Experimenting with the Law:
The Unique Concept of Reverse Corporate Insolvency Resolution Process

-Oorja Chari

"For the world hates change, yet it is the only thing that has brought progress with it."
-Charles Kettering

Introduction

One of the most celebrated legislations, The Insolvency and Bankruptcy Code ("**IBC**"), was promulgated to consolidate the existing laws pertaining to reorganisation and rehabilitation of corporate debtors ("**CD**") to improve their financial health and enable debt fulfilment in the future. It not only ensures a time bound resolution mechanism, but also maximization of the value of assets of the stakeholders and greater availability of credit, while balancing the interests of all the concerned stakeholders. The IBC prides itself in resolving and reorganising the CD as a going concern, failing which, liquidation is resorted to.

A corporate entity, in its daily functioning incurs a plethora of liabilities. Sometimes, it gets debt ridden to such an extent that the existence of the company is endangered and detrimental to the interests of the stakeholders. Thus, a robust restructuring and rehabilitation mechanism is a surefire way to balance the interests of all stakeholders. Ever since its conception in 2016, IBC has proved efficacious compared to its predecessors. In SICA, the control of the corporate debtor after initiation of insolvency remained with the promoters, resulting in the company hiding behind the protection provided by the moratorium for years together, without successful rehabilitation. The Companies Act, 1956 and SARFAESI restricted the provision of relief to only the secured creditors. The default amount triggering the corporate insolvency resolution process ("**CIRP**") is Rupees 1 Lakh, unlike previous legislations where sickness depended on the net worth of the entity. Hence, the IBC is a code that has been formulated by doing away with the flaws in the previously existing legislations, to solve the grave crises brought about by non-performing assets.

Procedural Overview

The CIRP can be initiated before the National Company Law Tribunal ("**NCLT**") by the Financial Creditors ("**FC**"), Operational Creditors ("**OC**") or CD. On acceptance of the application, a moratorium is imposed on all pending litigation by or against the corporate

debtor till resolution. An Interim Resolution Professional ("**IRP**") is appointed, who presumes the role of the disbanded board of directors. The IBC follows a strict timeline whereby the resolution process must conclude within 330 days. A time bound regime compels the parties to adhere to the timeline, failing which, the corporate debtor will be liquidated. This avoids unnecessary delays. Owing to their commercial wisdom, the Committee of Creditors ("**CoC**") composed of FCs approve the resolution plan ("**Plan**").

Amendment with respect to Homebuyers

First Amendment

The real estate market has been in doldrums from a long time. Builders have failed to complete the apartments assured to the homebuyers, and declared themselves bankrupt. Homebuyers, investing their entire life savings in purchasing one apartment, are sadly, left in a lurch. Earlier, the IBC did not provide any recourse to homebuyers. The term FC was restricted to banks and financial institutions that pump money into the real estate firms to keep them afloat. Granting relief to homebuyers, the IBC was amended[1], mandating treatment of allottees at par with FC. This benefited them, making them an integral part of the CoC and allowed them to actively participate in the resolution process. The definition of debt, was amended, to include, *"any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing"*.

One of the prominent cases where the plight of the homebuyers was considered was that of Jaypee Infratech[2], wherein IDBI Bank initiated a CIRP against Jaypee Infratech Limited, thereby imposing a moratorium. This acted detrimental to homebuyers, since they had their life savings tied up in the ongoing project of JIL. They contended that they were heavily invested in the CD and must demanded equal treatment with the FC. The Supreme Court ("**SC**"), on an appeal, stayed the CIRP, but after being apprised about the ramifications of staying the CIRP, allowed its continuation, subject to appointing a representative of the homebuyers to attend the CoC meetings. Pursuant to this case, a need to assuage the homebuyers was felt. Chief Justice Dipak Misra noted that *"the savings of the homebuyers cannot be brushed aside by citing technical reasons"*[3]. The scope of IBC was extended to include homebuyers as well. This

[1] Insolvency and Bankruptcy (Second Amendment) Act, 2018
[2] Chitra Sharma Vs. Union of India, 2018(5)BomCR712, 09-08-2018
[3] https://realty.economictimes.indiatimes.com/realty-check/diluting-homebuyers-right-under-ibc-will-be-irreparable-damage/3916

move, largely welcomed by the homebuyers, paved a path for them to act as creditors and individually/collectively initiate a CIRP against defaulting developers.

The amendment was criticised on two counts:

1. Primarily, the builder fraternity argued that IBC was not a recovery platform. RERA provided for a recovery mechanism in favour of the homebuyers against defaulting developers.
2. The amendment precipitated several individual homebuyers resorting to initiating a CIRP against developers, most of which were discovered to be frivolous. According to lobbyists in favour of developers, this "relief" acted as a roadblock for them, subsequently prolonging their ongoing projects.

Though the SC upheld its constitutional validity[4], developers demanded the introduction of a threshold, over homebuyers who could initiate CIRP and did not want individual homebuyers to initiate a CIRP, but stipulated that the application by these creditors should be filed jointly by at least 100 such creditors or 10% of their number.

Second Amendment

Considering the challenges faced by developers, the IBC was amended once again[5], introducing a threshold for allottees who wished to initiate the process. It mandated that an application could be made only if at least 10% of them or 100 such persons jointly initiate the process.

The 2020 Amendment was heavily criticised by the home buyers. This revised regime would pose a myriad of difficulties for homebuyers, left high and dry by the developers. The 2020 Amendment was alleged to obstruct justice by raising certain questions:

1. When the threshold to initiate a CIRP by FC and OC is 1 lakh, why are individual homebuyers being discriminated against? Most homebuyers have spent crores of rupees to buy one apartment, exceeding the statutory threshold. The outcome of the Second Amendment would result in cases where a FC who has loaned the CD 2 lakhs, would be preferred over a homebuyer who has invested 2 crores in the unconstructed flat.

[4] Pioneer Urban Land and Infrastructure Limited v Union of India & Ors, VII (2019) SLT 345

[5] Insolvency and Bankruptcy Code (Amendment) Act, 2020 ("**2020 Amendment**")

2. How will an individual homebuyer, wanting to initiate a CIRP, be able to search for 100 homebuyers to apply jointly with him? The search for similar applicants is a tedious process which the homebuyer must not unnecessarily be subject to.

Concept of Reverse CIRP

In the Swiss Ribbons case[6] the SC had observed that *"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."* With this principle in mind, a novel experiment was conducted by the National Company Law Appellate Tribunal ("**NCLAT"**) in *Flat Buyers Association Winter Hills-77, Gurgaon v/s Umang Realtech Pvt Ltd*[7], from which, a new concept called "Reverse CIRP" has germinated. This method can be used for the sake of convenience in real estate proceedings under the IBC framework. The idea driving this concept is that during the CIRP, no resolution applicant will partake in the process. The primary reason behind this is that although homebuyers are classified as FCs, they lack business or financial expertise to understand the viability of a Plan. Hence, the promoter, while staying outside the limits of the CIRP, will lend money to the CD to repay the creditors.

<u>NCLAT Judgement</u>

In the aforementioned case, an appeal was brought before the NCLAT against the order of the NCLT, New Delhi. The factual matrix of the case was that the allottees had initiated a CIRP as a FC, against M/s Umang Realtech Pvt. Ltd., the CD, a real estate company involved in construction of flats. They however disallowed a third party from formulating the Plan. The tribunal noted that in a real estate project only the infrastructure with respect to which the CIRP has been initiated, is affected, and not the other projects of the developer. Hence the CD would be unable to maximize all his assets, complicating balancing the interests of the allottees. Additionally, despite having voting rights as a FC, allottees lack the commercial wisdom of FC to assess the feasibility of the Plan. It was further noted that the asset of the CD i.e. the infrastructure could not be distributed to the secured creditors like banks, and had to be given to allottees who were unsecured creditors. This was because the banks would not want apartments and the homebuyers were entitled to it. Moreover, in a CIRP, a Plan must be formulated in a way that creditors take a haircut, but there cannot be a haircut of apartments.

[6] Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17, 25-01-2019
[7] 138(IBC)103/2020

Hence, the NCLAT concluded that a normal CIRP could not be followed and it effectuated the NCLAT to conduct a "legal experiment". It was decided that one of the promoters, Uppal Housing Pvt Ltd, must infuse funds to the CD as an "Outside FC" i.e. remaining outside the CIRP, he would act as a lender. This mechanism provided a win-win scenario, since neither would the project stall, nor would the allottees lose out on the apartments.

Analysis

This approach has been met with mixed views. While Reverse CIRP can be considered a gamechanger in IBC, some are skeptical about its execution. The moratorium imposed during CIRP is detrimental to homebuyers as developers are unable to continue their existing project. The money invested by the homeowners in the project is classified as "financial debt". However, these homeowners do not want money in lieu of their flat. They specifically want the apartment as promised by the developer. Looking at the situation from the standpoint of developers, a developers usually take loan from banks and financial institutions to finance the project and till the project is stalled the are loan cannot be repaid. Thus, the conventional CIRP is not conducive to both the developers and the homebuyers. For this very reason, the novel concept of Reverse CIRP has been introduced as a relief to the interested stakeholders, where the promoters can act as lenders to finance the project of the CD so that it does not stall.

However, the contention that has been made is that this concept infringes Section 29A of the IBC, which expressly disallows promoters to submit a bid since they were the ones who contributed to the insolvency of the company. Allowing promoters to finance the CD defeats the very premise of Section 29A. It was argued that the entire purpose of IBC was to ensure that the management shifted from the debtor, and allowing an official of the CD to work along with the RP questioned the sanctity of the CIRP.

Conclusion

Legal experimentation, an indispensable function of the judiciary, ensures that law remains dynamic. For every new law, there have been some kind of "legal experiments" conducted. Circumstances engender laws, the finest example of which is, the scope of Article 21 being expanded so as to include right to quality life and to bring under its umbrella, the right to education. As observed in the Swiss Ribbons case (supra), IBC was by itself a product of trial and error. The judiciary must try to make and alter laws, subject to restrictions, on an as-needed basis. While acknowledging the importance of legal experiments, it is important to note that such experiments don't contravene existing provisions. From its very conception, the unique approach of IBC has been a tour de force and, to cater to societal needs signifies a proactive step taken by the judiciary. To quote Henry Ward Beecher, *"Laws and institutions, like clocks, must occasionally be cleaned, wound up, and set to true time"*. However, it is imperative that statutory clarifications pertaining to the contentions raised be provided, for a clearer understanding on how Reverse CIRP will eventuate.