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# **INVERTING INSOLVENCY: A STRATEGIC ANALYSIS OF REVERSE CORPORATE RESTRUCTURING AND THE NEED FOR CODIFICATION**

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## **ABSTRACT**

*Reverse insolvency is new financial instrument aimed at reviving distressed companies by reversing traditional insolvency proceedings. While traditional insolvency implies liquidation or reconstruction of a company under the burden of existing debts, reverse insolvency proactively proposes to stabilise and revive companies before they reach critical financial distress. This Article investigates the mechanics of reverse insolvency, analysing its theoretical foundations and practical implementation.*

*This scheme is founded on the principles of early intervention, reallocation of assets, and the adoption of novel financing models. The aim is not simply the discharge of debt, but restoring solvency and operational efficiency to guarantee the long-term survival of the company.*

*This Article presents a series of case studies and comparative analyses to identify the conditions in which reverse insolvency is likely to be successful, and to map out the respective roles that creditors, investors and regulatory bodies play in its success. The results suggest that reverse insolvency is a credible alternative to traditional insolvency procedures, not only providing an alternative resolution to financial distress but also encouraging sustainable business recovery and long-term economic growth.*

*In addition, this Article will examine the need to codify this new mechanism into existing legal and regulatory reform, with particular reference to recent legislative reform, highlighting the potential institutionalisation of reverse insolvency as a tool of corporate rescue.*

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## Introduction

The Indian Insolvency and Bankruptcy Code came into existence in 2016 as a step towards codification of all the pre-existing acts and rules that recognized insolvency of a company or corporation<sup>4</sup>. The code created a path for the rise of the concepts of Corporate Insolvency Resolution Process (CIRP) and bankruptcy which has been long awaited and now brings a certain sense of clarity and relief to the process of resolving financial distress. Since its implementation the Code has been evolved and interpreted by various judicial instances through judicial interpretations and precedents. One of such evolution is the concept of “Reverse CIRP”.

The concept of reverse corporate insolvency resolution process was envisaged and developed as a supplementary process to resolve the insolvency of real estate companies after the landmark judgment in *Chitra Sharma*<sup>5</sup> in 2018 where the bench granted homebuyers the status of creditors. Its need was visualized by the National Company Law Appellate Tribunal (NCLT) in the initial pursuit as the traditional insolvency resolution process failed to deliver the interests of the stakeholders i.e. the homebuyers and other parties involved. The reverse insolvency process was a consequence of the failure of the traditional method of applying to real estate projects, to provide a process for resolution of debt while maximizing the value of assets which is ultimately the pursuit of welfare of stakeholders and homebuyers. The reverse CIRP process works in a similar way as the traditional method exists only with minor variations and differences.

A critical analysis of ‘Reverse CIRP’ would mean probing into its advantages and limitations as well. The question would arise as to how and why this process came into existence. The process would be traced from the earlier insolvency laws to the interpretation given by the Insolvency and Bankruptcy Code, 2016. The recent amendments in the IBBI regulations and its systemic implications are an important part of this exercise. Further, the discussion on comparative experiences from other parts of the world is also an essential aspect. The need for codification of Reverse CIRP for strengthening the protection of stakeholders and enhancing the efficacy of the insolvency regime is discussed.

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<sup>4</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, INDIA CODE (2016).

<sup>5</sup> *Chitra Sharma v. Union of India*, (2018) MANU/SC/1219/2017.

## Evolution of Reverse CIRP Mechanism

There has been a rampant increase in the real estate market in India, but with the growth, there have been issues of delays and defaults by real estate companies. However, there are existing legislations for addressing these concerns, such as RERA (Real Estate Regulation and Development Act, 2016), CPA (Consumer Protection Act, 2019), and IBC (Insolvency & Bankruptcy Code, 2016). However, this legislation was not enough to address the concerns of the homebuyers.

While RERA and CPA aimed to protect homebuyers by mandating refunds in case of defaults, and RERA required builders to deposit 70% of the project funds in a separate account, these legislations proved ineffective in practice.<sup>6</sup> They failed to provide relief to homebuyers facing long delays and did not offer the option of possession of flats instead of refunds, which many homebuyers preferred. Furthermore, Section 14 (Moratorium period) of the IBC imposes a stay on the claims of homebuyers under CPA or RERA if the company's creditors initiate a corporate insolvency resolution process<sup>7</sup>. This effectively sidelined the interests of homebuyers.

Additionally, homebuyers lacked the legal standing to approach the National Company Law Tribunal (NCLT) in case of defaults, as they were not considered eligible under Sections 7, 8, and 10 of the IBC. They were classified as "other creditors," leaving them with little to no say in the committee of creditors. Seeing the difficulties faced by homebuyers, the judiciary came to their rescue and included them under the definition of financial creditors through Section 5(7) of the IBC. The reasoning was that the assured return schemes offered by builders carried a commercial effect akin to borrowing, thereby qualifying as financial debt.

Later, in the Chitra Sharma case, the court held that homebuyers' representatives had full authority to participate in the committee of creditors.<sup>8</sup> This led to an amendment to the IBC, inserting homebuyers as financial creditors under Section 5(8)(f). The Supreme Court reaffirmed this interpretation.<sup>9</sup> However, in 2020, a statutory threshold of 10% or 100 allottees (whichever is less) was introduced to prevent frivolous and bogus cases by individual

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<sup>6</sup> Estate (Regulation and Development) Act, No. 16 of 2016, § 4(2)(l)(D), INDIA CODE (2016).

<sup>7</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, § 14, INDIA CODE (2016).

<sup>8</sup> Chitra Sharma v. Union of India, (2018) MANU/SC/1219/2017.

<sup>9</sup> Pioneer Urban Land and Infrastructure Limited v. Union of India (UOI) (2019) MANU/SC/1071/2019.

homebuyers.<sup>10</sup>

This judicial interpretation opened a new door of relief for homebuyers, as they now had remedies under three legislations: CPA, RERA, and IBC. However, the remedy under IBC was still deemed insufficient to address the homebuyers' plights, leading to the evolution of the concept of a separate Corporate Insolvency Resolution Process (CIRP) for real estate projects, known as “reverse CIRP.”

### **Unveiling Reverse CIRP**

The concept of reverse CIRP has yet to be introduced in the IBC; instead, it was an innovation introduced by the NCLAT in 2019. It is restricted to the real estate sector, wherein the promoter will act as a lender and will disburse funds to ensure the completion of the project.

The NCLAT Delhi first recognised the process of reverse CIRP in the case of Flat Buyers Association Winter Hills vs Umang Realtech. In the given case, a unique approach was adopted to ensure the successful completion of the insolvency resolution process and the delivery of flats/apartments to the allottees. One of the promoters (Uppal Housing Pvt Ltd) of the Corporate Debtor agreed to remain outside the CIRP but took on the role of a financial creditor, thereby providing the necessary financial support to facilitate the successful completion of the CIRP and the handover of the units to the allottees without any third-party intervention.<sup>11</sup>

Additionally, a financial institution consented to cooperate under the condition that it would receive 30% of the amount paid by the allottees at the time of registration for their respective flats/apartments. This arrangement aimed to create a scenario where the project could be completed, and the allottees could take possession of their units within a stipulated timeframe set by the NCLAT.<sup>12</sup>

The NCLAT also provided a few clarifications on the reverse insolvency process. It clarified that the process would be implemented on a project-wise basis. No financial or operational creditor or allottee of another project can apply for the IRP, and such applications should not be entertained. Further, the assets of the whole company need not be maximised, and only the

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<sup>10</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, § 7, INDIA CODE (2016).

<sup>11</sup> Flat Buyers Association v. Umang Realtech (P) Ltd., (2020) MANU/NL/0077/2020.

<sup>12</sup> Ibid.

assets of that particular project should be maximised.<sup>13</sup>

Moreover, any secured financial creditor would not be given preference over the allottee (the unsecured financial creditor) in the allotment of the assets (flats). One or both allottees can also opt for another flat in the same tower or another tower if it is not allotted to anyone else. This is done so that if any allottee is paying rent or interest to a bank, they may take earlier possession and get relief from the rent or interest. Moreover, if any single allottee wants to get a refund, then the sale cannot be allowed.

Thus, the reverse CIRP deviates from the traditional CIRP approach, where creditors initiate the proceedings. In the Reverse CIRP, the corporate debtor takes a proactive stance by proposing a resolution plan. This mechanism empowers the corporate debtor to address potential financial distress at an early stage, even before any formal insolvency proceedings are initiated.

Unlike the conventional CIRP, where creditors trigger the process, the Reverse CIRP allows the corporate debtor to take the lead in devising a resolution plan. This pre-emptive approach allows the corporate debtor to tackle financial challenges proactively, potentially averting the need for formal insolvency proceedings altogether. By enabling the corporate debtor to propose a resolution plan before any insolvency proceedings commence, the Reverse CIRP offers a proactive avenue for addressing financial difficulties at an early stage.

This mechanism facilitates timely intervention and resolution, potentially minimising the escalation of financial distress and the need for more extensive insolvency measures.

### **Global Dynamics of Reverse CIRP**

The concept of a debtor-driven insolvency resolution process is not unique to India and is implemented in various forms across different jurisdictions. While the core principles of empowering debtors in the resolution process are shared globally, the specific mechanisms and nuances vary.

In the United States, Chapter 11 of the Bankruptcy Code<sup>14</sup> Allows the debtor to propose a

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<sup>13</sup> Ibid.

<sup>14</sup> 11 U.S.C. ch. 11 (2021).

reorganisation plan to the bankruptcy court. The U.S. model involves the formation of an official committee of unsecured creditors to participate in negotiations and oversee the restructuring process. Additionally, it provides an automatic stay on creditor actions against the debtor, creating a breathing space for negotiations. Subsequently, the debtor proposes a plan of reorganisation outlining how it will address its financial obligations and continue operations. Successful restructuring results in the debtor's emergence from bankruptcy with a confirmed reorganisation plan, allowing the company to continue its operations while repaying creditors over time.

Similarly, the United Kingdom's Insolvency Act 1986 aims to enable the company to continue trading and preserve jobs while addressing financial difficulties. It provides for Company Voluntary Arrangements (CVAs), which are proposals made by the company's directors to its creditors for restructuring and repayment of debts. An insolvency practitioner supervises the implementation of a CVA to ensure compliance with the agreed-upon terms. Once approved by a majority of creditors, the CVA becomes binding on all creditors, including those who voted against it.<sup>15</sup>

These mechanisms in the U.S. and U.K. share the common goal of providing debtors with a structured framework to propose and implement restructuring plans while involving creditors in the process and enabling the debtor to continue operations during the resolution process. However, the specific methods, stakeholder roles, and legal frameworks differ across these jurisdictions.

### **Prospective Reforms in IBBI Regulations**

Although the judiciary has tried to make new judicial interventions to implement IBC for real estate companies, IBC is ill-equipped to regulate them. As a result, the Ministry of Corporate Affairs proposed a project-by-project insolvency process in cases of real estate companies' insolvency in a notice dated January 18, 2023.<sup>16</sup> This is due to the need for a separate process to handle such cases, which is currently absent. In this regard, the following amendments have been proposed: -

1. If a company that promotes real estate ventures defaults on one or more of its projects

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<sup>15</sup> Insolvency Act 1986, c. 45 (UK).

<sup>16</sup> Ministry of Corporate Affairs, Discussion Paper on Real-Estate Related Proposals–CIRP & Liquidation (Nov. 6, 2023), [https://ibbi.gov.in/uploads/public\\_comments/Discussion\\_Paper\\_Real\\_Estate\\_November2023\\_Final.pdf](https://ibbi.gov.in/uploads/public_comments/Discussion_Paper_Real_Estate_November2023_Final.pdf)

and an application is filed to initiate the Corporate Insolvency Resolution Process, the Adjudicating Authority may admit the case. However, it will apply the CIRP provisions only concerning the real estate projects in default. In other words, these projects will be treated as separate entities for resolution while the larger entity remains intact.

2. The same principles and guidelines governing the insolvency resolution process for a corporate entity will apply to real estate projects, with modifications as required to accommodate the unique characteristics and considerations associated with real estate projects.
3. The amendment gives the Resolution Professional the power to transfer the real estate project to the allottees after the Committee of Creditors (CoC, applying its commercial wisdom, approves such a transfer.

### **Challenges and Criticism of the Proposed Amendments**

The proposed amendments have been introduced on a project-by-project basis regarding the CIRP process, and there is a need for an indication of the well-established concept of reverse CIRP. While this move is seen as a move towards positive change, the ultimate objective and aim of the amendments can only be reached when backed by statute. There should be defined changes in the Code to accommodate the same modifications, which the tribunals and courts shall then use to ensure the proper dissemination of the concept as well as the spread of the process. A statutory framework in the code for reverse CIRP is necessary, as the process lacks guiding principles without which the mechanism is ineffective.

In Umang Realtech and other instances, the Hon'ble NCLAT permitted both project-wise and reverse CIRP to guarantee that the interests of the financial creditors and homeowners were met. As a result, the CIRP has been smooth and simultaneous, resulting in a win-win situation for all. While this judgment is incomplete, the gap can be filled through statutory backing, as already stated.

Further, the main task of the drafters should be on the wording describing the provisions enabling project-wise insolvency, as the same are prone to several interpretations. The wording is of utmost importance. If there is a lacuna in the wording of the law, then, irrespective of the aim and objective, the judicial actors shall exploit it in a method to favour their selfish interests,

diverting the ultimate intent of the legislature and defeating its purpose.<sup>17</sup>

The following should be borne in mind in such cases by the legislature and the insolvency courts:

1. It is challenging to utilise the code for exercising operational control over the resolution process. Further, there are uncertainties regarding the status of the board of directors. Their status remains in a vague condition, with uncertainty about whether their operation remains suspended or the IRP takes over their role in the company. Additionally, there may be challenges in binding the company to the decisions made by the CoC for the projects undergoing CIRP.
2. There may be complications when analysing avoidable transactions of projects undergoing CIRP, as these transactions can impact projects outside of CIRP.
3. According to RERA, real estate companies must comply with certain regulations, such as utilising 70% of the collected amounts for one project only towards the land cost and the cost of construction. Although the Insolvency Resolution Professional (IRP) may follow this requirement, there is no monitoring mechanism in place to ensure that the ex-management complies with this regulation for the projects kept outside CIRP.
4. Certainty on the bifurcation of creditors (such as operational creditors and employee dues) for each project is required, as the same is the biggest challenge that the code faces, irrespective of the statutory definitions.

### **Advantages Unveiled: The Bounty of Reverse CIRP**

#### **1. Creating the 'Going Concern' principle and existence of the Company**

The Reverse CIRP process is of utmost importance because it ensures compliance with the two key objectives of the code. The concept of 'going concern' is at the very heart of the code. It is vital to ensure that the corporate debtor can revive and continue to exist throughout the life of the company. In other words, even a hydrogen bomb cannot destroy the existence of a company. This emphasises the importance of preserving the existence of a company as a going concern. Furthermore, it encourages the principle of avoiding liquidation and promotes alternative solutions, which creates the point of liquidation as the last resort of the company

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<sup>17</sup> Ayush Mathur, Legislative Integration of Reverse CIRP in Real Estate Insolvency, Ctr. for Bus. & Com. Ls. Blog (NLIU Bhopal), (2023) <https://cbcl.nliu.ac.in/insolvency-law/legislative-integration-of-reverse-cirp-in-real-estate-insolvency/>.

## **2. Maximising the value of its assets**

Further, the reverse CIRP operates on the mechanism of the project model where the process is restricted to the specific project and does not by itself spill into the other projects of the corporate debtor, which ensures that the working and transactions of the corporate debtor are not hampered by the actions of either the moratorium under section 14 or by the CIRP process itself. This also helps the company avoid unnecessary devaluation of the corporate debtor's other projects and ensures timely completion, as the restriction is imposed on a particular project.

## **3. Non-involvement of the Resolution professional in the process**

Moreover, under the reverse CIRP, the promoter is given a chance to propose a resolution plan, along with a deadline to complete the project. In this scenario, the promoter is not considered as an RP but rather an outside lender. This ensures the timely completion of the project and allocates the required resources first for resolution, which is in the true spirit of the IBC. This is also beneficial as homebuyers often lack the financial wisdom to evaluate resolution plans. This was confirmed by the Supreme Court, which observed that Section 14 of the IBC shall be interpreted in such a way that the CD benefits.

## **4. Works on Cooperation**

The traditional CIRP follows a creditor-in-control model, where the corporate debtor often assumes a passive role. In contrast, the Reverse CIRP model inverts this dynamic by allowing the corporate debtor to take an active role in proposing a resolution plan. This shift encourages a cooperative and collaborative approach, moving away from the adversarial nature that often characterises traditional CIRP proceedings.

The cooperative approach inherent in the Reverse CIRP process contributes to a more efficient and harmonious resolution, aligning the interests of the debtor and creditors. The Reverse CIRP increases the likelihood of a mutually agreeable solution by involving the corporate debtor in crafting the resolution plan. This consensual nature of the resolution plan means that creditors have a higher chance of recovering their financial dues, mitigating the risk and uncertainties associated with traditional insolvency proceedings.

Moreover, the Reverse CIRP empowers the corporate debtor to propose resolution plans tailored to their specific circumstances. The corporate debtor's intimate knowledge of their business and industry enables them to incorporate diverse strategies, such as debt restructuring,

operational improvements, and other contextual approaches addressing the complexities inherent to the real estate industry. By placing the corporate debtor at the forefront, the Reverse CIRP facilitates a nuanced approach to resolving financial distress, acknowledging the intricacies of the real estate sector.

The debtor-driven mechanism of the Reverse CIRP allows for developing contextualised solutions, preserving the value of projects and ensuring their continuation. This approach recognises the unique aspects of the real estate industry and aims to protect stakeholder interests, benefiting both the corporate debtor and creditors. The proactive involvement of the corporate debtor and the collaborative approach can streamline the resolution process, leading to more efficient and timely resolutions. This can minimise the potential erosion of value due to prolonged financial distress, ultimately serving the best interests of all parties involved.

### **The Imperative NEED for Reverse CIRP Codification**

IBC was amended in 2017 to introduce Section 29A, which aimed to prevent defaulting promoters from regaining control of a company's management through the back door. This section bars certain individuals, including promoters, from submitting resolution plans to the Interim Resolution Professional (IRP). The Supreme Court has emphasised the need for a purposive interpretation of Section 29A, aligning with its objective of safeguarding creditors' interests and promoting corporate governance.<sup>18</sup>

In the Chitra Sharma case, the Supreme Court rejected creating an exception allowing promoters to participate in the resolution process. The court's stance was that Section 29A was enacted with the public interest and better corporate governance in mind. Permitting promoters to participate could harm the objectives and intent behind the IBC.<sup>19</sup>

However, in the Umang Realtech case, the NCLAT advocated for a balanced interpretation of Section 29A, considering its underlying purpose. The NCLAT directed the promoter to refrain from direct participation in the Corporate Insolvency Resolution Process (CIRP) and instead act solely as a lender. The order mandated that all payments be made by check and signed by both the authorised company representative and the IRP, ensuring proper utilisation of funds. The promoter was also required to cooperate with the IRP and provide insights on project

<sup>18</sup> Bank of Baroda v. MBL Infrastructures Ltd. (2022), MANU/SC/0060/2022.

<sup>19</sup> Chitra Sharma v. Union of India, (2018) MANU/SC/1219/2017.

completion.<sup>20</sup>

While the NCLAT aimed to restrict the promoter's direct involvement, it acknowledged the value of their expertise and allowed them to assist the IRP in the resolution process. This decision was a deviation from the typical IBC proceedings, where the management's role is completely suspended during the resolution process.

The Reverse CIRP is a case-specific procedure tailored to the unique details of each situation. Its application or non-application depends on the circumstances of each case. If the Reverse CIRP proves unsuccessful, the NCLAT reverts to the standard CIRP process. This highlights the importance of not leaving the decision solely to the court's discretion, as it could compromise the uniformity of court decisions.

The inconsistency between cases like *Chitra Sharma and ArcelorMittal* underscores the need to incorporate the reverse CIRP process into the code, creating an exception to Section 29A and specifying the conditions under which the court can utilise this process. Such legislative action would ensure a consistent and structured approach.

Ensuring the creditor's (CD) survival and continuance as a going concern is the primary goal of IBC. IBC should only apply to legal entities, and the insolvency process should be started against a particular company rather than a particular project. Reverse CIRPs should be reimagined as a strategy for resolving the insolvency of a real estate company on a project-by-project basis rather than starting the insolvency proceedings against a single project.<sup>21</sup>

As the proposed amendment contains provisions for project-by-project insolvency proceedings, there was an opportunity to integrate the Reverse CIRP into the code. However, this was not done. The Reverse CIRP lacks a solid foundation in the IBC. Further, its application is based solely on judicial discretion and conflicts directly with Section 29A of the IBC. Thus, there is an immediate need to codify the reverse CIRP process.

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<sup>20</sup> *Flat Buyers Association v. Umang Realtech (P) Ltd.*, (2020) MANU/NL/0077/2020.

<sup>21</sup> *Rachita Shah & Arundhati Diljit, Real Estate Developers and Homebuyers: Finding Harmony under the IBC*, NLS Bus. L. Rev. 79 (2020).

## CONCLUSION

While there exists a well-defined mechanism regarding the traditional CIRP, the introduction of a robust mechanism is the best solution for the problems faced by the real estate stakeholders. A well-defined mechanism with statutory backing for project-wise CIRP and reverse CIRP is a move towards the welfare of the major players, like the financial creditors and the homebuyers. The enabling provisions of law to initiate project-wise insolvency projects are necessary to fill the essential void. While efforts have been consistently made towards accommodating the changes, it is equally important that the code has its preventive mechanisms to ensure that the aim of the code is not defeated. The best interest of the players involved in the process is served.

