enter into chapter 11 reorganization proceedings.[219] The use of section 363(b) as a means to implement pre-pack negotiations was not foreseen by the US Bankruptcy Code and was a result of business creativity.[220] The key difference between the UK and US laws for selling a debtor's property during insolvency proceedings is that the US law requires the debtor or trustee to give notice and conduct a hearing before effecting a sale.[221] While a hearing before a bankruptcy court is not required under law, virtually all section 363(b) sales seek court approval.[222] This protects purchasers of the debtor's assets from having to face any claims on the property.[223] The bankruptcy court will hear the objections of creditors before approving a section 363(b) sale.[224] The bankruptcy court hearing is not a substitute for the creditors' voting process under a typical chapter 11 reorganization. During these hearings, bankruptcy courts are not concerned with whether a majority of creditors would have voted for the proposed section 363(b) sale.[225] The US Bankruptcy Code does not provide any standards or guidelines that steer judicial evaluations of section 363(b) sales. Accordingly, courts have developed their own standards to adjudicate applications under section 363(b).[226] This is permissible under the wide powers given to Bankruptcy Courts under title 11.[227] Section 105(a) of the US Bankruptcy Code empowers bankruptcy courts to pass orders that they consider necessary to give effect to the provisions of the Code.[228]

b. Chapter 11 pre-packs

To commence involuntary bankruptcy proceedings, three or more unsecured creditors, having claims exceeding 16,750 USD, may file a bankruptcy application against the corporate debtor.[229] Thereafter, the corporate debtor has 120 days to submit an insolvency resolution plan.[230] Within these 120 days, the corporate debtor has the exclusive right to formulate a plan for the consideration of all creditors.[231]

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[219] *See id.*

[220] *See* Mark J. Roe & Joo-Hee Chung, *How the Chrysler Reorganization Differed from Prior Practice*, 5 J. OF LEGAL ANALYSIS 399, 407 (2013).

[221] 11 U.S.C. § 363(b)(1).

[222] *See* Nocilla, *supra* note 59, at 72 ("While court approval of the [section 363(b)] sale is not strictly required, it is common practice to seek court approval for the purchaser's benefit.").

[223] *See id.*

[224] *See* Jason Brege, Note, *An Efficiency Model of Section 363(b) Sales*, 92 VA. L. REV. 1639, 1643; *see also* XIE, *supra* note 9, at 205; Nocilla, *supra* note 59, at 72.

[225] *See, e.g.*, Comm. of Equity Sec. v. Lionel Corp. (*In re* The Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983) (adopting the rule that "requires that a judge determining a § 363(b) application expressly find . . . a good business reason to grant such an application" and discussing several factors to consider in making such a determination).

[226] *See* Brege, *supra* note 224, at 1649.

[227] *See* 11 U.S.C. § 105(a) (2018) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); *see also* XIE, *supra* note 9, at 209.

[228] 11 U.S.C. § 105(a).

[229] *See* 11 U.S.C.A. § 303(b) (West 2019).

[230] 11 U.S.C. § 1121; *see also* XIE, *supra* note 9, at 179; *Chapter 11—Bankruptcy Basics*, *supra* note 58.

[231] *See Chapter 11—Bankruptcy Basics*, *supra* note 58.

Once this period expires, other claimants can propose plans, which are then considered and voted upon.[232] The corporate debtor can also file a bankruptcy petition; this is typically known as voluntary bankruptcy.[233] Voluntary bankruptcies are usually accompanied with a reorganization plan that is approved by claimants and confirmed by the bankruptcy court in the same manner as a plan proposed during involuntary bankruptcy proceedings.[234]

Chapter 11 plans need to divide claimants into classes with other similarly placed claimants and provide them with a disclosure statement before they vote on the plan.[235] The disclosure statement needs to contain all information that would be material to a claimant's decision to vote on the plan.[236] A class of claimants approves a plan if they vote on it by a two-third majority of the total debt owed to the class, so that this vote represents at least half the claimants in the relevant class.[237] Claimants whose debts are being paid in full are deemed to have accepted the plan, and claimants who receive nothing under the plan are deemed to have rejected it.[238] Therefore, the votes that really need to be won by a plan are those of "impaired claimants" or claimants whose debts are not being fully paid.[239] A bankruptcy court will confirm a plan if it meets the requirements set out in section 1129 of chapter 11—one of these requirements is the unanimous approval of the plan by all classes.[240] However, in case such unanimous acceptance is not received by a plan, the bankruptcy court can still approve a plan through the cramdown provisions under chapter 11.[241] Cramdown provisions require at least one impaired class of creditors to approve the plan and that the plan treats all claimants in a fair and equitable manner.[242] In the ordinary course of chapter 11 proceedings, the plan is voted on and accepted after the commencement of the bankruptcy proceedings.[243]

Chapter 11 allows the corporate debtor to not only formulate, but also seek the approval of, a plan prior to the filing of a bankruptcy petition.[244] This is the other route to pre-pack insolvency in the US. In chapter 11 pre-packs, a plan and

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[232] *See id.*

[233] *See* 11 U.S.C. § 301; *see also* XIE, *supra* note 9, at 177.

[234] *Chapter 11—Bankruptcy Basics*, *supra* note 58.

[235] *See* 11 U.S.C. §§ 1122(a), 1125–1126.

[236] *See id.* § 1125*; see also* Mark D. Plevin et al., *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. TEX. L. REV. 883, 886 (2003).

[237] 11 U.S.C § 1126(c).

[238] *See id.* § 1126(f)–(g).

[239] *See id.*; *see also* XIE, *supra* note 9, at 182.

[240] *See* 11 U.S.C. § 1129(a)(7)–(8).

[241] *See id.* § 1129(b)(2)(A) (codifying the chapter 11 cramdown provisions); *see also* Brian P. Hanley, *Preserving the Creditor's Bargain in Chapter 11 Cramdown Scenarios*, 8 BROOK. J. CORP., FIN. & COM. L. 494 (2014) ("[The cramdown provision] permits a bankruptcy court to approve a plan of reorganization even over the objection of secured creditors.").

[242] 11 U.S.C. § 1129(b)(2)(A); *see also* XIE, *supra* note 9, at 183–84; Hanley, *supra* note 241, at 497–98 (explaining chapter 11's cramdown provisions and the "fair and equitable" standard).

[243] *Chapter 11—Bankruptcy Basics*, *supra* note 58.

[244] *See* 11 U.S.C. § 1126(b).

disclosure statement are filed before the bankruptcy court.[245] The court will conduct a single hearing to determine the adequacy of the disclosures and whether the plan meets the conditions under section 1129.[246] Even in pre-packaged chapter 11 reorganization plans, claimants need to be divided into classes where all members of each class are substantially similar to each other, and the plan needs to be approved by the requisite majorities under chapter 11.[247] The bankruptcy court retains the authority to scrutinize the classes of claimants and decide whether their demarcation (and consequently the vote of acceptance) is valid.[248] Once a pre-packaged reorganization plan is confirmed by the bankruptcy court, it will bind all claimants, notwithstanding whether or not they individually voted in favor of it.[249] The debtor's obligations to creditors prior to the plan will be replaced with those enumerated in the plan.[250] Chapter 11 pre-packs are typically faster than conventional chapter 11 reorganizations, which often take years to complete.[251] Chapter 11 pre-packs can be confirmed within thirty to forty-five days from the date of formal filing with the bankruptcy court.[252]

The chapter 11 sanctioned pre-pack is relatively straightforward and offers more protections to creditors than pre-packs in the UK.[253] This is chiefly done by requiring disclosures prior the plan's execution and preserving creditors' voting rights.[254] These protective measures, however, reduce the speed associated with chapter 11 pre-packs when compared to other pre-packs.[255] This route to pre-packaging in the US lends flexibility to negotiations and allows them to be carried out discreetly, but the need to obtain creditors' approval increases the time required to complete the pre-pack.[256] However, the regulation of chapter 11 pre-packs is more robust and leads to fairer outcomes. Pre-packs under section 363(b) and schedule B1 have been difficult to regulate, as new devices to ensure their fairness need to be imposed on an existing

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[245] *See* Plevin et al., *supra* note 236, at 888 ("[A] debtor in a pre-packaged bankruptcy typically files along with its petition, a plan and disclosure statement.").

[246] *Id.* ("The court will . . . frequently hold a single hearing to determine the adequacy of the pre-petition disclosure and whether the plan should be confirmed.").

[247] *See* 11 U.S.C. § 1126(b); *see also* XIE, *supra* note 9, at 189–90.

[248] *See generally* Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits in Chapter 11 Claim Classification*, 11 BANKR. DEVS. J. 1, 2–3 (1995) (examining claim classification provisions and respective court opinions exploring such provisions).

[249] *Id.* at 6.

[250] *See id.* at 5–6.

[251] *See, e.g.*, Plevin et al., *supra* note 236, at 888 (stating "[p]re-packaged asbestos bankruptcy cases . . . proceed on a more expedited schedule").

[252] *See id.*

[253] XIE, *supra* note 9, at 200 ("Compared with the UK pre-pack administration, the US pre-packed Chapter 11 reorganisation is more regulated and it retains most of the safeguard mechanisms built to protect the procedural fairness of a standard Chapter 11 reorganisation. . . .").

[254] *See id.*

[255] *See id.* at 194.

[256] *See* Kimon Korres, Note, *Bankrupting Bankruptcy: Circumventing Chapter 11 Protections Through Manipulation of the Business Justification Standard in § 363 Asset Sales, and a Refined Standard to Safeguard Against Abuse*, 63 FLA. L. REV. 959, 960–61, 966 (2011).

legislative paradigm that does not initially require them.[257] Some initiatives to regulate pre-packs and increase the fairness of their outcomes are discussed below.

B. Regulating Pre-packs: Assessing the Adequacy of Current Reformative Trends

The UK and US have both contemplated ways to make the pre-pack process a fairer one. In the UK, the focus has been on self-regulation and increasing transparency. The US has not implemented any pre-pack specific reforms related to transparency for section 363(b) sales. However, there has been a push to reduce the speed with which such sales are effectuated after chapter 11 proceedings commence.[258] Chapter 11 pre-packs are regulated by the US Bankruptcy Code itself and need to comply with most of the requirements applicable to regular reorganizations.[259] This Section discusses the current trends in pre-pack reforms and critically appraises their effectiveness.

1. Transparency and self-regulation driven reforms in the UK

a. Statement of Insolvency Practice 16

In order to increase the transparency associated with the pre-pack process, the Joint Insolvency Committee of the UK introduced the Statement of Insolvency Practice 16 of pre-packaged sales in administration ("SIP-16").[260] SIP-16 has been updated thrice since its introduction in 2009; the latest version having been issued in 2015.[261] SIP-16 has detailed transparency requirements; it requires resolution professionals to provide creditors with a brief history of the distressed company and a justification for why a pre-pack sale was undertaken.[262] Specifically, the administrator must explain why it was not appropriate to offer the business for sale through the regular administration procedure.[263] Moreover, the administrator is required not only to mention the marketing strategies undertaken, but also justify them to creditors through the SIP-16 statement.[264]

If an asset valuation is conducted, then this valuation, along with the actual consideration paid in the sale, must be included under SIP-16.[265] The identity of the

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[257] *See, e.g., id.* at 961 ("[T]here is a well-founded fear that quick asset sales run the risk of circumventing the Chapter 11 process.").

[258] *See id.*

[259] *See* XIE, *supra* note 9, at 200.

[260] INSOLVENCY SERVICE, REPORT ON THE FIRST SIX MONTHS' OPERATION OF THE STATEMENT OF INSOLVENCY PRACTICE 16 ¶ 2.6 (2009), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/301183/sip16-first_six_months_2009.pdf.

[261] *See* Statement of Insolvency Practice 16 (2015), https://www.companyrescue.co.uk/fileadmin/uploads/cr/Documents/SIP_16.pdf.

[262] *Id.* ¶ 16.

[263] *See id.* at app. (listing the items of information that should be included in the administrator's explanation).

[264] *See id.*

[265] *See id.*

purchaser should also be disclosed, especially if they are a connected party.[266] Importantly, administrators have to disclose the details of their appointment and the extent of their involvement prior to the formal administration process.[267] These disclosures help creditors decide whether they are satisfied with an administrator's conduct in a pre-packaged sale and whether they want to take any action against them for a breach of duty.[268] The limitation of SIP-16 is that information can be disclosed to creditors up to seven days after the transaction is completed.[269] It is thus difficult for affected creditors to actually act on these disclosures.[270]

Transparency requirements are expected to work through market forces for resolution professionals.[271] The expectation is that administrators who adhere to transparency requirements and are able to justify pre-packs properly will be preferred over others who do not comply with these requirements.[272] But this market for insolvency resolution professionals is also heavily influenced by the incumbent management and secured creditors (mostly) who play a role in appointing administrators and paying for pre-packs.[273] Therefore, there will always be a market for resolution professionals who can secure work in cooperation with the incumbent management and focus on the pre-pack negotiations, rather than the comprehensiveness of their SIP-16 statements.

b. The pre-pack pool

A more recent effort to increase the integrity of pre-packs, especially pre-packs involving connected parties, is the pre-pack pool recommended by the Graham Report.[274] The pre-pack pool comprises independent experts who review the proposed sale to a connected party and give their opinion on it.[275] This is a purely voluntary process and has not been widely used in the UK.[276] The UK's efforts

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[266] *See id.*

[267] *See id.*

[268] *See* Finch, *Pre-Packaged Administrations*, *supra* note 133, at 28 (explaining administration application disclosures protect creditors from abuse and expense); *see also* FINCH & MILMAN, *supra* note 3, at 379 (discussing how it is difficult for general creditors to sue companies that have empty pockets after the pre-pack asset sale is complete).

[269] *See* Anthony Wijaya, *Pre-Pack Administration Sale: A Case of Sub Rosa Debt Structuring*, 25 INT'L INSOLVENCY REV. 119, 132 n.67 (2016) (stating the disclosure by the SIP-16 should be provided within seven days after the transaction).

[270] *See id.* at 132 (articulating the disclosure of information to junior creditors effectively cuts them out of the negotiation process to their detriment); *see also* Wellard & Walton, *supra* note 25, at 145 n.7, 146 (explaining the administrator may sell company assets without calling a creditors' meeting because it occurs, by definition, after the pre-pack has been executed).

[271] *Cf.* PRE-PACK SALES REPORT, *supra* note 12, ¶ 1.1(discussing how improving the transparency requirements of pre-pack sales will help rescue businesses who have been affected by COVID-19).

[272] *See* XIE, *supra* note 9, at 102.

[273] *See id.* (highlighting management's influence over the appointment of IPs as administrators).

[274] *See* GRAHAM REPORT, *supra* note 11, at 59–62.

[275] *See* PRE-PACK SALES REPORT, *supra* note 12, ¶ 2 (describing the pre-pack pool as a group of independent, experienced business people who provide their opinion on a pre-pack sale).

[276] *See id.*

towards regulating pre-packs have been largely circumspect and inadequate because of their voluntary nature. The limitations of a voluntary, transparency-oriented regulatory regime have prompted writers in the UK to suggest these measures be made mandatory.[277] For instance, it has been suggested the pre-pack pool's approval needs to be made mandatory in order for it to effectively ensure assets are not being undersold to purchasers.[278] In the Pre-pack Sales Report, it was noted the pre-pack pool was not being adequately used.[279] Since its creation in 2015, the use of the pre-pack pool has actually steadily declined, resulting in only nine percent of connected party sales being referred to the pool in 2019.[280] This trend clearly illustrates the limitations of voluntary regulations in the context of pre-packs. There is no incentive for the administrator or purchaser involved in a connected party sale to subject their transaction to independent scrutiny (by the pre-pack pool) if they are not required to.[281]

In an effort to remedy the lack of independent evaluations in connected party sales, the Pre-pack Sales Report suggested two reforms.[282] The first is to make creditor approval mandatory before executing a connected party sale within eight weeks of the administration's commencement.[283] Notably, this recommendation helps increase transparency by putting eight weeks in between an administration and a connected party sale without creditor approval.[284] The second suggestion was made as an alternative to the first.[285] To avoid getting creditor approval for the sale, the purchaser in the transaction would have to obtain an independent evaluation of the transaction.[286] However, purchasers are allowed to obtain multiple independent evaluations, and the outcome of the evaluation would not be able to stop the sale from going forward.[287] This suggestion is less likely to result in fairer prices in connected party sales, as it allows purchasers to seek multiple independent evaluations and attaches no legal consequence to the result of the evaluation.[288]

Based on the Pre-pack Sales Report's suggestions, the UK Government proposed regulations for connected party sales through pre-pack administration.[289] These

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[277] *See, e.g.*, Bolanle Adebola, *The Case for Mandatory Referrals to the Pre-pack Pool*, 32 INSOLVENCY INTEL. 71, 75, 77 (2019); Vaccari, *supra* note 109, at 196–97.

[278] *See* Adebola, *supra* note 277, at 75, 77; Vaccari, *supra* note 109, at 196–97.

[279] *See* PRE-PACK SALES REPORT, *supra* note 12, ¶ 5.1 ("Stakeholders were disappointed that the Pool is not being used effectively, or often enough.").

[280] *See id.*

[281] *See id.*

[282] *Id.* ¶ 7.3.

[283] *Id.*

[284] *See id.*

[285] *See id.*

[286] *See id.* (indicating the need for the connected party purchaser to obtain an independent opinion in lieu of creditor approval).

[287] *See id.* ("Where a report states that the case is not made for the disposal, an administrator can still proceed with the disposal but will be required to provide a statement setting out the reasons for doing so.").

[288] *See id.*

[289] SOS, PROPOSED DRAFT REGULATIONS TO REQUIRE SCRUTINY OF PRE-PACK SALES TO CONNECTED PARTIES, 2021, (UK), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/922230/Draftregulationstext_1.pdf.

regulations propose to amend the UK Insolvency Act to provide for better scrutiny of connected party sales.[290] They require creditor approval for any connected party sale or an independent report evaluating the sale.[291] The purpose of the independent report is to comment on whether or not the consideration for the sale is reasonable.[292] If enacted, these regulations would make creditor approval compulsory for connected party sales in pre-packs in the absence of an independent evaluator's report.[293]

2. Pre-pack disclosures and regulation in the US

Chapter 11 pre-packs need to meet the same disclosure requirements as regular pre-packs.[294] This means they must provide creditors with "adequate information" to ensure that their vote is informed.[295] The standard for determining what comprises adequate information is that which would be enough for a "hypothetical reasonable investor" from a class of claimants to make a decision on a plan.[296] Chapter 11 accommodates the need for varied disclosure requirements depending on the accessibility of information about a company and its history.[297] It is for bankruptcy judges to make the final decision as to whether the disclosure given was adequate.[298] In the context of chapter 11 pre-packs, bankruptcy courts can order for votes to be re-solicited if it is found the debtor gave inadequate disclosure.[299] This provides a strong incentive for the debtor to ensure adequate information is provided to creditors before their votes are solicited. There is thus statutory guidance for disclosure requirements of chapter 11 pre-packs. The more contentious issue in the US has been the regulation of section 363(b) pre-packs.

The 2014 Report of the American Bankruptcy Institute Commission (the "ABI Report") made recommendations to increase the stakeholder protections under a

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[290] *See generally id.*

[291] *See id.* Regs. 6–7.

[292] *See id.* Reg. 8(3)(f)(i).

[293] *See id.* Regs. 5(a), 6, 7.

[294] *See* 11 U.S.C. §§ 1125(a), 1126(b)(2) (2018); *see also* Pelvin et al., *supra* note 236, at 888.

[295] *See* 11 U.S.C. § 1125; *see also* Plevin et al., *supra* note 236, at 888 (explaining a court will hold a hearing after a debtor in a pre-packaged bankruptcy files its disclosure statement to determine the "adequacy" of the disclosure statement).

[296] Glenn W. Merrick, *The Chapter 11 Disclosure Statement in a Strategic Environment*, 44 BUS. LAW. 103, 109–10 (1988); *see also* Nicholas S. Gatto, Note, *Disclosure in Chapter 11 Reorganizations: The Pursuit of Consistency and Clarity*, 70 CORNELL L. REV. 733, 738–39 (1985) ("The flexible 'hypothetical reasonable investor' standard . . . allow[s] the debtor to draw up a disclosure statement based on the state of his books rather than stretching his financial means by preparing an unnecessarily detailed statement.").

[297] *See* 11 U.S.C. § 1125(a)(1) ("'[A]dequate information' means information of a kind, and in sufficient detail, as far as is *reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records*. . . ." (emphasis added)).

[298] *See id.* (listing considerations for the court "in determining whether a disclosure statement provides adequate information").

[299] *See, e.g., In re* Source Enters., Inc., No. 06-11707 (AJG), 2007 WL 7144778, at *4 (Bankr. S.D.N.Y. July 31, 2007) (finding the disclosure statement did not provide adequate information and ordering the debtors to amend the disclosure statement and re-solicit votes upon its approval).

section 363(b) sale.[300] In the status quo, secured creditors have a lot of control over section 363(b) sales by virtue of their control over the debtor.[301] Unsurprisingly, section 363(b) sales usually prioritize the interests of secured creditors, as they are privy to the negotiations that result in the final sale.[302] The ABI Report made two important recommendations to promote transparency and unsecured stakeholders' participation and protection. The first recommendation was a sixty-day moratorium on section 363(b) sales.[303] This suggestion is similar to the one in the UK's Pre-pack Sales Report to the extent that the likelihood of creditors having notice of the sale before it is completed or brought to the bankruptcy court for approval is increased.[304] The ABI Report noted that after 2000, the speed with which section 363(b) sales are being approved has significantly increased.[305] This reduces the extent of marketing involved in the sale and also reduces the time available to creditors and stakeholders to prepare and file their objections before the bankruptcy court during the hearing.[306] Accordingly, the report recommended a sixty-day moratorium on section 363(b) sales be imposed after a chapter 11 petition is filed.[307] This would mean that a sale cannot be proposed immediately after chapter 11 proceedings commence and that sixty days would have to elapse. The ABI Report recognized there would be some cases that require expedited sales and, in such a case, the sixty-day moratorium may be detrimental to the value of the company's assets.[308] However, these exceptional cases should not inform the basis of general rulemaking for section 363(b) sales.[309]

The second recommendation directly addressed the reduced protections given to stakeholders under section 363(b) sales compared to chapter 11 plans. The ABI Report recommended that standards should be legislated for the confirmation of section 363(b) sales just as they exist for chapter 11 plans under section 1129 of title 11.[310] In the context of a section 363(b) sale, these provisions would require that the plan is proposed in good faith, that it is reasonable, and that some of the purchase money is reserved for the payment of unsecured creditors, as per their statutorily recognized priority.[311]

These ABI recommendations have not been implemented by Congress; they also faced strong opposition from the industry, specifically, the Loan Syndications and

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[300] *See* AM. BANKR. INST., FINAL REPORT AND RECOMMENDATIONS: COMMISSION TO STUDY THE REFORM OF CHAPTER 11, at 197 (2014) [hereinafter ABI REPORT 2014].

[301] *See* Nocilla, *supra* note 59, at 75.

[302] *See id.* at 75–76.

[303] *See* ABI REPORT 2014, *supra* note 300, at 87.

[304] *See id.*; PRE-PACK SALES REPORT, *supra* note 12, ¶ 7.3.

[305] *See* ABI REPORT 2014, *supra* note 300, at 84–85.

[306] *See id.*

[307] *Id.* at 87.

[308] *See id.* at 86.

[309] *See id.* at 86–87 (stating "melting ice cube" exceptions "should not define the rules").

[310] *See id.* at 201, 206.

[311] *See id.* at 201; *see also* 11 U.S.C. § 507(3) (2018) (codifying the priorities of claims and expenses with unsecured claims listed as third in priority).

Trading Association[312] (the "LSTA").[313] The LSTA acknowledged 363(b) sales can operate to the prejudice of unsecured creditors, but it maintained that the need for court approval was a sufficient check on any excess of section 363(b) sales.[314] The LSTA also objected to the connection between 363(b) sales and increased control by secured creditors on the grounds that there was inadequate empirical evidence to suggest this.[315] However, other scholars would disagree with this view, and there is ample literature documenting the increased influence of secured creditors in a section 363(b) sale compared to a chapter 11 reorganization plan.[316]

3. The limitations of non-statutory regulations

While the issue with pre-packs ostensibly appears to be one related to voting rights and information asymmetry, this itself, paints an inaccurate picture. In the UK, smaller creditors are disenfranchised even in regular administration proceedings.[317] Studies have found that even in regular administrations, unsecured creditors do not vote on plans to sell the company.[318] Transparency, though an important means to secure fairness and accountability in pre-packs, informs creditors but does not ensure creditors are able to act on this information.[319] More timely disclosures about the pre-pack process will help creditors (such as suppliers) make decisions about sustaining their relationship with the company and prompt them to take legal action; these disclosures seldom alter the position of smaller creditors once a pre-pack sale is complete.[320] The informational focus of the SIP-16 does not increase creditor participation.[321] It is only participation that can actually give creditors a say in how their interests are being dealt with in a pre-pack.[322] The voluntary nature of the pre-pack pool makes it vulnerable to the same problems. Without a legislative mandate or some sanction associated with not using the pool, there is little incentive for parties to consult the pre-pack pool for connected party sales.

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[312] The LSTA is the principal advocate for the corporate loan market in the US. *See About*, LSTA, https://www.lsta.org/about/ (last visited Mar. 14, 2021).

[313] *See* David Griffiths & Doron Kenter, *LSTA to ABI Commission of Chapter 11 Reform: No Way, José*, AM. BANKR. INST., https://www.abi.org/feed-item/lsta-to-abi-commission-on-chapter-11-reform-no-way-jos%C3%A9 (last visited Mar. 14, 2021).

[314] *See id.*

[315] *See id.*

[316] *See* Nocilla, *supra* note 59, at 76 (referencing a study comparing section 363 sales with plan sales during the years 1996 to 2010, which found the main reason for the lower prices in section 363 sales was the diminished leverage of junior creditors relative to plan sales); Korres, *supra* note 256, at 967; Anne M. Anderson & Yung-Yu Ma, *Acquisitions in Bankruptcy: 363 Sales Versus Plan Sales and the Existence of Fire Sales*, 22 AM. BANKR. INST. L. REV. 1, 17 (2014).

[317] *See* FINCH & MILMAN, *supra* note 3, at 380.

[318] *See id.* at 379 n.50.

[319] *See id.* at 384–86.

[320] *See* XIE, *supra* note 9, at 76.

[321] *See id.* at 109; Wijaya, *supra* note 269, at 132.

[322] *See* Wijaya, *supra* note 269, at 132.

These deficiencies in the UK's insolvency regime have been linked to the lack of legislative recognition of pre-packs and the consequent lack of effective regulation.[323] It has been suggested the courts need to play a more active role in approving pre-pack sales.[324] Courts in the UK tend to defer to the discretion of an administrator when it comes to pre-pack sales.[325] The US model of courts approving section 363(b) sales has been considered as a guide for judicial intervention in pre-pack sales in the UK.[326] However, the treatment of section 363(b) sales by courts in the US is, in and of itself, quite complex. These issues, along with an examination of the UK's deferential approach to pre-pack sales during administration, are discussed in the next Subsection.

C. Judicial Treatment of Pre-packs

1. Trends in the UK

The deference shown to an administrator's decisions by UK courts in the context of pre-packs can be linked to the nature of the office of the administrator.[327] Before 2015, companies could effectuate a pre-pack sale by entering into voluntary liquidations and appointing a liquidator who was agreeable to the company's plan.[328] This process, like pre-packs through administration, allowed the assets of a company to be disposed of without creditors' approval.[329] The UK Government legislated against this practice in 2015 by amending section 166 of the Insolvency Act—the amendment required the court to approve the decisions of liquidators.[330] The key difference between administrators and the insolvency practitioners who used to be appointed during voluntary liquidations is that the former are always office bearers, whereas the latter did not have to be qualified office holders.[331] This may be one of the reasons why the UK has not legislated any statutory controls for pre-packs while it has effectively prevented the use of voluntary liquidations to pre-packs.[332] Courts in the UK, thus, perform important oversight functions in the context of pre-packs. Given the absence of any legislation on the issue, courts are the only authority that can decide on the validity of a pre-pack sale during administration.

A challenge to a pre-pack is made in the form of a challenge to the administrator's decision to sell substantially all the assets of a company without creditor approval. On multiple occasions, UK courts have held an administrator's schedule I power to

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[323] *See* Wellard & Walton, *supra* note 25, at 146.
[324] *See, e.g.*, Wijaya, *supra* note 269, at 132–33; Vaccari, *supra* note 109, at 188.
[325] *See* Wijaya, *supra* note 269, at 133.
[326] *See id.*
[327] *See* Wellard & Walton, *supra* note 25, at 149–50.
[328] *See id.* at 153.
[329] *See id.* (explaining liquidators would sell the business without ever calling a creditors' meeting).
[330] *See id.* at 153 & n.69 ("Section 166 of the Act was passed specifically to outlaw this practice by requiring the court's sanction to any sale by the liquidator prior to the creditors' meeting.").
[331] *See id.* at 153; CHRIS HOWARD, SULLIVAN & CROMWELL LLP, LAW & PRACTICE UK 578–79 (2014).
[332] *See* Wellard & Walton, *supra* note 25, at 153.

sell a debtor's assets during administration extends to the ability to sell *all* of the debtor's assets.[333] In *In re T & D Industries PLC*,[334] the question before the court was whether the administrator needed the court's approval to sell the debtor's property under the Insolvency Act (as it was before the Enterprise Act).[335] The court held the administrator could exercise its powers before the proposals were approved by the company's creditors.[336] Section 17 of the Insolvency Act (prior to amendments effectuated through the Enterprise Act) empowered the administrator to manage the business and property of the company in accordance with the court's directions. The court held the phrase "in accordance with any directions given by the court" did not mean that the court's permission was required to exercise its powers.[337] Rather, the phrase meant that if any directions were given by the court, the administrator must follow them. Thus, the administrator was not precluded from using its powers based on its own initiative.[338]

The judgment recognized that a decision to sell all or substantially all assets prior to the meeting of creditors would effectively nullify the creditors' right to vote on the administrator's proposal.[339] However, there are some situations that warrant such expedient action. The court held the administrator must be conscious of the implications of its decision on creditor's decision-making rights and weigh them appropriately with other factors affecting the case.[340] Suggested wherever it was possible, the administrator must at least consult the company's creditors before a decision to sell the assets of the company is made.[341] This case was decided prior to the Enterprise Act 2002, which amended the Insolvency Act,[342] and the same issue was again raised with regard to the amended Insolvency Act in *In re Transbus International Ltd*.[343] The court remarked that the Enterprise Act reflected a conscious

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[333] *See, e.g., In re* T & D Indus. PLC [2000] 1 WLR 646 (Ch) at 647 (UK) ("The issue [in this case] is whether, without a specific direction of the court, an administrator of a company appointed under section 8(3) can dispose of any or all of the assets of the company prior to the approval of his proposals by the company's creditors at a meeting pursuant to section 24.").

[334] *Id.*

[335] *See id.* at 647.

[336] *Id.* at 650 (finding "unless there is anything in the administration order to the contrary, which would be unlikely, the administrator can effect [asset] disposal[s] without the leave of the court," before a creditors' meeting).

[337] *Id.* at 650, 657.

[338] *See id.*; *see also In re* Transbus Int'l Ltd. [2004] EWHC (Ch) 932, [12] (UK) ("[A]dministrators are permitted to sell the assets of the company in advance of their proposals being approved by creditors. . . .").

[339] *In re* T & D Indus. [2000] 1 WLR (Ch) at 652 (noting one problem with the ultimate interpretation of the administrator's powers under the Act is that "it would seem surprising if an administrator should be effectively free to exercise his s.14 powers as he wishes until the creditor's s.24 meeting, and only thereafter can the creditors constrain him by the terms of the approved administrator's proposal as amended, if at all, or by rejecting the administrator's proposals").

[340] *See id.* at 657 (stating administrators should not take an unfair advantage because creditors' rights are limited).

[341] *See id.*

[342] *See In re* Transbus Int'l [2004] EWHC (Ch) at [2] ("This is an issue which had been the subject of conflicting decisions under the provisions of the Insolvency Act prior to its amendment by the Enterprise Act 2002, but was resolved . . . in *Re T&D Industries plc*. . . .").

[343] *Id.*

decision of the legislature to reduce the court's involvement in administrations.[344] After perusing the provisions of schedule B1, the court held administrators retained the power to dispose of the company's property without the approval of the court or the company's creditors.[345] Courts in the UK have thus authorized administrators to engage in pre-packaging, and this sanction has even been extended to cases where a major creditor has objected to the pre-pack.[346]

The UK's courts have therefore embraced an administrator's power to dispose of a company's assets before a creditor's vote. This power of the administrator has been upheld by UK courts despite multiple challenges.[347] In the absence of the ability to challenge the administrator's power to carry out a business sale, creditors have challenged the administrator's appointment itself.[348] This would have an implication on the success of a pre-pack, as a newly appointed administrator will not have participated in pre-pack negotiations and will not favor the pre-packaged sale. Two important cases that discuss the grounds on which an administrator's appointment can be challenged in the context of a pre-pack are discussed below.

a. Challenging an administrator's appointment

In *Clydesdale v. Smailes*,[349] the court had to rule on an application to replace the administrator in an administration proceeding. The facts of this case were similar to those of a typical pre-pack sale, with the only difference being the sale was completed upon the appointment of the administrator.[350] In *Clydesdale*, the sale agreement stated it would be completed upon the appointment of an administrator and would be voided if no administrator was appointed.[351] The creditors challenging the administrator's appointment noted the administrator was involved in the pre-pack negotiations and had failed to consult the distressed firm's major creditors before entering into an agreement to sell the firm.[352] Further, notice of the pre-pack was given only minutes before the administrator was appointed (thus, commencing administration).[353] There was also a lack of transparency about how the sale price was determined; this was relevant because the proprietor of the distressed firm who negotiated the sale was offered a well-paid position at the firm that was purchasing

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[344] *Id.* at [14].
[345] *See id.* at [12]–[14].
[346] *See* DKLL Solics. v. Her Majesty's Revenue and Customs [2007] EWHC (Ch) 2067, [18] (UK) ("The court could, exercising its powers under paragraph 55.2 of Schedule B(1), authorise the implementation of those proposals, notwithstanding the opposition of the majority creditor."); *see also* FINCH & MILMAN, *supra* note 3, at 378.
[347] *See, e.g.*, Clydesdale Fin. Servs. v. Smailes [2009] EWHC (Ch) 1745, [31] (UK).
[348] *See, e.g., id.* at [39].
[349] *Id.*
[350] *Id.* at [6].
[351] *Id.* at [5].
[352] *Id.* at [6].
[353] *Id.* at [8].

his distressed firm.[354] Together, these factors convinced the court there was a need for an independent inquiry into the sale, and that the administrator could not conduct such an independent inquiry because of his involvement in the negotiation of the sale.[355]

The precedent set in *Clydesdale* was followed in *Ve Vegas Investors IV LLC v. Henry Shinners*.[356] Even in *Ve Vegas*, the creditors challenged the appointment of the administrator on the grounds that an independent inquiry into the sale was called for and that this could not be carried out by an administrator who had been involved in the pre-formal negotiations.[357] Specifically, the creditors showed there existed a case for investigation into the directors' conduct and whether they had committed a breach of duty.[358] Normally, an administrator would carry out this investigation, but in this case (as in *Clydesdale*), the administrators had a conflict of interest since they were engaged in the pre-formal negotiations leading up to their appointment.[359]

The cases discussed above reveal that pre-packs can be challenged in the UK by challenging the appointment of an administrator, specifically with respect to its independence. In cases where the court has concluded the administrator needs to be removed, it has not commented on the validity of the pre-pack itself.[360] Rather, in these cases, the court agreed an independent inquiry into the sale or the company's affairs was needed; the administrators having participated in the pre-pack negotiations could not carry out this independent review.[361] It appears the courts consider the wishes of the majority creditors when deciding whether to remove an administrator, but they will not be bound by what the creditors consider appropriate.[362] In the absence of such accusations as those cast in *Smailes* and *Ve Vegas*, the merits of a pre-pack and whether it is the appropriate decision in a particular case will be left to the administrator's discretion.[363]

2. Judicial treatment of pre-packs in the US

Much like chapter 11 pre-pack disclosures, the judicial treatment of chapter 11 pre-packs is governed by the same provisions as regular chapter 11 plans.[364] The US bankruptcy court has the ability to scrutinize a plan and ensure it meets the requirements of section 1129.[365] The bankruptcy court has the ability to designate or void a plan's division of creditors into classes if the same has been done to

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[354] *See id.* at [18].
[355] *See id.* at [30].
[356] Ve Vegas Invs. v. Henry Shinners [2018] EWHC (Ch) 186 (UK).
[357] *Id.* at [19].
[358] *Id.* at [20], [22]–[23].
[359] *Id.* at [27].
[360] *See, e.g.*, Sisu Capital Fund Ltd. v. Tucker [2005] EWHC (Ch) 2170 (UK).
[361] *See, e.g., id.* at [433].
[362] *See id.* at [584]; *Ve Vegas*, [2018] EWHC (Ch) at [37].
[363] *See In re* Hellas Telecomms. (Luxembourg) II SCA [2009] EWHC (Ch) 3199, [8] (UK).
[364] *See* XIE, *supra* note 9, at 200–01; Markell, *supra* note 248, at 16–18.
[365] *See* Markell, *supra* note 248, at 18–19.

manufacture a consensus, without having regard for the characteristics of the creditors in each class.[366] This practice has been referred to as "gerrymandering" in the bankruptcy context and eschewed by courts.[367] Overall, the judicial standards applied to regular chapter 11 plans are retained even when a bankruptcy court is presented with a chapter 11 pre-pack. Section 363(b) sales, however, do not have any statutory guidelines for the judiciary to rely on.[368] Unsurprisingly, the development of judicial standards for approving section 363(b) sales has been inconsistent across different courts in the US.[369]

a. Section 363(b) pre-pack sales

The Second Circuit Court of Appeals in *In re Lionel* had to decide whether Lionel Corp. could sell its eighty-two percent share in Dale (amounting to one third of Lionel's assets).[370] Unlike Lionel, Dale was not subject to bankruptcy proceedings, and its business (manufacturing electronic components) was relatively resilient in the face of market fluctuations.[371] The Second Circuit acknowledged that a literal reading of section 363(b) would effectively bypass the reorganization scheme under chapter 11 of the US Bankruptcy Code.[372] The court concluded there was no risk of the value of Dale's stock diminishing in the absence of the sale.[373] The court used precedent to hold some level of urgency needed to be established in order to permit a sale of a large chunk of the debtor's assets before a reorganization plan is confirmed.[374] In addition to the likely change to the asset's value in the future, the court held bankruptcy judges must consider the proportional value of the asset to the rest of the estate, the probability of a reorganization plan being confirmed in the future, and the time that has elapsed since the bankruptcy petition was filed.[375] These factors were suggested as guidelines rather than as an exhaustive list.[376] The guidelines indicate section 363(b) proceedings should not be an alternative to the ordinary process of reorganization under chapter 11 of the US Bankruptcy Code.[377] Applying these guidelines to the facts of *Lionel*, the Second Circuit held there was no good business justification to sell Lionel's share in Dale—Dale's price was

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366 *See id.* at 18.

367 *See id.* at 2–3, 16.

368 *See* XIE, *supra* note 9, at 209, 222.

369 *See id.* at 221–22.

370 Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* The Lionel Corp.), 732 F.2d 1063, 1065 (2d Cir. 1983).

371 *See id.*

372 *Id.* at 1066.

373 *Id.* at 1071–72.

374 *See id.* at 1070–71 (explaining case law requires a finding of "perishable" or "deteriorating" property, or there must be an "emergency" before a debtor's property could be "sold outside the ordinary course of business").

375 *Id.* at 1071.

376 *Id.*

377 *See id.* (explaining section 363(b) and chapter 11 are not mutually exclusive, but should be used in conjunction when appropriate).

increasing, there was no urgent need to sell the stock to preserve its value, and the stock was being undervalued in the sale.[378]

Bankruptcy courts have also developed protections to ensure that section 363(b) sales do not predetermine the design of the actual chapter 11 reorganization plan. In *In re Braniff Airways Inc*.,[379] the Fifth Circuit Court of Appeals held a sale of all of the debtor company's assets was impermissible.[380] The court identified the following issues with the transaction that made it untenable. First, part of the sale consideration was reserved only for the debtor's employees, shareholders, and (to some extent) unsecured creditors.[381] This effectively dictated the terms of a future reorganization plan, which could not be allowed.[382] Second, the transaction also prevented creditors from exercising their chapter 11 voting rights and, third, altered creditors' rights by releasing the debtor of claims against it.[383] The court noted these conditions went beyond the ambit of a mere sale of the debtor's assets.[384] Transactions (such as the one in *Braniff*) that effectively decide the direction of chapter 11 proceedings or effectuate a reorganization plan through section 363(b) are considered to be *sub rosa*[385] and thus impermissible.[386]

The cases discussed above attempted to preserve the chapter 11 reorganization process and set guidelines for when sales under section 363(b) would be permissible. However, these guidelines have not been strictly adhered to in subsequent decisions. For instance, the court in *In re Chrysler LLC*[387] permitted the sale of substantially all of Chrysler's assets to another company through section 363(b). While the court referred to the *Lionel* standard in *Chrysler*, scholars have remarked that a diluted version of the standard was applied.[388] There was also a *sub rosa* issue where some lien holders (funds overseeing the investment of retirement assets) received only a third of the value of their claims as a result of the sale, and their collateral was transferred to the purchasing company.[389] It is unlikely the lien holders would have actually voted to approve a plan with these terms under chapter 11.[390] However, since the sale was designed under section 363(b), there was no need for a vote; once the

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[378] *Id.* at 1071–72.

[379] Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983).

[380] *See id.* at 940.

[381] *See id.* at 939–40.

[382] *Id.* at 940; *see also* XIE, *supra* note 9, at 212–13.

[383] *In re* Braniff Airways, 700 F.2d at 940; *see also* XIE, *supra* note 9, at 212–13.

[384] *See In re* Braniff Airways, 700 F.2d at 940; *see also* XIE, *supra* note 9, at 212–13.

[385] *Sub rosa* is a Latin phrase. In the context of section 363, it refers to transactions that are not public and are carried out in secrecy. *See* XIE, *supra* note 9, at 211 n.23.

[386] *See, e.g., In re* Braniff Airways, 700 F.2d at 940 (holding a debtor may not circumvent "Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets").

[387] 405 B.R. 84, 95–96 (Bankr. S.D.N.Y. 2009).

[388] *See id.* at 94–95; XIE, *supra* note 9, at 217 (suggesting the court in *In re Chrysler* applied the business justification analysis from *In re Lionel* inconsistently, relying on the principle only for factual comparisons).

[389] *See In re* Chrysler, 405 B.R. at 98–99.

[390] *See* Korres, *supra* note 256, at 966.

court approved the sale, it was binding on all claimants.[391] The court ultimately held the plan was not *sub rosa* because the purchaser (Fiat) was paying a fair price for Chrysler's assets.[392] Fiat's offer (2,000,000,000 USD) exceeded the liquidation value of Chrysler (800,000,000 USD).[393] The focus of the *sub rosa* analysis in *Chrysler* was not on the procedural implication of the sale and how it effectively reorganized the corporation. Rather, the court emphasized the attractiveness of the plan given that there were no alternative purchasers and that the price was fair.[394]

III. DEVELOPING A PRE-PACK FRAMEWORK FOR INDIA

Unregulated pre-packaging is capable of reducing insolvency procedures to a conduit for pre-formal negotiations. Pre-packs effectively bypass the mechanisms in insolvency procedures designed to ensure information dissemination and a fair opportunity for creditors to voice their concerns and vote.[395] Pre-packs may also reduce the competitiveness of plans, as they are inadequately tested by the market.[396] The lack of publicity, which is a benefit of the pre-pack, militates against inviting multiple offers and carrying any public marketing of the plan.[397] Unsecured creditors, individual bondholders, etc. are more likely to get steamrolled in pre-packs.[398] The interests of these stakeholders have been woven into insolvency regimes across the world due to the recognition that the costs of insolvency are not borne solely by the company's financial creditors.[399] However, section 363(b)-and schedule B1-style pre-packs in the US and UK tend to ignore those who do not have strong pre-insolvency rights against the debtor.[400] It has been argued pre-packs that retain creditor protections or require court approval are not pre-packs in the true sense, as they deny parties the benefits of a quickly executed sale.[401] However, this is a very conservative view; as already indicated, pre-packs exist on a spectrum, as do their benefits, and the speed offered by a pre-pack is usually inversely proportional to the protections retained for smaller creditors.[402] Chapter 11 proceedings in the US are

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[391] *Id.* (indicating there was no need to discuss the outcome of a possible vote because the court approved sale under 363(b) was automatically binding on all claimants).

[392] *In re* Chrysler, 405 B.R. at 97.

[393] *Id.* at 97–98.

[394] *See id.* at 96–98; *see also* XIE, *supra* note 9, at 216.

[395] *See* Neil Devaney, *A Step in the Wrong Direction?—UK and US Regulators Must Turn Their Attention to the Rise of Pre-Packaged Insolvencies*, 26 INT'L FIN. L. REV. 26, 26 (2007).

[396] *See* PRE-PACK SALES REPORT, *supra* note 12, ¶ 3.1; *see also* GRAHAM REPORT, *supra* note 11, at 20, 23; FINCH & MILMAN, *supra* note 3, at 378.

[397] *See* XIE, *supra* note 9, at 96–97 (explaining the "reasons for limited marketing in pre-pack sales").

[398] *See* FINCH & MILMAN, *supra* note 3, at 378–79; *see also* Walton, *supra* note 11, at 87.

[399] *See* XIE, *supra* note 9, at 10–11; *see also* Elizabeth Warren, *Bankruptcy Policy*, 54 UNIV. CHI. L. REV. 775, 789–90 (1987) ("By definition, the distributional issues arising in bankruptcy involve costs to some and benefits to others.").

[400] *See* FINCH & MILMAN, *supra* note 3, at 379, 407; *see also* Korres, *supra* note 256, at 961.

[401] *See* Walton & Wellard, *supra* note 25, at 159.

[402] *See* Walton, *supra* note 11, at 87 (acknowledging potential grievances that unsecured creditors may have with the decision to move swiftly by using the pre-pack process).

thus pre-packs, even though they are very different from the pre-pack sales seen under section 363(b) and schedule B1 in the UK.

A. Choosing a Pre-pack Route

The pre-pack regimes under schedule B1 of the UK and section 363(b) of the US are attractive options for India because they enable quick resolutions without having to solicit creditor approval for a plan. As already discussed, the IBC does not empower the resolution professional to sell a corporate debtor's assets.[403] Nonetheless, Parliament is at liberty to change this and enhance the powers of the resolution professional to include the sale of a corporate debtor's assets. This would facilitate the spontaneous evolution of pre-packs in India. While this is one viable option to introduce pre-packs, in our view it may be better for India to introduce pre-packs by providing a pre-pack track under the IBC. This would be similar to the US Bankruptcy Code, which has made provisions to allow a debtor to negotiate and solicit approval for a plan before it files for chapter 11 reorganization.[404] It has the added benefit of doing away with the need to define a pre-pack, something that has proven difficult given the spectrum of agreements and transactions that constitute pre-packs.[405]

Recognizing pre-packs through legislation will give lawmakers the ability to decide how pre-packs interact with the rest of India's insolvency regime. The Supreme Court of India has tenaciously upheld the financial creditor's right to file an insolvency application upon a default, notwithstanding any prior agreement with the debtor.[406] While such an application of the IBC has provided certainty to financial creditors, it has the potential to derail the formal part of the pre-pack process. It is important to remember a pre-pack is often negotiated after a default has occurred.[407] In case a majority of creditors agree to the pre-pack and decide to file formal insolvency proceedings under the pre-pack route, lawmakers should ensure that the regular insolvency resolution route is no longer open to other creditors. The Supreme Court of India has strictly interpreted the provisions of the IBC and allowed a financial creditor to file an insolvency application against a debtor, even if the debt is disputed or if it is alleged that the creditor has not fulfilled their obligations toward the debtor.[408] The moratorium of the pre-pack should be explicitly extended to cover any invocation of the regular insolvency resolution proceedings under the IBC;[409] this will avoid multiple insolvency applications against the same debtor.

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[403] *See* Singh, *supra* note 57, at 1; *see also* Kothari & Bansal, *supra* note 61, at 69.

[404] *See* 11 U.S.C. § 1126(b) (2018).

[405] *See* XIE, *supra* note 9, at 142; *see also* FINCH & MILMAN, *supra* note 3, at 400–01; Finch, *Pre-Packaged Administrations*, *supra* note 133, at 13–14.

[406] *See, e.g.*, Innoventive Indus. Ltd. v. ICICI Bank, (2018) 1 SCC 407 (India).

[407] *Cf.* XIE, *supra* note 9, at 72–74; *see also* The Insolvency and Bankruptcy Code, 2016, §§ 6–7 (India).

[408] *See Innoventive Indus.*, 1 SCC at 438, ¶ 28, 440, ¶ 34.

[409] *See* Singh, *supra* note 57, at 10.

The MCI Pre-pack Report opts for the more deliberate route by proposing a pre-pack track.[410] Under the pre-pack track, creditors would have to approve the commencement of pre-pack negotiations through a simple majority.[411] Thereafter, once the plan is filed before the NCLT, they will have to approve of it once again, this time adhering to the sixty-six percent majority requirement for the approval of an insolvency resolution plan.[412] While the decision to retain creditor voting rights seems to be in line with the regulatory efforts of the UK and US to empower claimholders, it is unclear why the Report opts for a two-fold voting process. A more flexible, and equally empowering, approach would be to allow the corporate debtor the option to solicit the required votes (sixty-six percent) before the plan is filed with the NCLT. In such a case, the NCLT's function would be similar to that of the US Bankruptcy Code, and it would ensure that the votes were solicited while following statutory procedures.

In terms of the types of transactions allowed in the context of a pre-pack, the MCI Pre-pack Report expresses a preference for the reorganization of the corporate debtor over both liquidation and the sale of the corporate debtor's assets.[413] The rationale for this is two-fold. The first refers to the objectives of the IBC. The second is rooted in a concern of misuse by which the liabilities of the corporate debtor are attached to its shell while the actual business is sold free and clear of any obligations. If this prohibition of asset sales is implemented in the pre-pack design, it would considerably restrict the freedom and scope of negotiations involved in the pre-packaging process. While the objectives of the IBC prioritize rehabilitation, there is nothing in the text of the IBC that prevents the CoC from approving a resolution plan that envisages a sale of assets. Rather, the CoC even has the power to approve a plan that results in the corporate debtor's liquidation. It may also be noted that the prohibition of the sale of a business as a going concern arises from case law (the *Binani Cements* case),[414] rather than statute.[415] This case law has been criticized for not having an economic or legal basis, given that the IBC does not direct how the CoC is supposed to use its discretion when deciding on a resolution plan.[416] Even when the Report refers to the pre-pack design, the prioritization of rehabilitation of the corporate debtor is inferred from the objectives of the IBC and not any express bar on going concern sales (through resolution plans within it). The ability to sell the corporation's assets may invite more bids and put these assets to better use as well. It may even be possible that a purchaser wants to buy a majority of the assets of the corporation to keep the business afloat, but does not want to purchase the

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[410] MCI PRE-PACK REPORT, *supra* note 2, at 13–15, 57.

[411] *See* Singh, *supra* note 57, at 3–4, 6–7.

[412] *See id.* at 7.

[413] *See* MCI PRE-PACK REPORT, *supra* note 2, at 33, 50.

[414] *See* Binani Indus. Ltd. v. Bank of Baroda, Unreported Judgments, No. 82 Of 2018, decided on Nov. 14, 2018 (NCLAT), 32, 35. This case will be discussed in more detail in Subsection C of this Part.

[415] *See* Debanshu Mukherjee & Oitihjya Sen, *IBC and the On-Going Crisis: A Case for Allowing Going Concern Sales in Resolution*, VIDHI CENTER FOR LEGAL POLICY (Sept. 11, 2020), https://vidhilegalpolicy.in/blog/ibc-and-the-on-going-crisis-a-case-for-allowing-going-concern-sales-in-resolution/.

[416] *See id.*

corporate entity. Given these possibilities, a blanket prohibition on asset sales may operate too harshly on the pre-pack negotiation process. On the issue of liquidation, it is unclear why the freedoms afforded to the regular insolvency resolution process should not be curtailed in the context of pre-packs. If liquidation through a sixty-six percent majority is allowed in the status quo, then there is no reason to increase this threshold in the context of pre-packs.

With regard to the issue of misuse, it may be considered that a check built into the pre-packaging process already exists within the proposed Report—mandatory creditor approval. Creditors have an interest to ensure their debts are paid, and since sixty-six percent of financial creditors' votes are required, they would have the interest and capacity to prevent a business sale, which puts them in a precarious position. The Report refers to this problem in the context of the UK.[417] However, the UK pre-pack administration process has the ability to circumvent creditors. This possibility has been removed under the design proposed by the MCI Pre-pack Report for India. Accordingly, the prospect of misuse by leaving behind a shell company with liabilities it cannot pay should not be the sole reason for preventing the sale of the business's assets through a pre-pack. Since there is nothing in the IBC that prevents the sale of a corporation as a going concern, the flexibility and effectiveness of India's pre-pack regime will increase if it embraces going concern sales.

B. Setting Up a Robust Disclosure Regime

Transparency and adequate disclosure are important in maintaining the fairness of pre-packs. While they have limitations when functioning on their own and on a voluntary basis, they can work well if given statutory force. From the experience of the UK and US, we find the effectiveness of transparency requirements is contingent on being able to affix post-facto liability to insolvency professionals based on violations of transparency requirements.[418] In the UK, SIP-16 has increased the amount of information available to creditors about a pre-pack.[419] However, the route to actually hold an administrator accountable for its decisions remains tenuous. One of the reasons transparency measures have not achieved the desired result of changing the conduct of administrators is that these requirements are not statutory in nature.[420] This is different from the position in the US, where chapter 11 requires adequate disclosure to be provided to creditors when obtaining their approval, even

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[417] *See* MCI PRE-PACK REPORT, *supra* note 2, at 27–28.

[418] *See* XIE, *supra* note 9, at 133; *see also In re* Hellas Telecomms. (Luxembourg) II SCA [2009] EWHC (Ch) 3199, [8] (UK).

[419] *See generally* Statement of Insolvency Practice 16, *supra* note 261.

[420] *See* XIE, *supra* note 9, at 141–42; THE INSOLVENCY SERVICE, CONSULTATION/CALL FOR EVIDENCE: IMPROVING THE TRANSPARENCY OF, AND CONFIDENCE IN, PRE-PACKAGED SALES IN ADMINISTRATIONS 3, 6 (2010) [hereinafter INSOLVENCY SERVICE CONSULTATION], http://www.britishprint.com/downloads/managed/industry_info/Pre-pack_consultation_document_-_Final.pdf; Vanessa Finch, *Corporate Rescue: A Game of Three Halves*, 32 LEGAL STUDS. 302, 315–16 (2012).

in a pre-pack.[421] Failure to meet this requirement will require the debtor to repeat the process of soliciting votes after providing adequate disclosure.[422]

In the UK, any breach of a transparency requirement will not affect the validity of the pre-pack, though it can be the basis on which disciplinary proceedings are conducted against the administrator.[423] However, the fines imposed by the Insolvency Service have proven to be inadequate in deterring administrators from repeating their problematic conduct.[424] Violating professional standards (such as the SIP-16) is also not the sole basis on which an administrator is removed from a case, but it can be considered by the court when deciding on a petition for the administrator's removal.[425] Were transparency requirements embedded in a statute in the UK, harsher penalties could be imposed on erring administrators, presumably increasing compliance.[426] A suggestion to this effect has been made in the UK but has been met with difficulties.[427] Since there is no definition of a pre-pack, there will be ambiguity involved in determining which situations administrators ought to have complied with pre-pack disclosure requirements.[428]

Since pre-packs have not evolved in the present Indian insolvency framework, their emergence will need some sort of statutory sanction. Disclosure requirements for valid pre-packs can be added to existing rules or enacted as new ones. Having a robust transparency framework in India alongside the introduction of pre-packs would go a long way in ensuring that unsecured creditors are appraised of the pre-pack's rationale and can make an informed decision about pursuing litigation against it. The government should combine the stability afforded by statutory recognition of pre-packs in the US with the detailed disclosure requirements contained in the UK's SIP-16.

Giving statutory force to the pre-pack related disclosures will have another significant implication. Non-adherence to these requirements will have a bearing on the validity of the pre-pack itself. Parliament can decide on the seriousness it wants to afford to a breach of disclosure requirements. We suggest that the imposition of punishment on the resolution professionals for non-adherence can be left to the professional body in charge of regulating them. Having clear disclosure requirements in the law will also unburden the court from having to develop standards (which risk being subjective) for what comprises adequate disclosure to creditors during informal pre-pack negotiations.

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[421] *See* 11 U.S.C. §§ 1125–1126 (2018).

[422] *See* Plevin et al., *supra* note 236, at 888.

[423] *See* XIE, *supra* note 9, at 141.

[424] *Id.*

[425] *See, e.g.*, Clydesdale Fin. Servs. v. Smailes [2009] EWHC (Ch) 1745, [31]–[34] (UK); *see also* Finch, *Pre-Packaged Administrations*, *supra* note 133, at 11.

[426] *See* XIE, *supra* note 9, at 142.

[427] *See, e.g.*, INSOLVENCY LAWYERS' ASSOCIATION, RESPONSE TO CONSULTATION/CALL FOR EVIDENCE ON IMPROVING THE TRANSPARENCY OF, AND CONFIDENCE IN, PRE-PACKAGED SALES IN ADMINISTRATIONS 7–8 (2010), https://www.ilauk.com/docs/pre-pack_consultation_ila_response.pdf (arguing disclosure requirements with statutory force would not improve information given to creditors).

[428] *See id.*; Finch, *Pre-Packaged Administrations*, *supra* note 133, at 13–14.

C. Protection of Creditors' Rights and the Limits of Judicial Oversight

On the question of creditors' rights, India should choose to retain the existing protections afforded to creditors. This would include the sixty-six percent approval threshold for a plan and the requirement that operational creditors are paid at least what they would receive in the event of a liquidation.[429] The government may consider relaxing notice requirements for creditors who are being paid in full under a plan. This is similar to the deemed approval of unimpaired creditors under chapter 11 of the US Bankruptcy Code.[430]

The IBC's limitation of voting rights to financial creditors reduces the number of votes a corporate debtor would have to solicit for a pre-pack. In the UK, one of the concerns relating to pre-packs is that they operate harshly against trade creditors (operational creditors under the IBC).[431] Even in the status quo, the IBC does not require operational creditors to approve the plan.[432] As a compromise for operational creditors' exclusion from the voting process, the CoC and the NCLT need to ensure that operational creditors get a minimum amount under the resolution plan (equivalent to the sum they would have gotten in the case of liquidation or if the purchase money were distributed as per the liquidation waterfall). The pre-pack legislation should strongly consider retaining this protection given to operational creditors under the IBC;[433] this will ensure they are treated fairly and reduce the number of votes a plan will need in order to be approved. When it comes to court approvals, the NCLT can grant approvals to pre-packs in the same way it does to a regular resolution plan.[434] The criteria for rejecting a pre-pack must be laid down in legislation and strictly followed by the NCLT. Importantly, the NCLT cannot continue its past trend of rejecting a plan and directing the CoC to consider another bidder's plan because it believes that a better deal can be achieved.

In the *Binani Cements* case, the NCLT rejected a resolution plan despite the fact that it was approved by ninety-nine percent of the CoC.[435] Ten percent of the CoC (votes of the Export Import Bank) who had approved the plan stated they had been forced to vote in favor of the plan; the alternative being that they would have only received the liquidation value of their claim.[436] The proposed repayment of the Export Import Bank's dues under the plan accounted for seventy-three percent of its

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[429] *See* The Insolvency and Bankruptcy Code, 2016, § 30 (India).

[430] *See* 11 U.S.C. § 1126(f) (2018).

[431] *See* Peter Walton, *When is Pre-Packaged Administration Appropriate?—A Theoretical Consideration*, 20 NOTTINGHAM L.J. 1, 2–3 (2011) (expressing concern that pre-packs favor interests of managers and secured creditors).

[432] *See* The Insolvency and Bankruptcy Code § 21(2).

[433] *See id.* § 30(2)(b) (stating the minimum payment amount for operational creditors).

[434] *See id.* §§ 5(1), 21, 31.

[435] Binani Indus. Ltd. v. Bank of Baroda, Unreported Judgments, No. 82 Of 2018, decided on Nov. 14, 2018 (NCLAT), at 8–9, ¶¶ 13, 15.

[436] *See id.* at 9, 20–21, ¶¶ 13, 24–25.

claims, and most of the other creditors were being paid in full.[437] The bidder's reason for not paying the bank in full was that the corporate debtor was a guarantor for a principal borrower on a non-performing asset.[438] The details of every claim were not explained in the judgment, which makes it difficult to assess the fairness of the first bidder's plan.[439] However, the NCLT was not able to identify the provision of the IBC that was contravened by the plan's distribution scheme.[440] Even if the voting share of the Export Import Bank were to be excluded, the plan still had the approval of eighty-nine percent of the CoC,[441] well above the sixty-six percent majority required by the IBC.[442] The main grievance of some creditors was that the plan discriminated against them while enriching other financial creditors.[443] Taking this into account, the NCLT asked the CoC to consider the plan of another bidder (Ultratech Cements), which fully paid all the debts of Binani Cements, and the NCLAT as the Appellate Tribunal upheld this decision.[444] In justifying the NCLT's decision and its own, the NCLAT held the first plan went against the principles of the IBC.[445] However, it was unable to point to the provision of the IBC that was violated.[446] The NCLAT emphasized the need to maximize the value of the debtor's assets and balance the interests of all the creditors.[447]

From the *Binani Cements* case, it is unclear what payment arrangements other than full payment to all creditors would have amounted to a fair allocation of money under a resolution plan. In *Essar Steel*,[448] the Supreme Court of India clarified the NCLT's power to approve or reject a resolution plan is to be exercised within the four walls of the relevant IBC provision.[449] The Supreme Court held there was no residual equity jurisdiction that vested in the NCLT of which could be used to question the decision of the CoC.[450] In this case, unsecured financial creditors were being repaid five percent of their debt under the approved resolution plan.[451] The Supreme Court held the CoC has the right to vote on how to distribute the proceeds of a resolution plan as long as it accounted for payments to operational creditors under section 30 of the IBC.[452]

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[437] *Id.* at 17–19, ¶¶ 18–19 (providing a table illustrating the distributions amongst creditors).
[438] *See id.* at 19, ¶ 20.
[439] *See generally id.*
[440] *See id.* at 42–43.
[441] *See id.* at 17–18, ¶ 18.
[442] *See* The Insolvency and Bankruptcy Code, 2016, § 30 (India).
[443] *See Binani*, No. 18 Of 2018, at 18–19, ¶¶ 19, 21.
[444] *See id.* at 9–10, 35, ¶¶ 15, 55.
[445] *Id.* at 32.
[446] *See id.*
[447] *Id.*
[448] Comm. of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta, (2020) 8 SCC 531 (2019) (India).
[449] *Id.* at 589 ("[I]t is clear the limited judicial review available . . . has to be within the four corners of Section 30(2) of the Code, insofar as the [NCLT] is concerned. . . .").
[450] *Id.* at 589–90.
[451] *Id.* at 630.
[452] *See id.* at 593.

As early as the introduction of the BLRC Report, creditors' wisdom was relied on to make business decisions relating to a distressed company.[453] To this extent, the notion of a *fair* resolution may be misleading because one cannot be certain a more equitable solution could not have been effectuated. But the question of what is a fair and equitable resolution will always have subjective responses that will be heavily influenced by the stakeholder answering the question. The NCLT's role, as correctly pointed out by the Supreme Court in *Essar*, is to be satisfied with the fairness of a plan, but within the limitations conceived by the IBC.[454] In the context of insolvency law, fairness is not an abstract standard that resolution plans must aspire to meet. Rather, it is achieved through a set of minimum protections that plans need to adhere to under the IBC; these protections include creditors' voting rights and minimum payments that are required to be made to operational creditors under a plan.[455] The Supreme Court's decision in *Essar Steel* reiterates the limits of the NCLT's discretion in approving a plan.[456] When it comes to the approval of pre-packs, the NCLT must be just as circumspect in using its judgment to override any decision of the CoC.[457]

For pre-packs to be effective in India, the NCLT cannot use the existence of a better offer to reject a plan that has been approved by the CoC. By their nature, pre-packs are not extensively marketed. Pre-pack negotiations are meant to be discrete and, thus, are not announced to the public to invite bids.[458] While a pre-pack can be marketed to multiple parties to invite bids, whether this actually happens depends on the approach taken by the parties involved. This is different from a formal insolvency process that can be publicized, allowing more bidders to put forth their proposals. The relative lack of marketing means that there may well be better bids in the market for the business of the distressed company.

If the government wants to avoid discrimination between larger and smaller creditors or secured and unsecured creditors in the pre-pack process, it must clearly state what would comprise this discrimination. It must set a threshold for minimum, non-negotiable creditors' rights and allow any negotiation respecting these rights to prevail. In the Indian context, these non-negotiable rights could be in the form of existing minimum payments to operational creditors and financial creditors' voting rights.[459] Such a restrained approach will allow India to have a pre-pack regime governed by court approval like the one in the US. This way, the NCLT can play an important role in ensuring the rights guaranteed under India's pre-pack track are respected. Importantly, the NCLT must strongly adhere to the precedent set by the

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[453] *See* BLRC REPORT, *supra* note 77, at 12 ("The appropriate disposition of a defaulting firm is a business decision, and only the creditors should make it.").

[454] *See Essar Steel*, (2020) 8 SCC at 589.

[455] *See* The Insolvency and Bankruptcy Code, 2016, § 30 (India).

[456] *See Essar Steel*, (2020) 8 SCC at 589.

[457] *See id.*

[458] *See* Alexandra Kastrinou, *Comparative Insolvency Law: The Pre-Pack Approach in Corporate Rescue*, 26 INT'L INSOLVENCY REV. 229, 230 (2017) (book review) ("Pre-pack rescue constitutes a very attractive strategy as it facilitates the sale of an ailing business in the most discreet and quick manner, hence preserving the value of the business.").

[459] *See* The Insolvency and Bankruptcy Code § 30.

Supreme Court in *Essar Steel* and not regress to interfere with creditors' decisions in the absence of a statuary basis.

The flexibility in negotiations enjoyed by pre-packs is not without its criticisms. Most insolvency regimes grant a right of participation to those who have dues against the corporate debtor.[460] These participation rights are undermined by the pre-pack process. Claimants who are going to be fully paid generally do not participate in the actual voting; they are simply deemed to approve the resolution plan.[461] Essentially, those who are unaffected by the plan in terms of the dues they receive do not decide on whether or not it ought to be implemented. The people most vulnerable during insolvency proceedings are usually unsecured creditors, and accordingly, they are usually the ones who vote on administration plans in the UK and on chapter 11 reorganization plans in the US.[462] Unfortunately, it is these unsecured creditors who are often left out of pre-pack negotiations in the UK and the US.[463] Empirical evidence from the UK suggests that while unsecured creditors do not have worse outcomes in pre-packs than in regular administrations, secured creditors enjoy better results in pre-packs than regular administration proceedings.[464] This suggests that while pre-packs may be good at maximizing the value of the corporate debtor, the surplus is disproportionately enjoyed by secured creditors and the company's incumbent management.[465] Irrespective of the types of disclosures, protections, and regulations imposed on a pre-pack regime, it is unlikely it will be the *best* outcome for all creditors involved.

D. Compromising on Speed for More Stability and Fairness

The pre-pack model proposed above for the Indian insolvency regime will not result in resolutions that are as quick as the ones seen under section 363(b). The Chrysler sale, for instance, was completed in forty-two days.[466] Opposition to regulating pre-packs in the UK has also relied on the effect regulations will have on the expediency of pre-packs.[467] However, the pre-pack model proposed above will still allow companies to spend shorter periods of time under the formal insolvency process than the current IBC regime.[468] The suggested pre-pack framework affords

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[460] *See, e.g.*, 11 U.S.C. § 1126(b) (2018).
[461] *See, e.g., id.* § 1126(f).
[462] *See* XIE, *supra* note 9, at 62, 182.
[463] *See* Walton, *supra* note 11, at 87.
[464] *See* FINCH & MILMAN, *supra* note 3, at 379–80; *see also* Walton, *supra* note 11, at 87.
[465] *See* FINCH & MILMAN, *supra* note 3, at 379–80; *see also* Walton, *supra* note 11, at 87.
[466] *See* XIE, *supra* note 9, at 208.
[467] *See generally* INSOLVENCY SERVICE CONSULTATION, *supra* note 420, at 3; *see* FINCH & MILMAN, *supra* note 3, at 400; Wellard & Walton *supra* note 25, at 151–52 ("The main criticisms of the proposals were . . . that the 3-day notice period would effectively frustrate the whole point of a pre-pack, that is, its speed and secrecy. . . .").
[468] *See* Aparna Ravi, *Introducing Pre-packs in India—A Useful Tool in Times of COVID-19*, OXFORD BUS. L. BLOG (May 25, 2020), https://www.law.ox.ac.uk/business-law-blog/blog/2020/05/introducing-pre-packs-india-useful-tool-times-covid-19 ("If a consensus between debtor and creditors can be reached, an out-of-court

protections to creditors that are similar to those under the regular resolution process, while increasing the flexibility of a distressed corporation's negotiations.

Some writers have suggested implementing a UK-style regime for asset sales without CoC or court approval.[469] Given the findings and suggestions of the UK's Pre-pack Sales Report, it appears even the UK is contemplating giving creditors the right to approve pre-pack sales to connected parties.[470] This demonstrates the optimal route to regulating pre-packs is increasingly being laid out by way of creditor empowerment. While it is true that India prohibits connected party sales, earlier discussions have explained why this prohibition should be lifted when introducing the pre-pack regime.[471] The UK's experience shows that India would benefit more from retaining creditors' voting rights in pre-pack insolvency than from retaining the prohibition on the incumbent management's and promoters' participation in the process.

Furthermore, the use of the power to dispose of assets was not meant to replace the insolvency resolution process. In the US, section 363(b) was never intended to be used as a route to pre-packaging, but that is precisely what it has become.[472] The section was originally inserted to ensure that any perishable items of the debtor could be sold during the insolvency process so that the value they represented is not lost.[473] However, this is no longer the basis for section 363(b) sales, as can be seen from the evolution of decisions from *In re Lionel* to *In re Chrylser*.[474] Further, the slow uptake of self-regulation, as seen through the sub-optimal use of the pre-pack pool in the UK, has increased calls for legislation on pre-packs, specifically connected party sales in the UK.[475]

The UK's experience has shown that reputational penalties (which self-regulation relies on) are inadequate motivators for compliance. This is evidenced by the compliance rates of SIP-16 and the use of the pre-pack pool.[476] Even the Graham Report stated that its suggestions should be legislated on if they are not implemented through the industry.[477] It may be time for the UK to consider legislating on at least one of the Graham Report's recommendations.[478] Pre-pack routes that retain procedural safeguards applicable to creditors do not need to rely on voluntary industrial regulation or even a mandatory version of these regulations. For instance,

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resolution can be completed within a shorter period of time at lower cost and with less disruption to the debtor's business than what a typical insolvency procedure would entail.").

[469] *See, e.g.*, OTIHJYA SEN ET AL., DESIGNING A FRAMEWORK FOR PRE-PACKAGED INSOLVENCY RESOLUTION IN INDIA: SOME IDEAS FOR REFORM 29–30 (2020), https://vidhilegalpolicy.in/wp-content/uploads/2020/02/Report-on-Pre-Packaged-Insolvency-Resolution.pdf.

[470] *See generally* PRE-PACK SALES REPORT, *supra* note 12.

[471] *See supra* Section II.C.

[472] *See* Korres, *supra* note 256, at 960–61.

[473] *See id.* at 964.

[474] *See* Comm. of Equity Sec. v. Lionel Corp. (*In re* The Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983); *In re* Chrysler LLC, 405 B.R. 84, 94–95 (Bankr. S.D.N.Y. 2009).

[475] *See* Adebola, *supra* note 277, at 77.

[476] *See id.*

[477] *See* GRAHAM REPORT, *supra* note 11, at 67.

[478] *See* Adebola, *supra* note 277, at 77.

if creditors get a say in deciding whether a pre-pack is approved, then there would be no need for a pre-pack pool of experts to certify the reasonableness of the pre-pack. Should India choose to, it can set up the machinery for such industrial regulation (such as the pre-pack pool in the UK). However, the fairness of the IBC's pre-pack provisions should not be dependent on self-regulation.

In the UK, companies have started using pre-packs to implement schemes of compromise with creditors.[479] Schemes of arrangement under the Indian Companies Act, 2013[480] and UK Companies Act 2006[481] follow similar procedures. Under both regimes, a compromise scheme needs to be voted upon by seventy-five percent of the class of creditors affected by the compromise.[482] When the process of debt restructuring is routed through a pre-pack administration in the UK, there is no need to get the seventy-five percent majority approval from creditors.[483] UK courts have allowed this practice, following their deferential approach when it comes to commercial decisions.[484]

The use of pre-packs to effectuate debt structuring is emblematic of the unpredictable nature of using broad powers to sell business assets. Pre-packs in the UK (and under section 363 in the US) are not a result of a deliberate policy decision; rather, they are a product of legal creativity and business ingenuity.[485] This type of ingenuity should be encouraged, as it often informs legislation by articulating the needs of commerce. However, its unpredictable nature should not undermine the objectives of insolvency regimes either. This is why we have proposed an approach that is safeguard-oriented. Ideally, the pre-pack track should be introduced with clear and effective safeguards in the form of creditors' procedural rights, disclosure, etc., as discussed above. This helps create a fairer environment for pre-packs, and the government and judiciary should not interfere with business decisions unless any of these safeguards are violated. While the pre-packaging process may take longer through this approach (as it does under chapter 11 when compared to section 363 in the US), the company will participate in formal insolvency proceedings for a shorter duration. If the NCLT adheres to the standards that are set out in the IBC for pre-packs, the process can be finished quickly and in a time-bound manner.

CONCLUSION

The meaningful question with regard to pre-packs is not how pre-packs can accommodate the interests of all creditors in the same way as a regular resolution

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[479] *See* Wijaya, *supra* note 269, at 120.

[480] The Companies Act, 2013 (India).

[481] Companies Act 2006, c. 46 (UK).

[482] *See* Companies Act 2006 § 899; The Companies Act 2013 § 230(6).

[483] *See* Wijaya, *supra* note 269, at 129 ("Because a scheme is not enjoined in such restructuring, it also follows that all the protections afforded to the creditors and specifically the junior creditors in a scheme are side-stepped and short circuited.").

[484] *See id.* at 127–28; *see also In* re Christophorus 3 Ltd. [2014] EWHC (Ch) 1162, [42]–[44] (UK).

[485] *See* Vaccari, *supra* note 109, at 180; Wellard & Walton, *supra* note 25, at 147.

process; they simply cannot. Some marketing has to be traded off in order to ensure a quick and quiet sale of the company's assets. This is why the majority of the discussion in the UK and US is anchored in providing adequate safeguards to creditors and bridging informational gaps. There are, however, important differences in the ease with which pre-packs can be regulated depending on the route through which they are introduced. Pre-packs introduced by empowering the insolvency professional or debtor to sell assets without creditors' approval have proven more challenging. Recent evidence has also shown they can be used not only in the context of insolvency law, but also for more general debt restructuring. Further, conflicts of interest that arise through connected party sales begin to affect the efficacy of the insolvency process as creditor participation and inputs are eschewed.

The Indian government will need to approach the discussion on pre-packs after deciding which parts of the IBC should remain non-negotiable, even in pre-packs, and which parts can be substituted for a more flexible process. We recommend that an IBC pre-pack regime retains required creditor voting thresholds and protections given to operational creditors. There are a range of measures that can be implemented to increase the transparency and fairness of pre-packs. Lawmakers and the courts should be focused on determining the minimum required thresholds of fairness that must be met and cannot be traded off for expediency and confidentiality. The IBC will also need to undergo broader changes with regard to its restrictions on connected parties' participation in the insolvency resolution process and its avoidance provisions. The focus should be on increasing the avenues and possible outcomes of pre-pack negotiations, while strongly maintaining the protections granted in the IBC. The NCLT cannot continue to step in and find reasons to get a better deal for all creditors. Rather, it needs to take a more restrictive approach, and the law on pre-packs needs to clarify exactly which parameters would warrant a fair challenge to a pre-pack.