VOLUME 5 | ISSUE 1 AUGUST 2024 ISSN: 2582-7340

VOLUME 5 | ISSUE 1

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

REVERSE CIRP: A MASTERSTROKE OR A MISSTEP IN INSOLVENCY LAW?

- Tripti Srija[1]

Abstract:

The Indian real estate sector is currently experiencing a substantial increase in the number of corporate debtors undergoing the Corporate Insolvency Resolution Process(CIRP). This statistic underscores the need for a thorough examination of Reverse CIRP, a newly implemented mechanism designed to address the intricate challenges of real estate insolvency. As of September 30, 2023, the Insolvency and Bankruptcy Board of India (IBBI) reported[2] that 7,054 corporate debtors were accepted into CIRP, with the real estate and construction sectors accounting for 33% of these cases. This data points towards the existing crisis in the real estate industry and emphasizes the necessity of dealing with these insolvency matters through useful strategies.

This paper explores the complex field of real estate insolvency with a special emphasis on the concept of Reverse CIRP. The paper will entail a critical analysis ofthe legal structure regulating real estate insolvency within the Indian context. This research aims to illuminate the unique challenge that Reverse CIRP poses while itseeks to alleviate the plight of homebuyers, constantly caught up in the web of delayed projects and financial instability, by scrutiny of the provisions of theInsolvency and Bankruptcy Code in tandem with pertinent case law.

The exploration would include a close analysis of key amendments made to the IBCin 2018 and 2019, and how such amendments have gone on to affect homebuyers aswell as developers. In the process, key judicial decisions that have determined thecourse of Reverse

[1] 5th year student KIIT School of Law Bhubaneshwar

[2] Insolvency and Bankruptcy Board of India. (2023). Discussion Paper on "Rationalization of the Regulatory Framework for Enhancing the Effectiveness of Insolvency Professional Entities in Insolvency Resolution Process." https://ibbi.gov.in/uploads/whatsnew/cff92741c41ddc4b0a5e81d9ff4063c2.pdf

©2024 International Journal of Advanced Legal Research

CIRP implementation would be brought out and assessed againstthe impact they have had on participants in the real estate industry, in particular,financial institutions.

This comprehensive study aims to shed light on the operational intricacies involvedwith Reverse CIRP and its potential implications for dispute resolution in the realestate market. This research will investigate various benefits and drawbacks of thisnew process while emphasizing the necessity of fair and just practices in real estatesector insolvency resolution. In conclusion, this paper seeks to improve understandingof the complexities involved with the insolvency of real estate and to providestakeholders with the lessons learned as regards the transforming nature of ReverseCIRP, thus encouraging discourse meant to improvetransparency and accountabilityin the industry.

Keyword: IBC, Reverse CIRP, Real Estate, Allottees, IBBI

History of reverse CIRP

"To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation."3

Citing this precedent set up in Swiss Ribbons Private Limited and Anr. vs. Union ofIndia and Ors, [4]the National Company Law Appellate Tribunal ("NCLAT") introducedthe concept of reverse CIRP in Flat Buyers Association Winter Hills—77, Gurgaon vs.Umang Realtech Pvt. Ltd through IRP and Ors.[5]

The Indian development of insolvency legislation, particularly as viewed through theframework of the Insolvency and Bankruptcy Code 2016, seems to illustrate a legalsystemthat presumably tries to approach the very complex issues associated with corporate insolvencies. A significant yet often overlooked aspect of this legal landscape is the concept of the Reverse Corporate Insolvency Resolution Process(CIRP), introduced by the National Company Law Appellate Tribunal (NCLAT) in itsdecision in Flat Buyers Association Winter Hills—77, Gurgaon vs. Umang RealtechPvt. Ltd through IRP and Ors[6]. This innovative mechanism emerged as a criticalresponse to the unique challenges faced by

[3]Swiss Ribbons Private Limited and Anr. vs. Union of India and Ors
[4] (2019) SCC OnLine SC 73
[5] 2020 SCC OnLine NCLAT 1199
[6]ibid

©2024 International Journal of Advanced Legal Research

homebuyers in the real estate sector,whose rights and interests had previously been at risk during traditional insolvencyproceedings.[7]

Traditionally, Reverse Insolvency was not covered by the IBC. Though successiveamendments, such as the inclusion of a homebuyer as a financial creditor, provided the veryfirst step in the march to evolve the Code, the typical processes for corporateinsolvency resolution were strewn with complexities that would have the potential todilute the rights of homebuyers. The NCLAT's new Reverse CIRP is a game-changer.It's not meant to replace the old ways of doing things, but to give us a better tool forsolving debt problems and getting the most out of assets.

The regular CIRP has been getting a lot of attention lately, especially when it comesto protecting homebuyers. That's why the courts started looking into alternative waysto solve these problems, like Reverse CIRP. This is especially useful for real estatecompanies. Promoters who want to avoid CIRP can now step in and become thelenders themselves by providing the necessary funds to finish the projects. TheNCLAT's directive in the Flat Buyers Case[8] emphasized this approach. They askedpromoters to work together with the Interim Resolution Professional to complete theprojects on time, but this time, they would be acting as financial creditors, not aspromoters.

Importantly, reverse CIRP is project-specific and addresses the specific context ofeach real estate development. The rulings of NCLAT stress that the CIRP, beinglimited to real estatecompanies alone, should be applied only to specific projects,thus protecting the rights of homebuyers and preventing them from forcibly gettingattracted into a wider insolvency process. This project-specific framework is furtherstrengthened by recent amendments to Section 7 of the IBC, ensuring that the interestsof the allottees are superior to the established objectives of the act.

The reverse CIRP contains an important element that enables the homebuyer to fileclaims for unappropriated amounts and, hence, to better his position in the creditorscommittee ranking. Furthermore, it enables the allottees to get support from theInterim Resolution Professional or the promoter to identify a third-party buyer fortheir units, thereby increasing the chances of

[7] Sharma, A. (2022). REVERSE CORPORATE INSOLVENCY RESOLUTION PROCEDURE: AN ANALYSIS. INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS, 2(6), 4–6. https://www.ijlra.com/productImage/Anjali%20Sharma.pdf

[8] Ibid.

©2024 International Journal of Advanced Legal Research

recouping their investment. Thismechanism supports the claims of the allottees against the regular financial creditorsbut establishes a precept that Favors the claims of the allottees compared to otherfinancial entities.

Set against this backdrop are these developments, so this paper will probe into theintricate aspects of reverse CIRP, analyse its importance to the homebuyers and thereal estate companies, its legal framework, and the potential it holds in redrawing the Indian insolvency landscape. Based on this comprehensive analysis, this paper shallcontribute to this greater conversation surrounding the insolvency resolutionmechanism as the mechanism to solve the varied challenges of the real estate sector.

Allottees as financial creditors

In 2017, the National Company Law Tribunal (NCLT) took a significant step byinitiating the Corporate Insolvency Resolution Process (CIRP) against several majorreal estate companies, including Jaypee Infratech Limited and the Amrapali Group.This move prompted substantial revisions to the Insolvency and Bankruptcy Code(IBC) 2016. The Report of the Insolvency Law Committee, published in March 2018[9],expressed serious concerns regarding the plight of real estate project allottees, whofelt marginalized in the insolvency process. The Committee emphasized the urgentneed to amend the Code to clarify that allottees should be classified as financialcreditors.

The report pointed to a worrying trend: apartment deliveries currently underconstruction were often delayed. Some projects comprised such a huge portion of thecapital received from allottees that it was repeatedly diverted into supporting thecontinuous development of the related projects, which raised an eyebrow over theirfinancial health.

In response to these critical issues, the Insolvency and Bankruptcy (Amendment)Ordinance, 2018 (the "Amendment Ordinance")[10], was enacted on June 6, 2018,incorporating many of the recommendations from the Insolvency Law Committee.

[9] Srinivas, I., Sahoo, M. S., Kaul, V., Vishwanathan, T. K., Sen, S., Shroff, S., Shah, R., Sriram, B., Vakil, B., Birla, S., Lele, M., Gupta, S., Gupta, N. N., & Gyaneshwar Kumar Singh. (2018). REPORT OF THE INSOLVENCY LAW COMMITTEE. https://ibbi.gov.in/ILRReport2603_03042018.pdf

[10] 'President Approves Promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018', Press Information Bureau, Government of India, Ministry of Corporate Affairs, 6th June 2018, available at <https://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Jun/President%20Approves%20Promulgation%20of%20the% 20Insolvency%20and%20Bankruptcy%20Code%20(Amendment)%20Ordinance,%202018 2018-06-06%2021:10:49.pdf>

©2024 International Journal of Advanced Legal Research

Among its key provisions, the Ordinance established that allottees would be formallyrecognized as financial creditors under the Code. This recognition was solidified bythe subsequent enactment of the Insolvency and Bankruptcy Code (SecondAmendment) Act,2018 (the "2018 Amendment") on August 17, 2018. For the firsttime, the law explicitly acknowledged the status of allottees in real estate projects asfinancial creditors.

The 2018 Amendment also included an important clarification in Section 5(8)(f) ofthe Code, stating that any amounts received from an allottee about a real estate projectwould be considered to have the "commercial effect of a borrowing." This definitionfirmly established the obligations owed to allottees as 'financial debt.'This inclusionwas not merely symbolic; it reflected a fundamental recognition of the uniquefinancial dynamics between allottees and real estate developers. Following thisamendment, the Supreme Court, in its ruling on Pioneer Urban Land andInfrastructure Limited vs. Union of India[11], held the amendment legally valid, it alsoheld that this amendment was done for furtherance of the objectives of the Code.

To meet this difference, the Code brought in Section 21(6A)(b) and Section 25A.Both these sections comprised the requirements to appoint an AuthorizedRepresentative or AR to represent the allottees on specific real estate projects. Thatwas a step forward in recognizing allottees as a diverse class of financial creditors,which empowered allottees to participate better in the decision-making processes, andallowed them to vote in the CoC committee meetings also. Per Section 25A(3A), theAuthorized Representative is obligated to cast votes in alignment with the majoritydecision of the allottees and to comply with any prior voting directives that have beengiven to them.

Challenging the 2018 Amendment

This decision is a significant achievement for the homeowners in that they would gainequality with the banks and other financial institutions in the process of determiningthe resolution. Through this legal setting, deception in development projects bydevelopers who still collect huge payments from house buyers without deliveringtheir projects is going to have an adequate deterrent.

However, the amendment was opposed by over 150 builders and developers, whoargued that declaring homebuyers as financial creditors was an unfair anddiscriminatory classification

[11] (2019) 8 SCC 416

©2024 International Journal of Advanced Legal Research

under Article 14 of the Constitution. They contended thatthis classification could destabilize the management of otherwise sound companies,suggesting that the actions of a single disgruntled homebuyer could jeopardize entirehousing projects. In addition, there were apprehensions that the changes may cause aninflux of petitions in the NCLT, thereby straining the system.

A major point put forth by the real estate developers was that homebuyers alreadyhave protection through the Real Estate (Regulation and Development) Act, 2016(RERA) as wellas consumer protection statutes and therefore should not come withinthe ambit of the Code. They claimed that booking amounts for apartments cannot betreated as 'financial loans', which is true to an extent, but this view ignores the factthat homebuyers also invest substantially in real estate projects.

The Supreme Court, however, held that the policy-makers deserve respect, especiallyin her economic sphere. The Court referred to the advances made by the InsolvencyCommittee, which sought to address the issues associated with the cause of delaysinvolving the completion of still-developing houses and appreciated that the moneycollected from the house buyers plays an important role in developing such projects.Therefore, the Court held that it was reasonable, if not expedient, to includehomebuyers as financial creditors in their protective ambit.

Besides, the Court considered the RERA Act and found that both RERA and the Codeco-existed, however, in case of inconsistency, the provision of the Code shall haveprecedence. This reading raises further issues related to the reality of these two lawsfor either home buyers or developers and the inherent aggressiveness of the policystrategy.

The court emphasized the unique situation of homebuyers. They're not just creditorsproviding a service, they've invested financially in the project itself, distinguishingthem from operational creditors. Homebuyers have a vested interest in the developer'sconstruction plan since their money is tied to the completion of houses. This sets themapart from operational creditors or mere consumers, denying them such distinctionwould likely affect their rights. This perspective invites us to consider how we mightbetter support homebuyers in securing their rights without inadvertently underminingdevelopers who are genuinely attempting to fulfil their obligations.

©2024 International Journal of Advanced Legal Research

The Supreme Court's decision reiterated that the classification of homebuyers asfinancial creditors is neither arbitrary nor irrational. Rather, it is consistent with theexpansive purposes of the Code which seeks to protect the position of all unsecuredcreditors including allottees. As a result of this, the Court has elevated the status ofhome buyers within the insolvency regime as they can pursue remedies under theCode while respecting the provisions of RERA and the consumer protection laws.

This historic ruling brings a hopeful narrative toward a fairer resolution process forthe homebuyers, who have suffered delays and empty assurances. With the blessing ofthe Court,the proceedings that had been paralyzed before the NCLT and NCLATmay now continue thereby rendering the much-awaited relief to the homebuyers.

Inthe end, this decision represents a momentous advance in establishing responsibilityin the housing market without overlooking the interests of home purchases. It alsobrings to the fore the question of how the real estate law will look in the future: Howdoes this decision affect the actor's relations; the developers and the homebuyers?Will it impact the way developments are carried out by the d developers and they willbe faster in finishing building projects? And how do attorneys deal with these changesin business as usual in the course of what normally entails a real estate transaction?

Threshold for Initiation of CIRP by Allottees

Undoubtedly, the 2018 Amendment to the Insolvency and Bankruptcy Code (IBC)was a much-needed development in protecting the rights of several homebuyers. Yet,this exception also accidentally became a boon for the section of society that resorts tolitigations, because a single unhappy allottee was granted the unqualified authority toinitiate Corporate Insolvency Resolution Process (CIRP) proceedings, not just againsta single project or multiple projects, but against entire real estate companies. Thisprompted the need for some legislative action which led to the passing of theInsolvency and Bankruptcy Code (Amendment) Act, 2020. This act was implementedon the 13th of March 2020.

The 2020 Amendment introduced a critical reform in Section 7 of the Code byestablishing a minimum threshold for initiating CIRP proceedings by homebuyers.Under the new provisions, a group of at least 100 allottees from the same real estateproject, or at least 10% of the total number of allottees, whichever is lower, mustjointly initiate the process.

©2024 International Journal of Advanced Legal Research

The constitutionality of this threshold was contested but ultimately upheld by theSupreme Court in Manish Kumar vs. Union of India[12]. The Court recognized thepractical challenges posed by the 2018 Amendment and confirmed the necessity of anumerical limit to ensure that the initiation of CIRP was not unduly burdensome ondevelopers who might be managing multiple projects. This decision had significantramifications, resulting in a surge of CIRP applications that impacted developmentprojects across the board.

In defining "allottee," the Code refers to Section 2(d) of the Real Estate (Regulationand Development) Act, 2016 (RERA), which describes an allottee as an individual towhom a plot, apartment, or building is allocated. The computation of every allotee intotal considers only the number of units allocated in a particular project leaving asideinstances of joint allotments where more than one person can be attached to one unit.For example, if 3 persons book 4 units each in a project with a total of 20 units, onlythree will be considered as unit allottees whereas the allotment of apartments madedirectly is overhead 12.

The Insertion of any numerical limit on the Code is a welcome one since it helps tocurb its excesses, but has come with its problems as well. For example, the first andprimary challenge is the information asymmetry to allottees that can be a barrier totheir capacity to achieve the new bar for commencing CIRP. This is even much worsewhen the developer is insolvent, barring any repayments and thus managerial changeshave to be applied.

This exemplifies a common problem in the real estate market where there is often aconflict of interest between the consumers and the service providers. The newthresholds in this scenario are aimed at addressing unmeritorious petitioners, butalthough this may sound just, it tilts the scale again towards developers in a mannerthat centralizes homebuyers' safety in the rights and other claims. To resolve theseunfair structures and to promote equity in the industry, it is imperative to introducemeasures that will compel building demonstrators to make public informationregarding allottees. If such information is available to the buyers, then the legislativeobjective of encouraging fairness in property transactions would be easier toaccomplish.

Reverse CIRP INTRODUCED

[12] 2021 SCC OnLine SC 30

©2024 International Journal of Advanced Legal Research

In a scenario tied to a particular real estate development, as per the provisions of theReverse Corporate Insolvency Resolution Process (CIRP) an advanced strategy hasbeen developed to control the financial exposure that one might face about thespecific projects without pulling the whole company into that web. This is especiallyuseful in the cases of the holding company being solvent and some of its projectsbeing under threat of bankruptcy. This was amply illustrated in the case of UmangRealtech,[13] where Reverse CIRP allowed the insolvency process to be restricted to theWinter Hills 77 project only and the rest of the projects under Uppal Housing Pvt Ltd.were left intact. Yet, the very strategy engenders issues that beg for answersconcerning the scope of fairness of the approach. In respect of the provisions of theInsolvency and Bankruptcy Code (IBC) and the general business malaise, a CIRP ismeant to apply to a company in turn around. But does it not offend the very tenets offair play that the Code seeks to promote through this methodology?

The NCLAT’s guidelines from the Flat Buyers Association vs. Umang Realtech(2020)[14] case shed light on this matter, delineating specific monitoring protocols forReverse CIRP. Here are the salient points from the ruling:

1. There should be an agreement between the promoter and allottees allowing thepromoter to act as a financial lender for the project (Para No. 13).[15]
2. The promoter must remain outside the CIRP while ensuring that allottees receivepossession during the proceedings, without the involvement of any third parties (ParaNo. 13).
3. Promoters are required to provide a timeline for project completion and for thedevelopment of common areas (Para No. 15).
4. Detailed accounts of amounts owed by allottees and any defaults should beprovided by thepromoter (Para No. 15).
5. Any payments made by the promoter, along with amounts generated from allotteesduringthe CIRP, must be deposited into the corporate debtor's account to sustain itsongoing operations (Para No. 26).

---

[13]Company Appeal (AT) (Insolvency) No. 926 of 2019
[14] Ibid.
[15] Abhani, H. R. (2024). Revolutionizing Corporate Insolvency Resolution in Real Estate: The Emergence of Reverse CIRP in India. THE RESOLUTION PROFESSIONAL, 21–23. https://www.iiipicai.in/wp-content/uploads/2024/05/21-27-Article-hiten-Abhani.pdf

©2024 International Journal of Advanced Legal Research

6. These funds can only be utilized through cheques signed by an authorized personfrom thecorporate debtor, countersigned by the Interim Resolution Professional (IRP)(Para No. 26).
7. Funds deposited in the corporate account should be allocated solely for the specificprojectin question (Para No. 26).
8. Banks are permitted to encash cheques only with the IRP's countersignature (ParaNo. 26).
9. Financial institutions and banks must be paid simultaneously during the resolutionprocess (Para No. 27).
10. Allottees are obliged to pay their dues by specified deadlines (Para No. 27).
11. Allottees are permitted to form Resident Welfare Associations (RWAs) tofacilitate theirclaims on common areas (Para No. 28).
12. The promoter is responsible for covering resolution costs, including the IRP's fees(Para No. 29).
13. Unsold flats or apartments can only be transferred back to the promoter afterobtaining a completion certificate from the IRP and the Adjudicating Authority (AA)(Para No. 29).
14. The IRP has the option to sell unsold inventory even during CIRP through atripartite agreement between the purchaser, IRP/RP, and the promoter (Para No. 30).

While these guidelines provide a structured approach to the implementation ofReverse CIRP, they raise pertinent questions about their efficacy in ensuring a fairresolution process. The judiciary's involvement in operationalizing Reverse CIRPthrough these directives is commendable; however, concerns persist regarding thepotential overreach of tribunal authority and the deviation from IBC principles.

The Ministry of Corporate Affairs (MCA) has recognized the advantages of aproject-specific insolvency resolution framework tailored for the real estate sector. Ina discussion paperdated January 18, 2023[16], the MCA proposed a formal structureunder which the Adjudicating Authority could initiate CIRP only for projects facingdefault rather than the entire corporate debtor.

[16] Ministry of Corporate Affairs. (2023). In Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016. MCA. https://www.mca.gov.in/bin/dms/getdocument?mds=%252F%252BvFPv8K3F2phOvVgShgDA%253D%253D&type=open

©2024 International Journal of Advanced Legal Research

This framework is intended to sustainthe ongoing projects as well as provide assistance to those who are in financialdistress. However, one nagging question endures: would this framework ensure theprotection of each party's interests including homebuyers, developers, and creditors?

The MCA's proposal implies that there is already an understanding of thecomplexities posedby real estate insolvency cases. It appreciates that there is a needto look at this industrydifferently because of the many sectoral and cross-sectoralfinancial legal arrangementswhere a corporate debtor is pursuing a number ofprojects with different financing terms.

In any case, to achieve broad acceptance of Reverse CIRP from the practicingcommunity, unambiguous provisions for its use must find their way into the IBC. Theabsence of statutory backing creates room for the Reverse CIRP's implementation tobe subjective and susceptible to dilemmas on its applicability to stakeholders'interests. That said, as we take stock of the aforementioned developments, a questionsurfaces: will the fitting of Reverse CIRP withinthe current insolvency structure serveto bring better protection for stakeholders, or will this be more burdensome in dealingwith an already complex system?

PROJECT SPECIFIC

There is a lot of debate on how to interpret and implement the Insolvency andBankruptcy Code (IBC), especially on the recent judgments passed by the NationalCompany Law Appellate Tribunal (NCLAT) on the Corporate Insolvency ResolutionProcess (CIRP) of real estate companies. Its landmark ruling in Umang Realtech Pvt.Ltd[17]. advised that CIRP for real estate companies should, instead of looking at theentire corporate debtor, only examine the specific "project in default." This approachfocuses on the need to protect projects that are capable of being financed and whichhave different stages of development, thereby ensuring that the IBC goals of assetmaximization are achieved. This project-centric approach was reiterated in multiplesubsequent judgments.

For instance, the NCLT restricted the ambit of the CIRP toindividual projects rather than extending it to the corporate entity as a whole inUmesh Chander & Ors. v. GRJ

[17]Ibid

©2024 International Journal of Advanced Legal Research

Distributorsand Developers Pvt. Ltd[18]. (ProjectAvalon Rosewood) and Anil Kaushal & Ors. v. Logix City Developers Pvt. Ltd.[19]

(Project Blossom Zest). Similarly, in the circulatingCIRP against Supertech Limited[20], NCLAT restricted the scope to the Eco Village-IIproject; the judgment was upheld by the Supreme Court by choosing not to intervenewhen moved by the litigants. The NCLAT further supported the concept ofproject-centric CIRP in Ambika Prasad Sharma v. Horizon Buildcon Pvt. Ltd.[21],which crystallizes the boundary set by the judiciary limiting CIRP to individualprojects.

All of these judgments incline the tendency of bankruptcy proceedings inreal estate to confine their reach and focus on protecting specific projects fromunwarranted interference. Thus, starting from 15 February 2024, the amendments inthe IBBI Regulations[22] have enabled the Administrator/Resolution Professional toprepare independent resolution Plans for respective projects, but subject to approvalfrom the Committee of Creditors. Further, the amendments would require separatebank accounts to be open for each real estate project to ensure accountability andtransparency in financial management. However, while these reforms can be seen asstepping forward, they do not address a very pertinent question concerningproject-specific CIRP for corporate debtors. Since there is no statutory structuregoverning this concept, this creates an apparent risk of abuse by developers wishing toprotect their more lucrative endeavours behind the fallacy of insolvency, abandoningunprofitable enterprises. These loopholes-inadvertently though ominously-couldexpose viable projects to an insolvency trajectory, delaying their completion andnegatively impacting the allottees.

Some critics of the NCLAT's approach note that confining a resolution plan within theambit of several projects undermines the enterprise "comprehensive structure"envisaged in the IBC, which is supposed to ensure expeditious resolution of corporatebankruptcy cases as a whole. In the past, Israel found that the principal object of theIBC was to maximize the value of the assets or schemes of a debtor to keep it as agoing concern. Thus, critics maintain that

[18] Initiated vide Order dated 16.02.2023 by the NCLT, Delhi in C.P. (IB) No. 477/ND/2021 and affirmed by the NCLAT vide Order dated 12.04.2023 in Company Appeal (AT) (Ins.) No. 406 of 2023.
[19] Initiated vide Order dated 17.08.2022 by NCLT, Delhi in C.P. No. 440/ND/2021.
[20] Order dated 27.07.2022 of NCLAT in Company Appeal (AT) (Ins.) No. 406 of 2022
[21] Judgment dated 08.04.2021 in Company Appeal (AT) (Ins.) No. 1398 of 2019
[22] Regulation 46A

©2024 International Journal of Advanced Legal Research

confining insolvency processes toindividual projects weakens the more expansive jurisdiction of NCLAT.

Furthermore, the premise of the NCLAT is not agreed upon, as it does not considerthat many creditors have similar interests across multiple projects: operationalcreditors are put in jeopardy of finding themselves completely orphaned in thesearrangements limiting the CIRP to only a single project's process, especially thosewhich have diverse exposures in all the projects undertaken by a particulardeveloper/real estate company. Moreover, the NCLAT has not sufficiently articulatedany requisite guidance for the application of a moratorium under Section 14 to befollowed for the specific-purpose CIRP, leaving open-ended questions regarding thetreatment of assets and liabilities during the corporate debtor's various projects.

The insight is that if the CIRP were limited in scope to certain less successful projects,the scenario would significantly open up restructuring objectives with the possibilityof treating the failing project as a subsidiary or SPV, which, until that point, is put atrisk by a receiver.

This would entail a spirit of protection to the other project's allottees under a limited CIRP dictated by the NCLAT; however, this assumption alsoignores all possible fall-outs. For instance, should the CIRP be limited to certainprojects, the allottees of those projects that fail would simply have not enoughremedies left for any sort of real recourse. In light of such concerns, the recentchanges in the insolvency management framework of real estate projects, as stated byIBBI, would be a major milestone. These amendments certainly aim to make theresolution process more accurate by allowing the CoC to instruct the ResolutionProfessional to invite distinct resolution plans for each project, thereby allowing CIRPto invoke only the performance-distressed assets that do not disturb the other projectswith operational viability.

The newness of the regulation indicates a heightened emphasis on real estatebankruptcies, necessitating developers to solicit project-specific expressions ofinterest. Requirements for maintaining separate project bank accounts have also beenprescribed to ensure responsibility, openness, and confidence in the utilization offunds throughout the resolution procedure.

Despite these developments, several issues and uncertainties remain. As currentlydrafted, the IBC does allow for a corporate debtor to be taken into CIRP withoutconsideration of individual projects. The corporate debtor is nothing other than thesummation of the corporate entity as a whole. The corporate debtor is defined asrepresenting a single corporate entity,

©2024 International Journal of Advanced Legal Research

identified under the Code's provisions inSections 3(8) and 3(7). As a result, introducing project-specific CIRP deviates fromthe fundamental framework of the Code and could lead to legal uncertainty.

In addition, even while the courts perceive real estate debts to be project-related, theyrun the risk of overlooking instances when obligations may extend over severalprojects or when the overall financial viability of the corporate debtor has aninfluence on the feasibility of certain projects. This raises serious questions regardingthe application of the moratorium as per Section 14. Does this involve the entirety ofthe corporate structure or solely the assets and liabilities of the project that facedifficulties? On the other hand, the implementation of project-specific CIRP mayenable a legal snowballing cascade in the absence of specific statutory provisions,which would hold the settlement process in abeyance.

In summary, the NCLAT's approach to CIRP in the real estate sector focuses onspecific projects, showing a growing awareness of insolvency issues. However, thereis considerable uncertainty about how effective these solutions will be and howfar-reaching they can be. As the courts and lawmakers grapple with these issues, it isimportant to establish a broad scope with clear statutory guidelines to ensure theinterests of all affected parties are considered, striking a balance between individualinterests and the objectives of the IBC.

Navigating Section 29A: The Controversial Position of Promoters as Financial Creditors

The notion of Reverse CIRP was initiated by the National Company Law AppellateTribunal (NCLAT) before Flat Buyers Association Winter Hills – 77, Gurgaon versus.Umang Realtech Pvt. Ltd[23]through IRP and Ors., following the direction passedin Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India (2019)[24]. The innovativeapproach of the NCLAT was born in the real estate market that had specific issues notcovered by the traditional CIRP applied to other industries.

It also realized that in case of insolvency of real estate firms, they needed a differentapproach for which Reverse CIRP was implemented. This mechanism allows thepromoters of a corporate debtor, particularly those in real estate, to circumvent theprovisions of Section 29A of the IBC. Section 29A also bars promoters from filingresolution plans for companies in

[23]ibid
[24]ibid

©2024 International Journal of Advanced Legal Research

default. But Reverse CIRP enables the promoters tocome up with a plan to finish and deliver the stalled real estate projects, provided theymeet some requirements with the creditors, and other stakeholders while supervisedby a Resolution Professional (RP) and National Company Law Tribunal (NCLT).

All the stakeholders especially the allottees and creditors are well protected by thisconcept since it seeks to ensure that all the keyed projects are fully and effectivelycompleted and the units delivered. It also gives back control of the business to themanagement if its previous management is given a second chance to rebuild theorganization, even while paying all the creditor claims in full. Reverse CIRP providesan opportunity for the promoters to become fund suppliers to invest fresh money tocarry out the delayed project instead of presenting a CIRP through a normal method.

Additional Section 29A was introduced to the IBC in 2017, presumably to addressmanipulation of the legal procedure by defaulting promoters who wanted to regaintheir control in their companies through a backdoor. Section 29A categoricallyexcludes certain parties from filing resolution plans; such as promoters of thecorporate that has defaulted. In the case of Reverse CIRP though, the promoters donot file a standard resolution plan. However, they bring in cash to settle the defaultfrom within the organization without the applicant to the third-party resolution. Thisdoes not invite provisions of Section 29A since the Resolution Professional does notmake any formal call for resolution plans as per Section 25(2)(h) read with Section 5 (25) and Section 5 (24) of the IBC.

As a result, Reverse CIRP functions in a pre-CIRP stage where the company isseeking to internally deal with its financial problems without calling for the standardresolution process. However, if this internal resolution does not work, the normalCIRP process would commence, in which Section 29A plays no part. However, theutilization of Reverse CIRP has provided questions on whether or not it helps theframers of Section 29A avoid their purpose of not allowing defaulters to regaincontrol of their businesses. The authors ask themselves if this mechanism erodes thefoundations of the IBC. The recent decision in ArcelorMittal India (P) Ltd. v. SatishKumar Gupta[25][(2019) 2 SCC 1] holds the nuances of Section 29A where the SupremeCourt of India has aimed at giving effect to the purpose of Section 29A, to protect thecreditors and infuse equity to disallow defaulting promoters to regain control of

[25][(2019) 2 SCC 1]

©2024 International Journal of Advanced Legal Research

theirbusinesses. his stage. However, the use of Reverse CIRP has raised concerns aboutwhether it circumvents the intent behind Section 29A, which was to prevent defaultersfrom regaining control of their companies. The authors question whether thismechanism undermines the core principles of the IBC.

In the case of ArcelorMittal India (P) Ltd. v. Satish Kumar Gupta[26],the Supreme Court emphasized the importance of giving a purposive interpretation toSection 29A, aiming to protect creditors and prevent defaulters from retaining controlof their businesses. The promoters of Umang Realtech Pvt. Ltd., in this case, areUppal Housing Pvt. Ltd and according to Section 29A clause (c) and (g). Nevertheless,in the case of Umang Realtech[27], the house buyers demanded the promoterarrange the funds for the resumption of the halted project, and such a plan was backedby the secured creditors. What this scenario implies is that perhaps the. Committee ofCreditors (CoC) been in place the promoter's proposal could have been acceptedalthough in direct violation of section 29A. According to IBC Section 30(4), the CoCcannot consider a resolution plan from an applicant ineligible under Section 29A evenwhile the CoC has the discretion to judge the feasibility of a plan. However, the rulingof NCLAT in the case of Umang Realtech permitted the promoter to continueoperation, but not much intervention was allowed in the course of the resolutionprocess. The words `stay out of the CIRP' mentioned in the judgment also imply thatthough the promoter funds, the corporate debtor is managed by the Interim ResolutionProfessional (IRP).

For accountability, the payments made by the promoter have to be reviewed andratified by the IRP as well as any other nominee representative of the corporate debtor.The promoter is still involved as a party to the overall process despite employing theIRP to "stay out" of the process of determining project outcomes, the promoter willhave to use his/her professional knowledge of how the project must proceed, to assistthe IRP in the completion of the stalled project and therefore make decisions that affect the results of the process. Hence, the issue of a clear separation of the CIRPfrom the pre-insolvency status is impacted by the promoter since they must notinterfere in the management of the CIRP but they are irrevocably involved in financialand operational decision-making.

[26]ibid
[27]Ibid

©2024 International Journal of Advanced Legal Research

In the Chitra Sharma v. In the Union of India[28] case it has done a good job by holdingthat there must be a complete separation of ownership and management and thatpromoters should not be allowed to regain control of the companies in the process ofresolution. The Court also stressed that Section 29A aimed at improving corporategovernance and being in the public interest. Per analogy, the involvement ofpromoters in the resolution process will be counterproductive to the IBC objectives.The Court also pointed out that the provisions of Section 29A must be complied withto the letter even though Reverse CIRP has its advantages. It asserted that anyvariations with this principle dissipate the purpose of the legislation.

Although NCLAT has tried its level best to keep a check and balance through RP,Reverse CIRP is exceptionally creating chaos in the Section 29A setting. It is to benoted that while applying Reverse CIRP, the promoters can even be the financialcreditors in contrast with the credit public policy intended by Section 29A whichaimed at denying defaulting promoters to regain control of their struggling companiesthrough a resolution plan. Such involvement has been a causing factor that makespeople wonder if Reverse CIRP acts as a contradiction of the IBC.

However, one more issue is that Reverse CIRP has no specific statutory backingwhich puts extra challenge. Although in ArcelorMittal India (P) Ltd. v. Satish KumarGupta[29] the Supreme Court reiterated the objectives of Section 29A, the NCLATin the recent decision of Umang Realtech allowed the promoter to contributefinancially but without management control. Due to such vague expressions of CIRPsuch as ‘stay out of the CIRP’, it has been difficult to nail down the latitude of thepromoter’s work. While a promoter is not directly overseeing the CIRP, theintervention of its financial arm and decision-making powers when overseeing theprocess makes it difficult to distinguish between meetings of compliance with, and acircumvention of, the IBC.

The Chitra Sharma ruling made by the Supreme Court showed that it is very hesitant to makeprovision for section 29A. The Court held that promoters should be barred fromparticipating in the process of the resolution as such a course of conduct wouldundermine the intent of the IBC, which seeks to enhance corporate governance andshield the public from unscrupulous promoters within the country. The decision of

[28] (2018) 18 SCC 575
[29] ibid

©2024 International Journal of Advanced Legal Research

theCourt is illustrative of the tension between the exigency of providing workablesolutions such as Reverse CIRP, on the one hand, and a potentially negative impact onthe core of IBC on the other.

In the following sections of this manuscript, the primary focus is the analysis of theUmang Realtech case[30] as a test of the innovation of the NCLAT, rather than as a finalmechanism for insolvency in the real estate sector. It to some extent is merely atransient fix that can implemented only when conventional CIRP methodologies areall but ineffective. The Reverse CIRP strategy provides promoters with an opportunityto deal with defaults intrinsically, although there is an option to switch to traditionalCIRP if internal attempts are fruitless. However, this approach resulted in the unequaltreatment of real estate insolvencies across the courts, and the judgments given inChitra Sharma[31] and ArcelorMittal [32]illustrate this.

The following analysis of Reverse CIRP is a reflection of larger concerns emanatingfrom the corporate insolvency process, specifically the position of promoters underthe law along with the lack of legal certainty that hovers around the Code. But if thelegislature decides to pass Reverse CIRP, it will have to clarify why it conflictswith Section 29A and then come up with guidelines on when and how promoters canget into resolving the insolvency of their companiesruling demonstrated the Supreme Court's reluctance to make exceptions to Section 29A. The Court argued that promoters should not be allowed to participate inthe resolution process as it would contravene the IBC’s intended purpose of fosteringcorporate governance and protecting the public interest. The Court's decisionhighlights the tension between the need for practical solutions, like Reverse CIRP,and the risk of undermining the IBC’s core principles.

The NCLAT's ruling in the Umang Realtech case, while innovative, serves as a trialrather than a definitive resolution mechanism for the insolvency of real estate firms. Itis a temporary solution that is triggered only when traditional CIRP methods areinsufficient. The Reverse CIRP mechanism gives promoters a chance to resolvedefaults internally, with the option to revert to the regular CIRP if internal efforts fail.

[30]Ibid.

[31]Ibid.

[32]ibid

©2024 International Journal of Advanced Legal Research

However, this approach creates inconsistencies in how courts handle real estateinsolvencies, as seen in the contrasting rulings in Chitra Sharma and ArcelorMittal.The debate over Reverse CIRP reflects broader questions about the role of promotersin the insolvency process and the need for legislative clarity. If the legislature decidesto formalize Reverse CIRP, it will need to address the apparent conflict with Section29A and establish clear guidelines for when and how promoters can be involved inresolving their companies' insolvencies.

With this definitude lacking, the application of Reverse CIRP remains a contestedpractice that poses a threat to the IBC objectives but holds a feasible method foraddressing the issues peculiar to the industry of real estate.

Examination of Special Purpose Vehicles in Real Estate and the Reverse CIRPMechanism

In the realm of real estate, the use of Special Purpose Vehicles (SPVs) has become awidely accepted practice, primarily for isolating specific projects from the liabilitiesof the parent company. SPVs are separate legal entities that are utilized for high-riskventures, offering a buffer that shields the parent company's assets and other venturesfrom potential financial fallout. This structure not only allows real estate firms tomanage risk effectively but also aids in the strategic distribution of businessobligations and ownership rights. In the context of the Indian Insolvency andBankruptcy Code (IBC), the role of SPVs becomes particularly relevant wheninsolvency proceedings are initiated against a subsidiary company operating underthis model.

The real estate market frequently employs SPVs to separate projects. A primeexample of this is seen in the case of Umang Realtech Pvt Ltd[33], a subsidiary of UppalHousing Pvt Ltd, which utilized an SPV to insulate one of its significant projects,Winter Hills 77. When insolvency proceedings, under the Corporate InsolvencyResolution Process (CIRP), were initiated against Umang Realtech, it was clear thatthe project Winter Hills 77 was appropriately separated from the other projectshandled by the parent firm. This separation ensured that the insolvency processremained project-specific, protecting the parent company and its other ventures fromunnecessary entanglement in the CIRP.

[33]Ibid.

©2024 International Journal of Advanced Legal Research

The IBC, under Section 18, mandates that all assets belonging to the corporate debtormust be handed over to the Resolution Professional (RP). However, there are specificprovisions under Explanation (b) of Section 18 that exclude assets owned bysubsidiary companies, like land, from being part of the parent company's CIRP. Inthis case, while Uppal Housing Pvt Ltd funded the project and collected funds frombuyers, the ownership of the land rested with its subsidiary, Umang Realtech.Therefore, the land associated with Winter Hills 77 was excluded from the CIRPagainst the parent company, demonstrating the legal separation that SPVs create insuch situations.

This exclusion raises a significant point of discussion. If the project-specific assets,such as land, are excluded from the CIRP of the parent company, it may render theentire process ineffective for that project. The parent company may not face the samelevel of financial distress due to this separation of assets and obligations. Thissituation becomes particularly problematic when the parent company and itssubsidiaries enter into separate contracts for land development and project execution.In such cases, the inclusion of third-party assets—such as land owned by a differententity under a contractual agreement—into the CIRP of the corporate debtor isrestricted under Explanation (a) of Section 18.

Although the Supreme Court has recognized that development rights are consideredan "asset" of the corporate debtor (as was seen in the Victory Iron Works Limited v.Jitendra Lohia[34] case), this decision does not necessarily resolve all issues. While thedevelopment rights may be held by the corporate debtor, the practical enforcement ofthese rights without access to the project land (owned by a separate entity) is nearlyimpossible. Without the land, it is unlikely that the project could be completed or sold,further complicating the CIRP process. This creates a legal quagmire where the realestate developer and the landowner are distinct entities, making it challenging toimplement an effective insolvency process without involving both parties.

The complex legal relationships between developers and landowners within the realestate sector necessitate a more nuanced understanding of the CIRP process for realestate firms. Section 18's Explanations were likely intended to protect third-partyassets from being swept up in insolvency proceedings. However, in real estate, whereprojects are often conducted through SPVs or separate subsidiary entities, theseprovisions create loopholes that can

[34] 2023 LiveLaw (SC) 193s

©2024 International Journal of Advanced Legal Research

potentially undermine the effectiveness of theCIRP. There is growing recognition that the restrictions on including subsidiary orthird-party assets in CIRP proceedings must be reevaluated in light of industry norms.

The use of Special Purpose Vehicles and the potential for Reverse CIRP highlight theneed for a more flexible insolvency framework in the real estate sector. The currentIBC provisions, particularly Section 18, are insufficient to address the complexities ofreal estate insolvency, where projects are often handled through separate legal entities.While SPVs offer a practical solution for managing risk and isolating liabilities, theyalso create challenges in the CIRP process, particularly when it comes to the inclusionof third-party assets.

Reverse CIRP, though promising, remains a legally ambiguous mechanism thatrequires legislative support to be effective. The MCA’s proposal for project-specificinsolvency resolution represents a step in the right direction, acknowledging theunique needs of the real estate sector. If formalized, this approach could provide amore equitable and efficient resolution process for real estate firms, ensuring thatfinancially stable projects are not unnecessarily disrupted by the insolvency of asingle project.

In the long term, legislative changes to the IBC that support project-specificinsolvency resolution and address the limitations of Section 18 would providemuch-needed clarity and fairness in real estate insolvency cases. By adopting a moretailored approach, the IBC can better serve the needs of all stakeholders in this criticalsector.

Conclusion

Reverse CIRP appears to emerge as a significant option but to be geared towardsaddressing the wider and most solution-based root issues faced by India's real estatesector. The innovative solution aims to safeguard the interest of homebuyers and alsopreserve the financial health of Developers, thereby resolving through the BalancingResolution Process for successful completion of Stalled Projects. This focus onproject-specific outcomes, particularly given the circumstances of the Flint Issue andits financial underpinnings, enables custom resolutions that can help to therapeuticallyre-engage a bittering market now suffering from poor results.

But for Reverse CIRP to become a part of the enacted law, it requires a robustlegislative scaffolding. Regulators need to enter into such rounds of conversationswith the industry and

©2024 International Journal of Advanced Legal Research

at the same time develop incredibly clear guidelines to ensurethat is mused on, as well as for which useful. Nevertheless, to assimilate ReverseCIRP with the legal system in place through proper legislation is a necessity. We alsoneed policymakers to convene industry stakeholders to produce guidance thateliminates misuse and bias and advances equity. This joint endeavour is crucial notsimply to fine-tune the bankruptcy process but, for it to be a well-balanced procedurewhere all parties have their interests secured.

Recognizing the nuances within real estate insolvency — from different levels of riskassociated with different projects to builder financial structurevariations—stakeholders can start building more effective solutions. By involving rreverse CIRP in all stages of a project, it is hoped that not only immediate financialdifficulties can be overcome rather a broader orientation for real estate investmentwill emerge, placing emphasis on both transparency of information and howspeculators are kept under control. In the courts and amendments made to IBC(Insolvency and Bankruptcy Code), the direction in which an overhauled insolvencyregime should develop is becoming increasingly clear. Time may not necessarilyequate to justice, but those living here even more earnestly require it for their survival.Nonetheless, with the real estate market adjusting to the realities of further economicrecovery from the COVID-19 post-pandemic era stacking up as one already differentthan most experienced by mankind before, we are now at a critical junction.

Preparing each venture with project-specific Resolution presents novel difficulties inIBC. The real estate sector comprises multiple projects spread over some time and indifferent locations. Each has to be entered into individually on account terms,commitments, etc. Ultimately, fostering a balanced approach to insolvency will notonly enhance the recovery prospects for homebuyers but will also strengthen theoverall health of the real estate market in India. In doing so, the country can movetowards a more equitable, transparent, and trustworthy insolvency regime that benefitsall stakeholders involved.

©2024 International Journal of Advanced Legal Research