

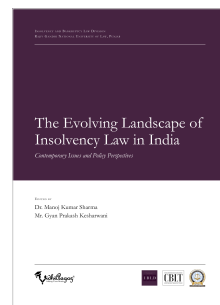
CHAPTER 6

Fraud in the Fast Lane: Exposing Risks in India's Pre-Pack Process

Shristy Yadav and Anmol Niranjan

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CHAPTER 6

Fraud in the Fast Lane: Exposing Risks in India's Pre-Pack Process

SHRISTY YADAV* AND ANMOL NIRANJAN**

In 2021, the government introduced the pre-pack insolvency resolution process, also called PPIRP, through the Insolvency and Bankruptcy Code (Amendment) Ordinance. PPIRP in India is a quasi-formal process with limited judicial oversight before admission to a formal insolvency proceeding. As of now, it applies only to Micro, Small, and Medium Enterprises (“MSMEs”), and is still in its nascent stage.¹ However, in this limited time, multiple instances of fraud have been recorded, which is alarming. Through this paper, the authors seek to expose the loopholes and gaps in the current pre-pack framework that enable fraudulent practices by resolution parties. This paper has three sections; in the first part, it analyses the statutory provisions under the Code dealing with fraud, deceit, and malicious intentions. The second part explores liquidation as a remedy in cases of pre-pack where fraud has been found. Lastly, in the third section, it criticises the weak provisions and discusses missed opportunities for strengthening the framework, which consequently threaten MSME recovery and financial stability. Moreover, a critical comparative study of PPIRP in other countries like the US and UK has been done in order to draw insight from such jurisdictions. Through the analysis of case laws, statistics, and reports, this paper emphasises the urgency of increased transparency, judicial oversight, and protections for creditors to further fortify India's insolvency regime against fraud, which is hindered by the risk of information asymmetry, potential suppression of minority creditor interests, and the looming financial threat to banks. By addressing these challenges and suggesting feasible reforms, this paper fills the small vacuum of current literature, which is underexplored, and endeavours to improve the pre-pack insolvency resolution process of MSMEs in India.

Keywords: Pre-Pack Insolvency Resolution Process, MSMEs, Fraud, Creditor Protection, Judicial Oversight

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¹ *Avoidance Transactions: Protecting Creditors' Interest Under IBC*, 32 QUARTERLY NEWSLETTER OF THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, July–Sept. 2024 (Sept. 30, 2024), <https://ibbi.gov.in/uploads/whatsnew/edc044b410d37f0fd22cbe07a74665f3.pdf>.

1 INTRODUCTION

The Parliament enacted the Insolvency and Bankruptcy Code in 2016 (“Code”), revolutionizing the insolvency framework in India. Earlier there were a few restructuring and insolvency mechanisms such as CDR (Corporate Debt Restructuring)², SDR (Strategic Debt Restructuring)³, and JLF (Joint Lenders Forum)⁴, scrapped in 2018 because of their opacity, inefficiency, and misuse by the corporate lenders and borrowers. Learning from the failure of these resolution methods, the framers filled the gap in the current Code.⁵ However, the rising volume of insolvency cases and instances of fraud and misuse have necessitated alternative approaches, leading to the introduction of the Pre-Packaged Insolvency Resolution Process (PPIRP) for MSMEs in 2021. While Corporate Insolvency Resolution Process (“CIRP”) offers a fairly efficient mechanism, it is tedious and costly and often used by debtors to escape liability and buy time.⁶ To ease the burden of court and provide a cost-savvy and informal alternative, Pre-pack was introduced, with an intention to cover all industries in a phased manner, but due to the pandemic, no further extension could be made to other industries except MSMEs.⁷

The Sunil Mehta Committee headed a project called ‘Project Sashakt,’ launched in 2018. It acted as a precursor for the introduction of pre-packaged insolvency of MSMEs in India in 2021. ‘Project Sashakt’ was an initiative aimed at tackling bad loans through quick, bank-led solutions outside court, focusing on reviving businesses, creating jobs, and boosting public sector banks’ value. Currently in India, pre-pack is available for MSMEs only and is still in its nascent stage, with a reported 13 applications since its inception, out of which seven cases are still ongoing, and the resolution plan for five cases has been approved.⁸ However, in this limited application, multiple instances of fraud have been recorded, which is alarming. It is high time that we discuss it now and action be taken so that it does not linger, paralyzing the mechanism in the future.

² Circular on Corporate Debt Restructuring, 2001, Gazette of India, pt. II sec. 3(i) (Aug. 23, 2001).

³ Circular on Strategic Debt Restructuring Scheme, 2015, Gazette of India, pt. II sec. 3(i) (June 8, 2015).

⁴ INDIAN ECONOMY.NET, <https://indianeconomy.com/splclassroom/what-is-joint-lenders-forum-jlf/> (last visited June 12, 2025).

⁵ *Pre-packaged Insolvency in India: Lessons from USA and UK*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3518287 (last visited June 20, 2025).

⁶ Vellayan Subbiah & Pranay Mehrotra, *Pre-pack Insolvency Resolution Process: Judiciously Strengthening IBC in Times of Crisis*, in QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016 347 (2021), <https://ibbi.gov.in/uploads/whatsnew/1d8b31fc65f7ac6f09a973be8f12f868.pdf>.

⁷ M. P. Ram Mohan & Sriram Prasad, *Lessons from Pre-Packaged Insolvency Cases in India: A Long Road Ahead*, in IBBI, IBC: EVOLUTION, LEARNINGS AND INNOVATION 175 (2023), <https://ibbi.gov.in/uploads/whatsnew/525cbe1dd3b1f9fd9866fe77676a96ae.pdf>.

⁸ *Avoidance Transactions: Protecting Creditors’ Interest Under IBC*, 32 QUARTERLY NEWSLETTER OF THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, July–Sept. 2024 (Sept. 30, 2024), <https://ibbi.gov.in/uploads/whatsnew/edc044b410d37f0fd22cbe07a74665f3.pdf>.

2 CORPORATE FRAUD UNDER THE CODE: DEFINITIONS AND STATUTORY PROVISIONS

The Code does not define “fraud” in isolation but incorporates general corporate fraud concepts by reference (for example, Section 447 of the Companies Act 2013 defines fraud to include any act or omission with intent to deceive or injure the interests of the company or its creditors). Under the Code, two key provisions address corporate fraud:

2.1 Fraudulent or Malicious Initiation

Section 65(1) penalises any person who “initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than resolution.” It authorises the National Company Law Tribunal (“NCLT”) to impose a penalty of ₹1 lakh to ₹1 crore on such petitioners. Sub-section (2) similarly penalises voluntary liquidations filed with intent to defraud. Sub-section (3) extends the penalty to pre-pack insolvency. The object is to ensure that CIRP is invoked only for *bona fide* insolvency purposes.⁹

2.2 Fraudulent/Wrongful Trading

Section 66(1) applies if, during CIRP or liquidation, “any business of the corporate debtor has been carried on with intent to defraud creditors or for any fraudulent purpose.” On the Resolution Professional’s (“RP’s”) application, the NCLT may direct any person knowingly party to such business to contribute assets to the debtor. Sub-section (2) (amended 2020) is akin to “wrongful trading”: if a director knew that there were no reasonable prospects of avoiding insolvency and failed to exercise due diligence to minimize creditor loss, the NCLT may require that director to contribute to the debtor’s assets. The combined Sections 43–46 (preferential/undervalued transactions) and 66 seek to undo transactions that have “the intent to defraud creditors”. By these statutes, “fraudulent intent” in CIRP has a narrow meaning, it refers to dishonest or collusive dealings to prejudice creditors, and not mere business failure.¹⁰

2.3 Judicial Interpretation of “Fraudulent Intent”

Courts have repeatedly held that “fraudulent or malicious intent” under the Code is not easily presumed: it must be proved by evidence. The National Company Law Appellate Tribunal (“NCLAT”) and NCLT emphasize that Section 65 penalties and Section 66

⁹ A. Jha & B. Yadav, *Preventing Fraudulent and Malicious Initiation of Insolvency Proceedings in India*, AZB & PARTNERS (Apr. 21, 2023), <https://www.azbpartners.com/bank/preventing-fraudulent-and-malicious-initiation-of-insolvency-proceedings-in-india>.

¹⁰ Anuj Jain v. Axis Bank Ltd., 2019 SCC OnLine NCLAT 435.

liabilities require proof of intent to defraud, not mere insolvency. For instance, the NCLAT recently held that the mere act of filing an insolvency petition (even if it halts recovery proceedings) does not automatically imply malicious intent.¹¹ The tribunal held that unless there is a *prima facie* case of fraud or malice, no penalty should be imposed under Section 65.¹²

Similarly, applications under Section 66 of the Code demand clear, specific facts. As one NCLT bench observed, “suspicion alone can never take the place of proof” – allegations of fraudulent trading must be supported by unimpeachable evidence. In *Mr. Anuj Bajpai (RP) v. Surendra Lodha*¹³, the Tribunal cited the principle (from *A. L. N. Narayan Chettiar v. Official Assignee*¹⁴) that fraud in civil proceedings is to be proved beyond reasonable doubt. There, a forensic audit report alone was deemed insufficient “to dub transactions as fraudulent” without concrete documentary evidence. The Tribunal also noted that Section 66’s Explanation creates a rebuttable presumption in favour of ex-directors: once a fraud is alleged, the RP must show the intent and knowledge of fraud “at the very inception of the transaction and not later”.¹⁵

The Supreme Court, too, has underscored the high bar for establishing fraud. In *Anuj Jain (IRP, Jaypee Infratech) v. Axis Bank* (2020)¹⁶, the Court explained that the inquiries for preferential, undervalued, and fraudulent transactions are distinct. Pleading “fraudulent trading” under Section 66 requires separate, specific material facts showing intent to defraud, unlike the mechanically presumed preference under Section 43.¹⁷ Absent such pleaded intent, normal transactions cannot be retroactively labelled fraudulent. In short, Indian courts require a “high degree of proof” of fraudulent intent, and mere financial failure or default does not suffice.¹⁸

3 ROLES OF NCLT AND INSOLVENCY PROFESSIONALS

3.1 NCLT / Adjudicating Authority

Under the Code, the NCLT, and on appeal, the NCLAT or the Supreme Court, has wide powers to detect and punish fraud in insolvency. Before admitting any CIRP petition, the tribunal must exercise discretion under Section 7(5) and consider any *prima facie* evidence of

¹¹ Getz Cables Pvt. Ltd. v. SBI, 2024 SCC OnLine NCLAT 1324.

¹² Jha & Yadav, *supra* note 9.

¹³ Anuj Bajpai (RP) v. Surendra Lodha, (2023) 240 Comp Cas 371.

¹⁴ A.L.N. Narayan Chettiar v. Official Assignee, AIR 1941 PC 93.

¹⁵ Bank of India v. Monorex Pvt. Ltd., CP/1381/IB/2018.

¹⁶ Anuj Jain v. Axis Bank Ltd., 2019 SCC OnLine NCLAT 435.

¹⁷ Bank of India v. Monorex Pvt. Ltd., CP/1381/IB/2018.

¹⁸ Getz Cables (P) Ltd. v. SBI, 2024 SCC OnLine NCLAT 1324.

fraud or collusion.¹⁹ Section 65 empowers the NCLT to set aside or penalise malicious or fraudulent petitions: the adjudicator may require proof of a *prima facie* case of fraud before imposing penalties. Notably, courts have held that the tribunal can seek assistance from other agencies and even order an investigation under the Companies Act if it finds evidence of fraudulent initiation. In one case, the NCLT “pierced the corporate veil,” ruling that where “a corporate character is used for defrauding others, the court can ignore the corporate character” to do justice. Similarly, upon an RP’s application under Section 66, the NCLT may order recovery from anyone knowingly involved in fraudulent trading. The NCLT must distinguish good-faith transactions from bad: if mortgages or transfers were made in the ordinary course and without evidence of intent to defraud, they cannot be set aside as “fraudulent.”²⁰ Only where the RP brings forward “tangible materials” on fraudulent purpose and “relevant facts” are pleaded can the tribunal hold transactions to be fraudulent.²¹

3.2 Insolvency Professional (“IP”)

The IRP/RP is the eyes and ears of the insolvency process. By duty (Section 25 and the IBBI Code of Conduct), the RP must preserve the debtor’s assets and rigorously examine its accounts. In practice, RPs often commission forensic audits to uncover hidden fraud. For example, one CoC unanimously directed a forensic audit to detect preferential or fraudulent transfers, and when the final report revealed “transactions not in the best interests of the company but done with a fraudulent motive,” the RP promptly filed a Section 66²² petition.²³ Thus, an RP should identify suspect transactions and either (i) challenge them as antecedent avoidance (Sections 43–51)²⁴, or (ii) file under Section 66 for “fraudulent trading.” Insolvency Professionals must report such findings to the NCLT and CoC, rather than stakeholders taking the law into their own hands. In *Deepak Upadhyaya v. State*²⁵, the Court admonished a creditor who bypassed the mechanism under the Code by lodging an FIR against an RP, holding that complaints against an RP’s insolvency-related conduct should be handled by IBBI or NCLT, not by criminal police procedure. In short, IPs must expose

¹⁹ Jha & Yadav, *supra* note 9.

²⁰ Anuj Jain v. Axis Bank Ltd., 2019 SCC OnLine NCLAT 435.

²¹ Bank of India v. Monorex Pvt. Ltd., CP/1381/IB/2018.

²² Insolvency and Bankruptcy Code, 2016, § 66.

²³ IDBI Bank Ltd. v. Kanakadhara Ventures Pvt. Ltd., 2022 SCC OnLine NCLT 29182.

²⁴ Insolvency and Bankruptcy Code, 2016.

²⁵ Deepak Upadhyaya v. State, 2023 SCC OnLine Mad 2567.

fraud through insolvency channels and the NCLT rather than adjudicating or referring it onward, and rather than aggrieved parties using extraneous legal forums.²⁶

4 LIQUIDATION AS A REMEDY IN FRAUDULENT CASES UNDER THE CODE (PRE-PACK FRAMEWORK)

PPIRP is lucrative for CDs because it gives a clean slate to start over and is an absolute regrowth model. Technically, the purpose of PPIRP is restructuring and not liquidation, though it is the last resort under the Code when fraud compromises the integrity of the pre-pack process. It ensures asset recovery, penalizes misconduct, and protects creditors when revival is no longer feasible.

4.1 Liquidation Trigger and Process

Under Chapter III of the Code, liquidation is initiated when corporate rescue fails. Section 33 mandates that if no viable resolution plan is approved in the allotted time, the adjudicating authority “shall pass an order requiring the corporate debtor to be liquidated”. Similarly, Section 33(2) provides that if the Committee of Creditors (“CoC”) resolves to liquidate at any stage, the Resolution Professional (RP) must apply for a liquidation order, which the NCLT then grants. In addition, Section 33(3) and (4) allows any person (other than the debtor) to seek liquidation if a confirmed plan is contravened by the corporate debtor. Once a liquidation order is made, a limited moratorium applies and, under Section 34, the existing RP typically continues as liquidator. Section 34 further provides that upon liquidation, the board and management of the debtor cease their powers and the liquidator assumes full control, with fees to be fixed by the IBBI and paid from the estate.

In fraud-related cases, these provisions operate in conjunction with anti-fraud measures. Notably, Section 66 empowers the RP or liquidator to recover assets or require contributions from persons who carried on the debtor’s business “with intent to defraud the creditors”.²⁷ Thus, evidence of fraud during insolvency can bolster the liquidation estate. In the new pre-packaged insolvency regime (MSME pre-packs under Part IIIA), the law explicitly provides for management takeover and liquidation where fraud is found. Section 54J allows the CoC to transfer management to the RP if there is proof of fraud or gross mismanagement. If a pre-pack plan fails (for example, is rejected or violates eligibility norms), Sections

²⁶ Apoorva, *Approaching Police Without Resorting to Special Procedure Under IB Code to Arm Twist the Resolution Professional Is Inappropriate: Madras High Court*, SCC TIMES (May 1, 2023), <https://www.sconline.com/blog/post/2023/05/01/police-complaint-without-resorting-to-ibc-code-inappropriate-madras-hc-to-arm-twist-rp-legal-news/>.

²⁷ Bomi Daruwala, *NCLAT: Fraud for the Purpose of Section 66 of the IBC Includes a Debt Where the Debtor Has No Intention to Repay*, VAISH ASSOCIATES ADVOCATES (May 22, 2023), <https://www.vaishlaw.com/Nclat-Fraud-For-The-Purpose-Of-Section-66-Of-The-Ibc-Includes-A-Debt-Where-The-Debtor-Has-No-Intention-To-Repay/>.

54L–54N require the authority to terminate the pre-pack and initiate regular insolvency. If the management remains with an alleged wrongdoer and the pre-pack plan is unviable, the Adjudicating Authority (“AA”) “may order liquidation” under Section 33. Likewise, if a pre-pack is terminated after management transfer, the AA must order liquidation under Section 33 and include pre-pack costs in the liquidation estate. In summary, Sections 33–34 and in the PPIRP context (Sections 54J–54N) set out the trigger mechanisms for winding up a debtor. The detection of fraud can accelerate this transition to liquidation (via Section 66 remedies and PPIRP safeguards), ensuring that fraud-tainted assets are marshalled into the estate for creditor benefit.

4.2 Asset Maximisation and Fair Distribution

Liquidation under the Code is designed to maximize recoveries for creditors when rehabilitation fails. As the Supreme Court has observed, the Code’s “primary objective” is to revive stressed companies in a time-bound manner to “maximize the value of assets” for stakeholders.²⁸ By statute, even a liquidating company can be sold as a going concern to preserve value. *Swiss Ribbons*²⁹ held that liquidation is truly a “last resort” under the Code (used only if no resolution plan is approved) and that “even in liquidation, the liquidator can sell the business as a going concern.”³⁰ Thus, liquidation still strives for highest realizable value of the corporate entity. Empirical data confirms that resolution outcomes typically beat liquidation: the approved resolution plans yielded on average 161% of the value that liquidation would have fetched.³¹ In other words, rescue procedures recover more, but liquidation guarantees that at least the statutory liquidation value is distributed when revival is impossible.

Equally important is fair distribution. Section 53 of the Code prescribes a strict statutory waterfall for applying liquidation proceeds. The liquidator must first pay insolvency and liquidation costs, then the *pari passu* dues of workmen (last 24 months) and any unsecured debt of a secured creditor (if security is relinquished).³² Next are dues to other employees and unsecured financial creditors, followed by government dues and unpaid secured debts. Any remaining claims, then preference shareholders, and finally equity shareholders are paid as per Section 53.³³ This formula ensures that all creditors are treated according to the

²⁸ *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17.

²⁹ *Id.*

³⁰ *Id.*

³¹ GOV’T OF INDIA, MINISTRY OF FIN., DEP’T OF ECON. AFF., ECONOMIC SURVEY 2024–25 (2025), <https://www.indiabudget.gov.in/> (last visited June 15, 2025).

³² Trisha Shreyashi & Kumar Gourav, *Supreme Court Upholds Waterfall Mechanism Under IBC; Division Bench Overturns Rainbow Ruling*, BAR AND BENCH (Aug. 24, 2023, 8:17 AM), <https://www.barandbench.com/columns/supreme-court-upholds-waterfall-mechanism-under-ibc-2-j-bench-overturns-rainbow-ruling>.

³³ *Id.*

priority of their claims under law. In this way, liquidation under the Code operationalises its objectives of value maximisation and equitable treatment of stakeholders. The Supreme Court has noted the Code's aim to "balance the interests of all the stakeholders" in a time-bound resolution.³⁴ By forcing a definitive value realization and *pro rata* payout, liquidation serves these objectives even if, practically, it often recovers less than a going concern sale. (Indeed, official data suggest resolutions under the Code recoup about 86% of the estimated fair value of assets,³⁵ whereas pure liquidations recover far less.)

4.3 Deterrence and Public Interest

Liquidation carries a strong deterrent message against fraud and abuse. The prospect of mandatory winding up, with loss of control and credit, discourages debtors from engaging in fraudulent conduct. The Code itself embeds punitive measures: for example, Section 66 of the Code allows the liquidator to claw back benefits obtained through "fraudulent trading", while Section 65 authorises fines (₹1 lakh to ₹1 crore) on anyone who "fraudulently or maliciously" triggers insolvency or liquidation to defraud creditors. Together these provisions mean that directors or promoters who mismanage or siphon funds face both civil and criminal sanctions. The economic rationale for stopping a race to the bottom in insolvency has been recognized as being in the public interest. The deterrent effect of the Code is evident in reports that many distressed companies pre-empt proceedings or settle early once the risk of insolvency, and liquidation, looms.³⁶

From a policy standpoint, liquidation in fraud cases aligns with creditor and public interests by penalizing dishonesty and protecting the credit system. Courts have emphasized that insolvency law is as much about public interest and creditor confidence as it is about corporate rescue. For example, in *Swiss Ribbons*,³⁷ the Court held the Code to be a balanced scheme of insolvency and liquidation provisions that serve commercial needs. Importantly, the Code imposes an "insolvency condemnation" on assets so that creditors (including the State) recover what they can when fraud has occurred. By converting assets to cash and distributing them transparently, liquidation ensures that wrongdoers cannot indefinitely postpone liability or leave creditors empty-handed. In sum, the availability of compulsory liquidation backed by avoidance and penalty provisions serves as a concrete disincentive against fraudulent conduct and furthers the Code's public interest goal of timely, fair outcomes.

³⁴ *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17.

³⁵ ECONOMIC SURVEY 2024–25, *supra* note 31.

³⁶ *Id.*

³⁷ *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17.

4.4 Drawbacks

Despite its role, liquidation has serious limitations, especially when used as a blunt response to fraud. A fundamental drawback is value destruction. Liquidation generally yields far lower recoveries than successful restructuring. Delay exacerbates this: the Supreme Court³⁸ has cautioned that “the more the delay, the more likely it is that liquidation will be the only answer”, and that assets lose economic value over time. In liquidation, the mandatory moratorium and cessation of the firm’s operations often cause steep haircuts. The liquidation can impose a punitive haircut on creditors themselves (aside from the fraudster), undermining the very “maximisation” goal of the Code.

Liquidation can also carry high social costs. As the liquidation process typically entails shutting down the business, it often leads to significant job losses. In each case, the affected workers (and downstream communities) bear a heavy burden, which arguably undermines public interest goals of the Code. Moreover, liquidation is not instantaneous; any legal challenges or claims of impropriety (ironically, even by creditors who feel short-changed) can prolong liquidation. *Swiss Ribbons*³⁹ explicitly warned that prolonged insolvency increases liquidation risk and reduces recovery. In practice, winding up proceedings can exceed the IBBI’s model timeline (one year) due to litigation and procedural steps, further eroding asset value and delaying any distributions.

Another drawback is finality and loss of flexibility. Once liquidation begins, the scope for renegotiation or correction is largely foreclosed. In *Punjab National Bank v. Kiran Shah*⁴⁰ (Org Informatics Ltd.), the NCLAT underscored that after a liquidation order, the CoC “has no role to play.” Creditors cannot replace the liquidator or reverse the course, and the insolvent firm is soon dissolved. This means that if facts change (for example, if a restructuring opportunity emerges) or if the liquidation process is contested, creditors have very limited remedy. The irreversible nature of liquidation thus makes it a very harsh sanction: in cases of fraud, it means the culprit loses everything, but it also means that any innocent stakeholders (unsuspecting shareholders, junior creditors, etc.) are swept away with them.

While liquidation acts as a deterrent and a remedy in cases of fraud under the CIRP, it comes at a cost of value deterioration, prolonged timelines, and the finality of winding up, which highlights the need for a safer alternative method. In this light, the paper further discusses the fraud risk in the PPIRP framework.

³⁸ SBI v. Murari Lal Jalan & Florian Fritsch (Consortium), (2025) 4 SCC 354.

³⁹ Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17.

⁴⁰ Punjab Nat’l Bank v. Kiran Shah, 2019 SCC OnLine NCLAT 1030.

5 PRE-PACK INSOLVENCY IN INDIA: RISK AND MITIGATION

While PPIRP offers several benefits, it comes with a few drawbacks and loopholes that can lead to the risk of abuse through asset stripping, collusive base plans, and information asymmetry. This section examines these vulnerabilities and proposes mitigation mechanisms.

5.1 Debtor-in-Possession Arrangements and Fraud Risk

In PPIRP, the corporate debtor's board remains in charge unless 66% of the members of the CoC votes to transfer control to a Resolution Professional.⁴¹ Section 54H of the Code explicitly vests management with the existing board to “sustain the company”, while Section 54J lets the RP take over with the support of a majority of creditors. This DIP model preserves continuity but risks enabling a fraudulent insider to steer the process. Critics note that a debtor-in-possession may conceal financial irregularities, transfer assets, or delay investigations during the pre-pack period, thereby highlighting the need for enhanced cash-flow controls and oversight mechanisms to prevent any undesirable actions during the resolution process. In effect, fraud-detection mechanisms (normally triggered by an independent Interim Resolution Professional in a standard CIRP) are largely deferred until after admission.⁴²

In practice, this implies that a debtor suspected of fraud can initiate PPIRP and continue running the company unless a majority of creditors intervene. Observers caution that this arrangement creates a tension: the very parties under scrutiny, e.g., defaulting promoters, draft the “base resolution plan” and run day-to-day operations, potentially undermining fraud investigations. The RP may need additional checks on debtor actions to avoid misuse.⁴³ Moreover, MSMEs are small scale and largely unorganised, and often lack proper documentation, so the CD has an upper hand, as only he knows the intricacies of his business. Consequently, there is firm control over the management and a power to potential abuse of the process.

5.2 Less Judicial Scrutiny

Courts have also expressed concern regarding the oversight by the NCLT. One NCLT judge commented that the tribunal must “develop trust” in PPIRP and avoid being “paranoid” about fraud, but judges still spend time probing PPIRP proposals.⁴⁴ It is observed that

⁴¹ A. Rathi, *Pre-Packaged Insolvency Resolution Process*, ICSI INST. INSOLV. PROF. 1 (June 2022), <https://aracs.in/wp-content/uploads/2022/12/PPIRP-By-Akansha-Rathi.pdf>.

⁴² Dr. Isha Goel & Dr. Sunita Gupta, *IBC for MSMEs: Hits and Misses*, in IBBI, NAVDRISHTI EMERGING IDEAS ON IBC 235 (2023), <https://ibbi.gov.in/uploads/publication/a06c288c54627bad9b3b8f6ae322f0e3.pdf>.

⁴³ *Id.*

⁴⁴ Ram Mohan & Prasad, *supra* note 7.

tribunals initially treated PPIRP like a CIRP, issuing formal notices and demanding detailed filings, causing delays.⁴⁵ This reflects a struggle. PPIRP is meant to be quicker, yet judges wrestle with transparency needs, undermining the purpose of an independent and swift resolution mechanism.

5.3 Asset-Stripping and Bad-Faith Resolutions

A related concern is that debtor control during PPIRP could enable asset-stripping or sham deals before a plan is sealed. Under a normal CIRP, once proceedings start, the IRP safeguards assets and can invoke avoidance provisions like fraudulent, preferential, or undervalued transaction recovery under Sections 43–51 of the Code. Despite these protective provisions, the ground reality of “case resolution” presents a systematic failure. According to the IBBI data, out of 808 resolved cases, 200 applications are listed for asset stripping or avoidance transactions, which is alarming.⁴⁶ In PPIRP, much of the pre-filing period is unsupervised or minimally overseen. Managers could, in theory, sell off assets and machinery, divert funds to affiliates, or enter “bad faith” transactions to reduce the estate’s value. With such weak oversight during the negotiation period, MSMEs could easily be the next ventures for money laundering.⁴⁷

5.4 Avoidance Provisions under the Code

The Code’s avoidance remedies still exist for PPIRP. For example, Sections 43–44 (preferential transfers), 45–48 (undervalued transactions), and 50–51 (extortionate credit) technically apply to PPIRP just as in CIRP. Likewise, Section 49 provides for recovery if the debtor “had defrauded its creditors” prior to insolvency.⁴⁸ However, practical enforcement is limited: the RP can challenge such transactions only after appointment, and only if the CoC or creditors catch them in time. Given PPIRP’s 90–120-day timeframe, there is pressure to approve plans swiftly, potentially before any review of complex pre-insolvency transfers.⁴⁹ Moreover, the RP’s role is so limited before admission that he does not get enough evidence and opportunity to uncover such transactions. One thing that can be proposed is that the debtor declare all prior transactions from the past 12-24 months.

⁴⁵ *Id.*

⁴⁶ IBBI, THE QUARTERLY NEWSLETTER OF THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, vol. 28, July–Sept. 2023, at 14, <https://ibbi.gov.in/uploads/whatsnew/b4ce3516920836e9ff9b1e816137bf97.pdf>.

⁴⁷ Kanishka Agrawal & Saurav Singh, *Critical Analysis of Pre-Packaged Insolvency Resolution Process Under IBC*, IBC LAWS (Apr. 16, 2024), <https://ibclaw.in/critical-analysis-of-pre-packaged-insolvency-resolution-process-under-ibc-by-kanishka-agrawal-and-saurav-singh/>.

⁴⁸ Kushagra Gahoi & Akash Krishnan, *Comparative Analysis of Key Provisions of Corporate Insolvency Resolution Process and Pre-Packaged Insolvency Resolution Process Under the Insolvency and Bankruptcy Code, 2016*, 4 INT’L J.L. MGMT. & HUMAN. 1238, 1238–39 (2021), <https://heinonline.org/HOL/LandingPage?handle=hein.journals/ijlmhs12&div=120&id=&page=>.

⁴⁹ *Id.*

5.5 Immunity after Plan

Another issue involves immunity provisions. The amended Code grants that once a resolution plan is approved and management is replaced, the corporate debtor is immune from prosecution for past offences except for continuing offences.⁵⁰ In PPIRP, this is embodied in Section 54N (5), which provides that, if the plan is approved and the promoter exits, the company cannot be prosecuted for prior fraud. While this encourages new investment, it may blunt deterrence against fraud. PPIRP could be used as a “shield” by fraudsters to evade criminal or civil clawbacks by restructuring just enough to change management and gain immunity.⁵¹

5.6 Dissenting Voice in Informal Negotiations

Just like in CIRP, in the Pre-Packaged Insolvency Resolution Process, the CoC is dominated by Financial Creditors, and they wield significant power to approve or reject the base resolution plan. In this skewed arrangement, minority dissenting financial creditors and operational creditors (“OCs”), who are normally not entitled to vote under Section 24⁵² unless their claims are substantial, hardly get any scope to shape or resist these plans. If we see the trend in the case of CIRP, courts prioritise the CoC’s commercial wisdom, as seen in cases like *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*,⁵³ in which it was held that the minority creditors need to prove significant statutory violations to overturn a plan.⁵⁴ This recourse is even stricter and more limited for operational creditors, as seen in the case of *Swiss Ribbons Pvt. Ltd. v. Union of India*.⁵⁵

Combined with PPIRP’s private negotiations and short timeline, the lack of transparency restricts access to critical information, often creating information asymmetry. While Section 61 empowers creditors to appeal to the NCLAT for an instance of fraud, the bar is very high.⁵⁶ The court in the case of *K. Sashidhar v. Indian Overseas Bank* clarified that challenges must show clear evidence of fraud, statutory non-compliance, or significant harm to stakeholders.⁵⁷ Mere dissatisfaction with commercial distribution or arrangement is insufficient. The court said that the NCLT has a very limited role in reviewing a CoC-approved

⁵⁰ *Id.*

⁵¹ V. Anantha Nageswaran & Aakanksha Arora, *Insolvency and Bankruptcy Code: A Path Well Travelled*, in IBBI, IBC: IDEA, IMPRESSIONS, AND IMPLEMENTATION 21 (2022), <https://ibbi.gov.in/uploads/whatsnew/b5fba368fbd5c5817333f95fbb0d48bb.pdf>.

⁵² Insolvency and Bankruptcy Code, 2016, § 24.

⁵³ *Comm. of Creditors of Essar Steel (India) Ltd. v. Satish Kumar Gupta*, 2019 SCC OnLine NCLAT 38.

⁵⁴ *Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta*, (2019) 2 SCC 1.

⁵⁵ *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17.

⁵⁶ Insolvency and Bankruptcy Code, 2016, § 61.

⁵⁷ *K. Sashidhar v. Indian Overseas Bank*, 2019 SCC OnLine SC 257.

resolution plan.⁵⁸ It only needs to check whether the plan meets the conditions under Section 30(2) of the Code. These conditions include proper payment priority, management of the corporate debtor, how the plan will be implemented and monitored, and compliance with the law. The NCLT cannot go beyond this while reviewing the plan. In the case of *Garodia Chemicals*,⁵⁹ the AA rejected a PPIRP bid for circumventing SEBI takeover rules demonstrating that tribunals will police pre-packs for improper tactics. Still, with only a handful of PPIRP cases so far, hard lessons are just emerging.⁶⁰

5.7 Limited Oversight by RP

Unlike CIRP, in pre-packaged insolvency, the RP has a less proactive role. He is appointed before plan submission to the Adjudicating Authority and assists in preparing the base resolution plan and ensures compliance under Section 54F.⁶¹ During the negotiation period, he is just a facilitator, which negatively affects his work in subsequent phases. His role includes detection of fraud and bad transactions, but he lacks the authority and resources to detect them in the pre-filing phase, when it is the most susceptible to fraud and mismanagement. The debtor's dominion over the submitted information and the tight deadline restrict the RP's capacity to carry out detailed due diligence, preventing fraud or concealment from being caught. To fix these issues, the RP must be given more than superficial power in the pre-filing phase, and to ensure "real supervision," he must be included in meetings with directors and provided with minutes of the meetings, so that he can keep track of any malicious activity.

5.8 Information Asymmetry and the Role of Information Utilities

Information asymmetry poses a significant impediment in PPIRP, slowing down and discouraging equitable solutions in the case of MSMEs where the formality and documentation are underestimated. It is reported by the Bankruptcy Law Reforms Committee (BLRC, 2015) that it "serves as a major barrier to equitable negotiations and slows down timely conclusion of the insolvency process."⁶² To overcome this, the Code created Information Utilities (IUs), like the IBBI-registered National E-Governance Services Ltd. (NeSL), which

⁵⁸ Indulia B & Ridhi, *The Real "Deal": Implementation of Resolution Plan Under the Insolvency and Bankruptcy Code, 2016*, SCC TIMES (June 20, 3:52 PM), <https://www.scconline.com/blog/post/2025/02/04/the-real-deal-implementation-of-resolution-plan-under-the-insolvency-and-bankruptcy-code-2016/>.

⁵⁹ *Garodia Chem. Ltd. v. Serene Indus. Ltd.*, 2018 SCC OnLine Bom 9783.

⁶⁰ Chinna Aswathy Abraham & Pooja Shree, *PPIRP Probed: Examining Progress and Challenges in MSME Insolvency*, SURANA & SURANA (Feb. 12, 2024), <https://suranaandsurana.com/ppirp-probed-examining-progress-and-challenges-in-msme-insolvency/>.

⁶¹ Insolvency and Bankruptcy Code, 2016, § 54F.

⁶² 1 THE REPORT OF THE BANKRUPTCY LAW REFORMS COMMITTEE VOLUME I: RATIONALE AND DESIGN (Nov. 4, 2015), https://ibbi.gov.in/BLRCReportVol1_04112015.pdf.

obtain, store, and distribute confirmed financial information, including debt, defaults, and claims of creditors, as required by Section 215.⁶³ Under the PPIRP for MSMEs, IUs can help mitigate asymmetry by making available correct financial data. While effective, their efficiency is constrained by the debtor-in-possession paradigm (Section 54A). In contrast to the CIRP, under which an RP assumes control, PPIRP provides exclusive access and control to debtors in terms of financial and operational information, thus providing informational leverage to a certain extent. This asymmetry is compounded by MSMEs' informal practices, e.g., inaccurate record-keeping, non-standard accounting, and informal structures like loans and borrowings from local vendors and relatives.⁶⁴

These are frequently outside IUs' capture, compelling RPs and creditors to be dependent on debtor disclosures, which can be selective or timed to benefit the debtor's interests. For instance, a debtor might exclude cash-based loans from IU records or list creditors that are not present in the books of account, deceiving creditors about the actual obligations. The Base Resolution Plan ("BRP"), drawn up by the debtor prior to NCLT admission (Section 54C), further exacerbates this problem since operational creditors have no full access to financial information or independent valuation to assess it in the early stages. RPs and creditors are hindered from confirming the debtor's financial situation because of informal documentation, MSME scale, and PPIRP's short timelines.⁶⁵

Moreover, IUs' credibility is undermined by dependence on creditors and debtor-sourced data, which can be incomplete or doctored.⁶⁶ Whereas RPs are authorized to verify records (Regulation 36), field-level verification is virtually infeasible given the non-cooperation of debtors, off-record practices, and the lack of time. It is thus easy for debtors and their chosen creditors to conceal fraud. The debtor's control over information with limited IU data and poor verification and authentication processes enables strategic withholding or misrepresentation, defeating transparency and fairness in PPIRP. With poor documentation, accounts, audits, and lack of disclosure and declaration, PPIRP will always be plagued with the risk of fraud.⁶⁷ Once the transactions of MSMEs are recorded and formalized on paper, we can make the declaration of financial data with IUs a mandate and prerequisite to PPIRP.⁶⁸

⁶³ Insolvency and Bankruptcy Code, 2016, § 215.

⁶⁴ Sumant Prashant et al., *Issues with the Regulation of Information Utilities*, NIPFP (July 13, 2017), <https://www.nipfp.org.in/publication-index-page/blog-index-page/issues-with-the-regulation-of-information-utilities/>.

⁶⁵ NeSL, *Awareness on Information Utility Under the IBC, 2016*, IPA ICAI (Sept. 27, 2018), https://www.ipaicmai.in/IPANEW/UploadFiles/PPT/NeSL_IPA_27-09-2018.pdf.

⁶⁶ Debajyoti Ray Chaudhuri, *Information Utility - A Vision for the Future*, in IBBI, IBC: EVOLUTION, LEARNINGS AND INNOVATION 211 (2023), <https://ibbi.gov.in/uploads/whatsnew/525cbe1dd3b1f9fd9866fe77676a96ae.pdf>.

⁶⁷ *Id.*

⁶⁸ Rama Subramaniam Gandhi, *Information Utility Ver 2.0*, in IBBI, IBC: EVOLUTION, LEARNINGS AND INNOVATION 203 (2023), <https://ibbi.gov.in/uploads/whatsnew/525cbe1dd3b1f9fd9866fe77676a96ae.pdf>.

5.9 Banks as Creditors

In PPIRP, the fast and DIP-led restructuring mechanism for stressed MSMEs presents considerable fraud risks when creditor banks fail to implement proper checks and balances. MSMEs that are part of larger corporate groups pose a major risk of fraud.⁶⁹ Under the statute, they are eligible for PPIRP, but their inclusion defeats the overall purpose of PPIRP for MSMEs. These entities often have access to financial and operational support through their parent companies; hence there is a risk of fraud and misuse of the PPIRP. Such conglomerate-backed MSMEs could manipulate the process with the tacit cooperation of banks, giving rise to the perception of misuse or creating avenues for backdoor bailouts, while real distressed enterprises are left out.⁷⁰ The parent company can use these “distressed” MSMEs for asset stripping and money laundering, thereby lowering the recovery of banks.

Banks may avoid classifying certain accounts as non-performing by pushing through quick, opaque restructuring deals, engaging in a form of “evergreening,” thereby keeping stressed assets appearing healthy without real financial recovery.⁷¹ As PPIRP prohibits initiation of a second insolvency proceeding against the same corporate debtor for three years after resolution, the process can be abused to keep bad debt recognition in abeyance perpetually. The debtor can also use this method to postpone liability and save its assets. There is also a possibility that the bank agrees to an unfavourable plan just to recover a fair fraction of the loan to avoid NPA and avoid the time costs of a lengthy CIRP.

5.10 Consideration for RBI and Bank’s Board of Directors

To encourage the pre-packaged insolvency while curbing fraud, the Reserve Bank of India (“RBI”) can issue guidelines targeting transparency and oversight. First, the RBI should issue guidelines for enhanced scrutiny in case of those MSMEs that are backed by conglomerates, which have robust support ecosystems, as seen in *GCCL Infrastructure* (NCLT Ahmedabad, 2021), where opacity raised collusion risks. It also helps prevent misuse and fraud, such as hiding intra-group debts.⁷² Banks should monitor loan restructurings, include them in Early Warning Systems, and report exposures in financial statements to prevent any foul play by the debtor. To curb the issue of evergreening, the RBI must introduce prudential

⁶⁹ Subbiah & Mehrotra, *supra* note 6.

⁷⁰ *Id.*

⁷¹ Sugata Ghosh, *ET Analysis: Is Evergreening of Loans Evergreen?*, ECON. TIMES (Dec. 21, 2023, 12:04 AM), <https://economictimes.indiatimes.com/industry/banking/finance/banking/et-analysis-is-evergreening-of-loans-evergreen/articleshow/106163189.cms?from=mdr>.

⁷² *In re GCCL Infrastructure & Projects Ltd.*, MANU/NC/3909/2021.

safeguards.⁷³ One important step would be to mandate higher capital requirements for loans restructured under PPIRP. This would act as a buffer against potential future defaults, acknowledging the elevated risk of failure given the absence of a fallback insolvency mechanism for three years.⁷⁴

Additionally, the RBI should require specific provisioning norms for PPIRP cases. This means banks would be obligated to set aside a portion of funds to cover possible losses from these restructured accounts, discouraging them from using PPIRP simply to avoid making provisions under normal NPA guidelines.⁷⁵ Further, bank boards need specific, quantitative policies for choosing PPIRP over CIRP to ensure consistent decisions, given low PPIRP adoption. In addition to this, proactive risk surveillance using transaction data and analytics is essential, as MSMEs' informal practices evade conventional monitoring. Finally, initially restricting PPIRP to high-risk sectors like services and trade, excluding asset-heavy real estate, aligns it with low-recovery industries, enhancing efficiency.⁷⁶ These measures promote PPIRP's integrity, protect banks, and address fraud risks, ensuring wider acceptance.

6 PRE-PACK INSOLVENCY: PROTECTION AGAINST FRAUD ACROSS DIFFERENT JURISDICTIONS

In the United States, protections against fraud heavily depend on judicial and administrative regulation. Bankruptcy Courts examine pre-pack plans upon approval hearings to ensure adherence to fairness benchmarks.⁷⁷ The US Trustee, akin to the RP, oversees filings and checks for fraud, i.e., asset hiding or preferential transfers. Creditor committees review the plans and object to any instance of fraud. Finally, the discretion of the court to authorize DIP financing needs to be carefully monitored to avoid abuse through related party sales.⁷⁸

Conversely, the United Kingdom puts more emphasis on safeguards by practitioners, supported by recent changes. Statement of Insolvency Practice 16 ("SIP 16") requires disclosure to creditors after sale in detail, vindicating the need and fairness of the pre-pack. In addition, the pre-pack pool ensures independent review of related party sales, but since its

⁷³ Subbiah & Mehrotra, *supra* note 6.

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ D.F. Dunne, D.C. O'Donnell & N. Almeida, *Prepackaged Chapter 11 in the United States: An Overview*, GLOBAL RESTRUCTURING REVIEW (Mar. 4, 2022), <https://globalrestructuringreview.com/guide/the-art-of-the-pre-pack-archived/edition-2/article/prepackaged-chapter-11-in-the-united-states-overview>.

⁷⁸ *Id.*

adoption is optional, its influence is limited.⁷⁹ Besides, to address the practice of phoenixing, the Corporate Insolvency and Governance Act 2020 created a requirement of independent reports by assessors for related party sales within eight weeks of administration. In the event of irregularities, the Insolvency Service has the power to penalise practitioners for improper conduct, although the absence of pre-sale creditor engagement and use of voluntary measures undermine fraud deterrence.⁸⁰

6.1 Lessons for India

In comparison to the US and the UK, India's legislative regime has explicit penalties and preventive measures, yet its sidelining of operational creditors and judicial delays negate intended effectiveness. The pre-pack in India is a thoughtfully crafted framework, meticulously designed to address the unique needs of Indian industries, particularly MSMEs. It strikes a delicate balance between efficiency and stakeholder confidence, reflecting the economic and sentimental realities of the Indian market. This is one reason why it is not advisable to directly implement measures from other jurisdictions.

However, we can take cues from the United States that help further sharpen our framework. In the U.S., bankruptcy cases are referred to specialized bankruptcy courts by district courts, where experienced judges make it efficient and uniform to deal with intricate insolvency issues.⁸¹ India can adopt this provision by introducing a special insolvency division or bench within the NCLT, with judges trained on the subtleties of insolvency of MSMEs. This would lighten the workload of the NCLT, especially in fraud cases that are filed objecting to the base resolution plan.⁸² In the case of MSMEs, which tend to have very thin margins, this practice would facilitate quicker resolution, consistent application of principles of insolvency, and scrutiny of pre-negotiated plans with the same careful attention, balancing speed with equity. However, this route would not be viable anytime soon because establishing a tribunal incurs substantial economic and operational costs, which would be warranted only by a multifold increase in PPIRP cases or a broadening of the framework to cover industries other than MSMEs.

⁷⁹ MINISTRY OF CORP. AFF., GOV'T OF INDIA, REPORT OF THE SUB-COMMITTEE OF THE INSOLVENCY LAW COMMITTEE ON PRE-PACKAGED INSOLVENCY RESOLUTION PROCESS 2020–2021 (Oct. 31, 2020), <https://ibbi.gov.in/uploads/resources/24c7fc03cdffff69960ce374416fa646.pdf>.

⁸⁰ Nageswaran & Arora, *supra* note 51.

⁸¹ 28 U.S.C. § 157(a) (2012).

⁸² Himani Singh, *Pre-Packaged Insolvency in India: Lessons from USA and UK*, SSRN (Jan. 13, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3518287.

7 CONCLUSION

The current pre-pack mechanism is an ambitious effort towards simplification of insolvency resolution for MSMEs via an informal, debtor-led route, given that they cannot afford the expense and timeframe of traditional insolvency.⁸³ By emphasizing speed and cost-effectiveness, PPIRP seeks to ease the burden on the NCLT and provide a lifeline to stressed MSMEs, a critical cog in India's economic engine. Yet, as this paper has made clear, the framework's flexibility and minimal regulation have set Pandora's box of vulnerabilities loose, with reported cases of fraud likely to call its effectiveness into question. The analysis exposes a regime caught in the twin imperatives of efficiency and accountability. The debtor-controlled paradigm of PPIRP, while sound in theory, encounters practical challenges because of the stringent burden of proof for fraudulent intent and the tight timelines of PPIRP.⁸⁴

The NCLT's discretion and the RP's investigating role are key shields against fraud, but their efficacy is impaired by information asymmetry, judicial oversight restrictions, and financial creditor dominance in decision-making. Creating dedicated insolvency benches within the NCLT, requiring improved disclosures via information utilities, and having tighter RBI regulations for banks could strengthen the regime against misuse. Most importantly, allowing operational creditors and dissenting voices to participate and be more transparent would put PPIRP in line with the Code's philosophy of fairness towards all stakeholders.

At a fork in the road in its insolvency journey, the PPIRP experiment reminds us that efficiency for the sake of efficiency is a pyrrhic victory. To achieve its transformative promise, PPIRP must transition to a system that not only saves viable MSMEs but also protects the sanctity of the insolvency ecosystem. By intertwining strong oversight, transparent procedures, disclosure, declaration and documentation, India can create a PPIRP regime that tips the scales of swiftness and justice in the right direction, without the threat of fraud.

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⁸³ Subbiah & Mehrotra, *supra* note 6.

⁸⁴ Sunil Mehta, *Pre-Pack: A Great Enabler for Resolution of Stress in MSMEs*, in IBBI, QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016 371 (2021), <https://ibbi.gov.in/uploads/whatsnew/1d8b31fc65f7ac6f09a973be8f12f868.pdf>.