

The Proposed Creditor-Led Resolution Process (CLRP): A Hybrid Model for Insolvency in India- An attempt to revive Pre-Pack without addressing key issues

The introduction of the **Pre-Packaged Insolvency Resolution Process (PPIRP)** in 2021 was seen as a significant step in speeding up insolvency proceedings for MSMEs. However, its success was limited due to a complex procedure, lack of flexibility, and the preference of creditors and corporate debtors for alternatives like One-Time Settlements (OTS). With **PPIRP** failing to gain traction, the **Insolvency and Bankruptcy Board of India (IBBI)** is now exploring the **Creditor-Led Resolution Process (CLRP)**¹ to address the significant delays in the admission stage of Corporate Insolvency Resolution Process (CIRP). However, the CLRP does not appear to be a true creditor-led process but rather a **hybrid mechanism**, combining elements of creditor initiation with the debtor's continued control of the business. In this alert, we explore the framework of CLRP, its objectives, and the challenges it may present for financial creditors, particularly banks.

Why CLRP is Being Proposed

The Challenge

At present, the key challenges for banks under the IBC are two-fold. First, there are significant delays in the admission of Section 7 applications to initiate the insolvency process. Although the IBC mandates a 14-day timeline for admission, in practice, it takes more than 6 months on average, with some cases stretching even longer due to procedural bottlenecks. Second, there is the delayed approval of resolution plans, where plans take 12 months or more to be approved by the NCLTs, far exceeding the prescribed 330-day limit for the overall process.

Delays at both the admission and resolution plan approval stages severely erode the value and realization for banks, as rising operational costs, legal expenses, and mounting interest burden diminish the recoverable amount. Additionally, prolonged delays prevent banks from reallocating resources to more profitable opportunities, further exacerbating their financial losses.

While the CLRP attempts to address the first challenge by expediting the initiation of the insolvency process, it does so only partially. Faster initiation under CLRP is likely to occur only when the borrower cooperates with the bank, which is not guaranteed. In cases where the borrower is uncooperative, CLRP will face the same challenges as the normal CIRP, including delays in admission and legal challenges. Moreover, CLRP fails to address the second challenge of delayed approval of resolution plans, leaving banks to prolonged waiting periods for the resolution of distressed assets.

The primary motivation for CLRP is to address the process of **admission**. Under CLRP, creditors can initiate the resolution process without waiting for **National Company Law Tribunal (NCLT)** approval, allowing the process to start immediately after a resolution professional (RP) is appointed. However, many of the subsequent steps remain prone to the same judicial interventions and challenges faced by normal CIRP cases.

The failure of PPIRP can largely be attributed to the complexity it added to the insolvency process without providing significant advantages over CIRP. Similarly, CLRP risks being ineffective in achieving its objective if it fails to streamline the entire resolution process and merely expedites the initiation stage.

Key Elements of CLRP

- **Initiation by Creditors:** CLRP is proposed to be initiated by financial creditors (FCs) holding at least **51%** of the total financial debt. Unlike CIRP, the debtor's participation in the initial decision-making process is not required, potentially allowing creditors to act swiftly in triggering insolvency.
- **Borrower's Role:** The corporate debtor (CD) is served with a **Notice of Lenders**, similar to the notice procedure under Section 13(2) of the **SARFAESI Act**. The debtor may respond, but the creditors are not bound to accept the debtor's

¹ <https://ibbi.gov.in/uploads/resources/ede9252b24c28166ea95602ca3c214b1.pdf>

explanation, thus limiting the debtor's influence in the early stages of the process. However, the creditors will have to consider such representations from the debtor and provide suitable reply.

- **Debtor in Control:** Despite creditor initiation, CLRP operates under a **debtor-in-possession model**, meaning the existing management of the corporate debtor continues to run the business. This differs significantly from CIRP, where a resolution professional takes over management. While this debtor-in-possession model may reduce operational disruptions, it also raises concerns for financial creditors who may fear that the debtor will continue to mismanage assets or deplete value during the insolvency process.
- **Absence of Section 28 Control:** Under CIRP, **Section 28** of the IBC provides financial creditors control over major decisions during the insolvency process. This section is not applicable under CLRP, leaving creditors with limited power to prevent detrimental actions by the debtor during the resolution process.
- **Moratorium and Judicial Oversight:** A moratorium under **Section 14 of IBC** is not automatically triggered but must be applied for by the RP. This introduces the risk of delays in protecting assets, as the moratorium could be subject to court challenges. Similarly, extensions of the moratorium require additional applications, further exposing the process to litigation and judicial delays.

Overview of the CLRP Process

Creditor-Led Resolution Process (CLRP) Flow



- **Default Occurs:** The corporate debtor defaults on its financial obligations.
- **Agreement Among Creditors to Initiate CLRP:** Financial creditors holding at least 51% of the total financial debt agree to initiate the CLRP process.
- **Notice to Borrower:** The creditors serve a notice to the borrower (corporate debtor), like the SARFAESI Act notice under Section 13(2). This notice informs the debtor of the creditors' intention to initiate CLRP.
- **Reply by Borrower:** The borrower (corporate debtor) responds to the notice. The response may include objections, claims, or defenses regarding the default and financial status.
- **Consideration and Disposal of Borrower's Representation by Creditors:** The creditors consider the borrower's reply, dispose of the representation, and decide on the course of action.
- **Appointment of Resolution Professional (RP):** The creditors appoint a resolution professional to manage the CLRP process and handle claims, plans, and other procedural aspects.

- **Filing of Application Before NCLT for Intimation of RP Appointment:** The creditors file an application before the National Company Law Tribunal (NCLT) to inform them of the RP appointment.
- **Application for Moratorium:** The RP applies for a moratorium under Section 14 of the IBC to halt all ongoing legal proceedings against the corporate debtor, protecting the debtor's assets during the resolution process.
- **Invitation and Admission of Claims:** The RP invites creditors to submit their claims. The RP verifies and admits these claims in the CLRP process.
- **Formation of Committee of Creditors (CoC):** The CoC is formed based on the verified claims submitted by financial creditors.
- **Invitation for Resolution Plans:** The RP invites resolution applicants to submit resolution plans for the corporate debtor.
- **Approval of Resolution Plan by CoC (66% Voting Requirement):** The submitted resolution plans are evaluated, and the CoC votes on the best plan. A minimum of 66% approval from the CoC is required to pass the plan.
- **Avoidance Applications:** If any avoidance transactions (fraudulent, undervalued, or preferential transactions) are identified, the RP files avoidance applications.
- **Approval of Plan by NCLT:** The approved resolution plan is submitted to NCLT for final approval. The NCLT reviews and approves the plan if it meets all legal requirements.
- **Implementation of Plan / Failure of CLRP**
 - If the plan is approved and implemented successfully: The resolution is complete.
 - If the plan fails: The CLRP is deemed unsuccessful.
- **Filing Section 7 Application if CLRP Fails:** If the CLRP fails, the creditors may initiate a fresh Corporate Insolvency Resolution Process (CIRP) by filing a Section 7 application with the NCLT.

Challenges with CLRP

While CLRP addresses admission delays, many other elements remain unchanged from CIRP, making the process equally susceptible to delays and challenges. Below are the key challenges identified:

- **Risk of Litigation from the Outset:** Since the borrower is excluded from the decision to initiate CLRP, this exclusion could prompt litigation even before the process officially begins. Borrowers may contest the process at various stages, including during the notice period, making it difficult for creditors to proceed without judicial intervention.
- **Limited Creditor Control:** Under CLRP, creditors have limited control over the debtor's management of the business during the insolvency process. Without the protections provided under Section 28 of IBC, financial creditors—especially banks—may be exposed to the risk of asset depletion or operational mismanagement, particularly in cases where they do not trust the current management.
- **Inefficiencies in the Claim and Resolution Plan Process:** The process of collecting claims and approving a resolution plan under CLRP mirrors that of CIRP. As seen in CIRP, these stages are often fraught with disputes and delays, particularly around claim admission, resolution plan evaluations, and legal challenges. CLRP does not introduce any significant reforms to expedite these stages, thus potentially undermining the very objective of a faster resolution.
- **Risks from Failure of CLRP:** In the event that CLRP fails, creditors would have to initiate a fresh CIRP under Section 7 of IBC. This could lead to significant delays, especially as the corporate debtor remains in control throughout the CLRP process. This aspect could dissuade banks from opting for CLRP, as they may view it as risky in contentious insolvency cases.
- **Delays in Plan Approval :** While CLRP expedites initiation, it does not address the critical issue of delays in approval at the resolution plan stage. Each day of delay in approving a plan result in financial losses for banks, as funds remain locked in the insolvency process. Judicial intervention and challenges to resolution plans will likely continue under CLRP, as stakeholders like workers, unsuccessful resolution applicants, and operational creditors can still contest the process.

Assessment and Conclusion

- While the proposed CLRP seeks to streamline insolvency by expediting admission, it does not fundamentally address the issues of delays, creditor control, or judicial intervention that plague the CIRP. In contested cases, banks may find that CLRP exposes them to greater risks, as they have limited control over the debtor's actions and would have to file a fresh CIRP application if the process fails. On the other hand, CLRP could benefit situations where the corporate debtor is cooperative, as it allows for quicker initiation without waiting for court approval.
- The proposed CLRP process, like the **SARFAESI Act**, involves a similar mechanism where creditors issue a notice to the corporate debtor (CD) before initiating further action. This makes the process potentially **litigation-prone**, especially when borrowers are uncooperative or contest the proceedings.
- The creditors issue a **Notice of Lenders** to the corporate debtor under the CLRP, akin to the **Section 13(2) notice** under the SARFAESI Act. This notice informs the debtor of the intention to initiate the resolution process. As seen under SARFAESI, the borrower is likely to challenge the notice, arguing against the creditors' claims and raising issues related to the loan or financial transactions.
- **Challenge in CLRP:** Given the experience under SARFAESI, it is likely that creditors in CLRP will face similar delays in responding to borrower objections. If the borrower challenges the validity of the default or raises other defenses, the process could be drawn into lengthy litigation, preventing creditors from moving forward with appointing a resolution professional or securing a moratorium.
- The experiences under SARFAESI provide a clear warning for banks considering the CLRP process. Since the framework draws inspiration from SARFAESI, it carries the same risks of **litigation** and **delays**.
- Without borrower cooperation, the process is likely to be delayed by legal challenges at every step, from the initial notice to the appointment of the RP and the moratorium.
- Unlike in CIRP, where a moratorium automatically takes effect upon admission, the RP must apply for a moratorium under CLRP, providing further opportunities for the borrower to contest the process. This delays the protection of the debtor's assets and exposes the creditors to risk.
- **Debtor in Control Model:** Unlike CIRP, where the RP takes control of the debtor's business, CLRP follows a debtor-in-possession model, which allows the existing management to continue running the business during the insolvency process. This is inherently risky for banks, especially in cases where the management's previous actions have contributed to the company's distress. The absence of Section 28 of IBC—which gives financial creditors control over key business decisions during CIRP—further reduces creditor oversight, leaving banks vulnerable to asset depletion or value erosion during the CLRP.
- **Challenges Relating to Approval of Resolution Plans**

One of the critical pain points for banks during insolvency proceedings, is the approval of the resolution plan by the Adjudicating Authority (NCLT). This process is often hampered by multiple challenges, including the filing of interim applications, opposition by various stakeholders, and complex legal issues that prolong the decision-making process. As a result, even after the CoC's approval, the creditors are left waiting, sometimes for extended periods, for the NCLT's final nod, which is critical for implementing the plan.

While CLRP is designed to expedite the insolvency resolution process by allowing creditors to initiate proceedings out-of-court, it **fails to address the bottlenecks related to plan approval by the NCLT**.

- **Potential for CLRP Failure:** One of the most significant risks under CLRP is that, if the resolution plan fails or the process is otherwise unsuccessful, creditors are forced to initiate a fresh CIRP under Section 7. This adds another layer of uncertainty and potential delay, further reducing the attractiveness of CLRP for banks.

In overall assessment from Bankers' perspective, CLRP does not provide any additional benefit to creditors, particularly banks, as the delays in approval of resolution plans remain a major concern and appears to be as **litigation-prone** and time-consuming as in CIRP.

The challenges currently being addressed through the introduction of yet another form of insolvency process could be more effectively resolved by amending Section 29A and making the Pre-Pack Insolvency Process more practical by eliminating procedural hurdles. From the banks' perspective, the CLRP in its present form offers limited relief and is likely to be litigation-prone and challenging, especially if initiated without the cooperation of the borrower or debtor.

However, the system still wishes to experiment with one more hybrid form of insolvency process, it will have to be made much more user friendly.

To make CLRP a more attractive and beneficial option for banks, several key improvements could be made:

- **Automatic Moratorium:** Introducing an automatic moratorium upon initiation of CLRP, similar to CIRP, would provide immediate protection to the debtor's assets. This would reduce the risk of legal challenges at the initial stages and ensure that creditors have greater control over the debtor's assets during the resolution process.
- **Strengthening Creditor Control:** The debtor-in-possession model could be revised to give creditors more control over the debtor's business during the CLRP process. Implementing Section 28-like provisions, where the CoC has the power to approve or reject critical business decisions, would give banks more confidence that their interests are protected and that the debtor's management is not engaging in practices that could erode value.
- **Limiting Borrower Litigation:** To mitigate the risk of litigation at the notice stage, clear guidelines should be set regarding the borrower's representation rights and the disposal of such representations. The process should limit the debtor's ability to challenge every step of the process, thus minimizing delays. Additionally, creating a fast-track mechanism to resolve disputes over borrower responses could prevent drawn-out legal battles.
- **Expedited Plan Approval:** One of the most critical areas of improvement would be to streamline the approval of resolution plans at the NCLT stage. Introducing statutory timelines for the approval of plans and reducing the scope for challenges by stakeholders after CoC approval could significantly reduce the delays that banks face in realizing their dues.
- **Stronger Enforcement of Approved Plans:** In cases where resolution plans are successfully implemented, stronger enforcement mechanisms should be introduced to ensure compliance by the corporate debtor. This would reduce the risk of post-approval defaults and minimize the need to initiate fresh insolvency proceedings under Section 7.
- **Simplified Process for Smaller Cases:** For smaller insolvency cases, particularly MSMEs, a simplified version of CLRP with less procedural complexity and fewer opportunities for litigation could be introduced. This would help banks recover their dues more efficiently in cases where the financial stakes are relatively low.

Thus, while the proposed CLRP attempts to resolve the issue of admission delays, it falls short in addressing the **core challenges** faced by banks during insolvency *proceedings*. The lack of creditor control, the potential for litigation at multiple stages, and the risk of plan failure make CLRP a less attractive option compared to CIRP, particularly in contested cases.

In summary, CLRP offers **limited advantages** over CIRP and may not be the preferred option for banks in contentious insolvency situations. However, it could be beneficial in cases where a cooperative debtor is willing to work with creditors to resolve the insolvency quickly and efficiently.

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