

**THE FUTURE OF REAL ESTATE INSOLVENCY IN INDIA:  
TOWARDS A SECTOR-SPECIFIC RESOLUTION FRAMEWORK**

*Syed Alwaz Asif & Areen Asif\**

**ABSTRACT**

*The construction sector, a crucial driver of India's economy, is projected to reach a market size of INR 83 lakh crores by 2030, contributing 13% to the Gross Domestic Product by next year. Despite its growth, the sector faces systemic financial challenges, with over 1,400 real estate and construction firms entering insolvency as of June 2024 under the Bankruptcy Code (IBC, 2016). While the bankruptcy code has brought resolution to some companies, more than 35 % of admitted cases remain unresolved, reflecting deep inefficiencies in the current insolvency framework.*

*This paper critically examines the shortcomings of India's existing insolvency framework in addressing the unique challenges faced by the real estate sector. It highlights how fund mismanagement, contractual disputes, and the multi-project nature of the industry exacerbate insolvency risks, stalling project completions, and frustrating stakeholders, including homebuyers, contractors, and lenders.*

*Drawing from international best practices, particularly the Australian insolvency model, the paper proposes the introduction of specialized mechanisms in India. It advocates for the adoption of Project Bank Accounts (PBAs), retention trust accounts, and a rapid adjudication process to resolve payment disputes swiftly. The PBA model, designed to protect contractors and subcontractors by isolating project-specific funds, would curb fund diversion—a key cause of financial distress in India's real estate sector. Additionally, integrating these mechanisms into the Real Estate (Regulation and Development) Act, 2016 (RERA) would enhance financial accountability and ensure the timely completion of projects.*

*The paper concludes by making a strong case for a sector-specific insolvency framework, arguing that without such reforms, India's real estate sector risks continued financial instability, undermining its potential contribution to the country's economic future.*

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\* Syed Alwaz Asif is a Final Year Law Student, Dr. Ram Manohar Lohiya National Law University, Lucknow and Areen Asif is a First Year Law Student, OP Jindal Global Law School, Sonapat.

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## **I. INTRODUCTION**

After the agricultural sector, the construction industry contributes significantly to the Indian economy, coming in as the second biggest source of jobs. According to statistical projections, the real estate industry is expected to grow from INR16 lakh crore in 2021 to a market size of INR 83 lakh crore by 2030. Furthermore, its contribution to the Gross Domestic Product is expected to increase to 13% by the next year<sup>1</sup>. The real estate industry experienced remarkable expansion due to factors such as rising household incomes, nuclear family formation, and rapid urbanisation<sup>2</sup>.

The real estate industry is expected to provide an even greater economic contribution given the rate at which urbanisation is now occurring. By 2047, its

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<sup>1</sup> India Brand Equity Foundation, Indian Real Estate Industry Analysis Presentation, IBEF, <https://www.ibef.org/industry/indian-real-estate-industry-analysis-presentation>, accessed on August 14, 2024.

<sup>2</sup> Suyash Tripathi, Investment in Indian Real Estate: Opportunities and Risk, TAXGURU (Jan. 24, 2024), <https://taxguru.in/corporate-law/indian-real-estate-investment-opportunities-and-risks.html>.

market size will balloon to INR 481.4 lakh crore, making up 15.5% of the GDP<sup>3</sup>. The figures highlight the sector's vitality and its critical role in the broader economic framework of the country.

However, despite its contributions to the structural growth of the economy, the real estate sector faces severe challenges, particularly in terms of financial stability. As of June 2024, approximately 1,400 real estate and construction companies had been accepted into the resolution process under the Code (*IBC, 2016*).<sup>4</sup> Out of these, 645 companies were successfully rescued through withdrawals, resolution, or closure of the process, while 261 companies were liquidated. This gives an overall resolution rate of approximately 64.7%, the significant number of liquidations, and the fact that over 35% (494 companies) remain unresolved highlight persistent challenges within the current insolvency framework. The high liquidation rate, coupled with a substantial backlog of unresolved cases, underscores structural inefficiencies in addressing the unique complexities of the real estate sector.<sup>5</sup>

Despite the sector's economic importance, the current insolvency framework under the IBC, 2016 is struggling to address the unique challenges faced by real estate and construction companies. The current data reveals that a significant portion of the companies admitted into the insolvency process remain unresolved, which indicates persisting inefficiencies in the current system. The low success rate, coupled with the high number of unresolved cases, posits the urgent need for a more specialized and effective insolvency framework tailored to the distinct needs of the industry.<sup>6</sup>

This paper aims to analyse the existing insolvency framework as applied to real estate businesses. It aims to identify the gaps and inefficiencies that contribute to

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<sup>3</sup> *Id.*

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

<sup>5</sup> Insolvency and Bankruptcy Board of India, Quarterly Newsletter, April-June 2024, <https://ibbi.gov.in/en/publication>, accessed on August 10, 2024.

<sup>6</sup> Mukesh Chand, The Evolution And Effectiveness Of The Insolvency And Bankruptcy Code, 2016: An Analytical Perspective, MONDAQ (August 14, 2024), <https://www.mondaq.com/india/insolvencybankruptcy/1505536/the-evolution-and-effectiveness-of-the-insolvency-and-bankruptcy-code-2016-an-analytical-perspective>.

the low-resolution rate. By examining the current provisions under the IBC and comparing them with international models such as the Australian framework, in addition to recent proposals by the Insolvency and Bankruptcy Board of India (**IBBI**), this paper seeks to propose a new, specialized framework.

## **II. CURRENT LEGAL FRAMEWORK AND CHALLENGES**

The insolvency landscape in India, especially in the construction and real estate sectors, showcases a rather distinct set of hurdles that need to be adequately addressed by the existing legal framework under the I.B.C., 2016. The inherent intricacies within these sectors have resulted in many unresolved insolvencies, liquidations, and financial struggles. This situation calls for a deeper dive and some much-needed reform.<sup>7</sup> Real Estate firms in India go through the liquidation process for the following reasons:

### **A. FACTORS CONTRIBUTING TO INSOLVENCY IN THE CONSTRUCTION INDUSTRY**

Insolvency in the construction industry often arises from a combination of factors, each contributing to the financial downfall of contractors and developers<sup>8</sup>:

#### **1. Absence of Entrance Barriers**

In India, the construction sector has low entry barriers, which has led many smaller firms with limited management expertise to join the fray. These firms often lack the necessary skills and managerial experience to navigate the complexities of large-scale projects, resulting in mismanagement and eventual insolvency. The low entry barriers have resulted in a situation where too many companies jump into the industry without proper preparation, creating a

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<sup>7</sup> Sandeep Bhuraria and Parijat, *The Paradigm of Real Estate Insolvencies: Judicial Trends, Roadblocks and The Way Ahead*, *LIVELAW* (March 27, 2024), <https://www.livelaw.in/law-firms/law-firm-articles-/paradigm-of-real-estate-insolvencies-judicial-trends-challenges-and-roadblocks-cirp-ibbi-253531>.

<sup>8</sup> Patel, RutaNilam, RajnikantTrivedi, DevanshuPandit, and Chirag N. Patel. "Identification of Reasons for Contractor Insolvency in the Indian Construction Industry" *JOURNAL OF THE INSTITUTION OF ENGINEERS (INDIA): SERIES A* 103.1 (2022): 129-137.

repetitive pattern of failure and economic struggles<sup>9</sup>.

## **2. Diversification into Non-Core Businesses:**

Many contractors attempt to diversify their business activities to stabilize cash flow and increase profits by venturing into counter-cyclical industries<sup>10</sup>. However, such diversification often involves miscalculated risks that result in substantial losses. These losses can become unrecoverable, pushing the firm into insolvency.

## **3. Cash Flow Issues:**

One of the major factors that lead to insolvency in the construction sector is poor management of working capital. A lack of sufficient funds to carry out daily operations can destabilize a project.<sup>11</sup> Contractors frequently experience sudden declines in demand, which reduces the turnover of a firm and creates cash flow issues that result in insolvency.

## **4. Absence of strict Financial Control:**

Many smaller firms in the real estate sector fail to maintain a proper financial record which makes it difficult for firms to track their money.<sup>12</sup> This financial mismanagement often leads to accumulated debts and an inability to meet financial obligations, ultimately resulting in insolvency.

## **5. The Domino Effect:**

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<sup>9</sup> Coggins, J., Teng, B. and Rameezdeen, R. 2016. Construction insolvency in Australia: reining in the beast, *CONSTRUCTION ECONOMICS AND BUILDING*, 16(3), 38-56. DOI: <http://dx.doi.org/10.5130/AJCEB.v16i3.5113>, accessed on July 30, 2024.

<sup>10</sup> *Id.*

<sup>11</sup> Ive, G., Murray, A., & Bartlett School of Construction and Project Management, UCL. (2013). Trade Credit in the UK Construction Industry: An Empirical Analysis Of Construction Contractor Financial Positioning And Performance. BIS RESEARCH PAPER NUMBER 118 (No. 118). Department for Business, Innovation and Skills, (2013), [https://assets.publishing.service.gov.uk/media/5a7b87c240f0b645ba3c4e9f/bis-13-956-trade\\_credit-in-uk-construction-industry-analysis.pdf](https://assets.publishing.service.gov.uk/media/5a7b87c240f0b645ba3c4e9f/bis-13-956-trade_credit-in-uk-construction-industry-analysis.pdf), accessed on August 2, 2024.

<sup>12</sup> Coggins, J., Teng, B. and Rameezdeen, R. 2016. Construction insolvency in Australia: reining in the beast, *CONSTRUCTION ECONOMICS AND BUILDING*, 16(3), 38-56. DOI: <http://dx.doi.org/10.5130/AJCEB.v16i3.5113>, accessed on July 30, 2024.

The failure of a single contractor in the supply chain can create a cascading effect affecting subcontractors, suppliers and clients. This knock-on effect can be particularly devastating for the whole sector, where the failure of a single firm can disrupt multiple projects and lead to widespread financial distress.<sup>13</sup>

## **6. Overwhelming Contract Claims:**

Construction contracts in India contain several one-sided contractual clauses that disproportionately burden contractors<sup>14</sup>. These contracts often include unfair provisions such as "no-claim clauses," which prevent contractors from seeking compensation for delays caused by the employer. In *R.L. Kalathia v. The State of Gujarat* (2011),<sup>15</sup> the Supreme Court ruled that valid claims cannot be barred by simply issuing a "no due certificate". This action offered significant relief to contractors, although similar clauses are still widespread in construction contracts. They force contractors into financial distress as they cannot recover costs for project delays or additional work. Furthermore, time-bar clauses compound their financial vulnerability by restricting contractors' ability to file claims within short, rigid timeframes. In *Muni Lal v. Oriental Fire and General Insurance* (1996),<sup>16</sup> the Supreme Court noted that a contract would be defective to the extent that it stipulates a shorter statute of limitations to file a complaint than the legal statute of limitations. This is in compliance with Section 28 of the Indian Contract Act.

Such unfair practices create overwhelming claims under contracts, pushing contractors towards insolvency, especially when disputes arise over liquidated damages or non-compliance with specifications. A more balanced approach to construction contracts could reduce the financial stress on contractors, improving the overall stability of the sector.

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<sup>13</sup> *Id.* at 12.

<sup>14</sup> Chandrasekaran R, Organizing the unorganised: the Indian construction industry, FOX MANDAL (May, 2023), <https://www.foxmandal.in/organizing-the-unorganised-the-indian-construction-industry/> accessed on August 11, 2024.

<sup>15</sup> *R.L. Kalathia v. The State of Gujrat* (2011) 2 SCC 400.

<sup>16</sup> *Muni Lal v. The Oriental Fire and General Insurance Company Limited* (1996) 1 SCC 90.

## 7. Predominance of Trade Credit:

The construction industry relies heavily on trade credit for the purchase of materials and equipment. In cases where projects are delayed or fail to complete, the accumulation of large credits can lead to insolvency. The dependence on credit without corresponding cash inflows exacerbates financial instability.<sup>17</sup>

### **B. CHALLENGES IN THE REAL ESTATE BUSINESS**

After the advent of the I.B.C. in 2016, several challenges related to construction insolvency have come to the fore, primarily due to its unique characteristics compared to other corporate entities. Although, it was a positive step, the IBC's recognition of homebuyers as financial creditors also brought about new complications. The Supreme Court's historic ruling in *Pioneer Urban Land and Infrastructure Limited v. Union of India (2019)*<sup>18</sup> upheld the 2018 amendment to Code,<sup>19</sup> which categorised homeowners as financial creditors. This ruling empowered homebuyers by giving them a say in the resolution process through the Committee of Creditors (CoC). The court observed that the company should treat the funds raised from homebuyers as financial debt. However, in an insolvency resolution process, homebuyer's objectives often differ from those of traditional financial creditors. While financial institutions may focus on financial recovery, homebuyers are primarily concerned with the transfer of their homes. This divergence can lead to conflicts within the CoC, where the interests of these two groups may not always align.<sup>20</sup>

It also puts homebuyers along with financial creditors which is in turn a problem as then it requires the judgment of insolvency laws moving into an area

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<sup>17</sup> *Id.*

<sup>18</sup> *Pioneer Urban Land and Infrastructure Limited v. Union of India*, 2019 SCC ONLINE SC 1005.

<sup>19</sup> *Supra* note 4.

<sup>20</sup> Abhilash Pillai and Tarun Agarwal, Home Buyers = Financial Creditors: Supreme Court Reigns, INDIA CORPORATE LAW CYRIL AMARCHAND MANGALDAS (August 14, 2019), <https://corporate.cyrilamarchandblogs.com/2019/08/home-buyers-equivalent-financial-creditors-supreme-court-rules/>.

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Framework*

where they are not necessarily best-equipped to operate. The question that emerges from this is whether the current legal framework under the IBC ensures adequate protection for homebuyers or inadvertently places them with duties over which they have no expertise.<sup>21</sup> The recognition of homebuyers as financial creditors was an essential step, but it has also rubbed in the necessity to handle differently with this unique sector called real estate insolvency.<sup>22</sup>

In *Manish Kumar v. Union of India (2021)*,<sup>23</sup> the SC upheld that additional prerequisites are mandatory for homebuyers to fall within financial creditors under IBC. The court stressed the need for a threshold number, where it will not entertain insolvency proceedings filed by an individual homebuyer(s) unless there is some critical mass of such homebuyers. Otherwise, it would amount to a frivolous and harassing claim, which cannot be permitted under IBC. While this is a welcome development, it also stresses the importance of ensuring that home buyers are able to exercise their legal rights without putting undue burden on the insolvency process. But it also reveals a limitation, where aggrieved homebuyers often have no other recourse than the IBC given their modest means and slender leverage in legal matters (unless they could gather support from several instances of distressed buyers). This judgement brings the conflict between legislative intent and judicial discretion, most prominently in economic laws where judgements can have far-reaching implications.

Judicial innovation has also played a crucial role in dealing with some of the problems posed by real estate insolvencies. The concept of "reverse insolvency," or project-wise insolvency, was introduced by the NCLAT in the case of *Flat Buyers Association Winter Hills vs Umang Realtech Pvt.*<sup>24</sup> The approach was needed in real estate development, where there might be several projects that different

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<sup>21</sup> Ashwin Mathew, Inclusion of Home Buyers in the Insolvency Process: An Analysis, INDIA CORPLAW (June, 2018), <https://indiacorplaw.in/2018/06/inclusion-home-buyers-insolvency-process-analysis.html>.

<sup>22</sup> Harshita Vaashite, From Unseen to Foreseen: The Financial Creditor Status of Homebuyers in IBC, IBC LAWS BLOG, <https://ibclaw.blog/from-unseen-to-foreseen-the-financial-creditor-status-of-homebuyers-in-ibc-by-harshita-vaashite/>.

<sup>23</sup> *Manish Kumar v. Union of India*, 2021 SCC 5 1.

<sup>24</sup> *Flat Buyers Association Winter Hills v. UmangRealtechPvt.Ltd.*, Company Appeal (AT) (Insolvency) No. 926 of 2019.

companies work on simultaneously, and they can all be completed at different stages. The NCLAT observed that the insolvency process could only be applied to incomplete projects, protecting completed ones from being pushed into Insolvency. This decision represented a major improvement, but it also raised concerns about the fragmentation of the insolvency process and the possibility of inconsistent outcomes across different projects. Project-wise resolution offers a practical solution but can complicate the administration of Insolvency, especially if one must segregate assets and liabilities between different projects.

The overlap between the IBC and Real Estate Regulatory Authority (RERA) has also generated considerable litigation. RERA was enacted to protect homeowners and to secure the timely completion and delivery of real-estate projects, whereas IBC deals with debt resolution, focusing mainly on maximizing the value of corporate debtors' assets. This dual regulatory regime has, at times, been the cause of two conflicting objectives colliding, which is most visible when bankruptcy proceedings against a developer trigger shutdowns in ongoing projects. In the *Amrapali Group* case (*Bikram Chatterji v. Union of India*),<sup>25</sup> the SC utilized its constitutional authority under Article 142 to safeguard the rights of homebuyers by directing the completion of projects outside the typical insolvency resolution process. This intervention highlights the inadequacies of the IBC in addressing the specific needs of real estate insolvencies and highlights the necessity of a more integrated approach that reconciles the objectives of both RERA and the IBC. Without such an approach, the resolution process may continue to face significant obstacles, leaving homebuyers in a precarious position.

Another critical development in protecting homebuyers' rights under the IBC came in *Alok Sharma & Ors. v. M/s. P Construction Pvt. Ltd.*<sup>26</sup> where the NCLAT ruled that the rights of homebuyers already in possession of their units should be protected during the insolvency process. The NCLAT held that these units should not form part of the liquidation estate, and thus, they cannot be taken over by lenders once a developer goes into liquidation. This crucial decision was taken to

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<sup>25</sup> *Bikram Chatterji v. Union of India*, W.P.(C) No.-000940 / 2017.

<sup>26</sup> *Alok Sharma & Ors. v. M/s. P Construction Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 350 of 2020, NCLAT, Principal Bench, New Delhi.

protect the interests of homebuyers and secure their homes from being entangled in the insolvency process. While it is essential to protect homebuyers, this protection must be balanced against the rights of financial creditors who may see their recoveries diminished as a result.

The challenges faced by the real estate sector under the IBC are multi-faceted and stem from the sector's unique characteristics, which differ significantly from those of other corporate entities. The case law discussed above illustrates the judiciary's efforts to address these challenges through innovative solutions and evolving legal standards. While judicial interventions clearly play a crucial role, they also underscore the inadequacy of the existing insolvency regime and the need for wide-ranging improvements to serve the requirements of the real estate sector. A unique legal framework pitting the IBC and RERA objectives together, but at the same time providing a roadmap for how bankruptcies in the real estate sector can be resolved is necessary to safeguard all stakeholder interests while ensuring successful resolution of financial distress within this space.

### **III. GOVERNMENT AND IBBI'S PROPOSED SOLUTIONS**

In order to tackle the rising insolvency problems in real estate, the Central Government and IBBI, have introduced various modifications for making IBC processes more efficient. These proposals aim to tackle some of the difficulties posed by the real estate sector, especially in cases where the insolvency of real estate developers affects multiple projects, many of which are in different stages of completion.

The IBBI suggested several changes to the resolution system for the construction industry in its discussion paper dated November 6, 2023,<sup>27</sup>. These include compulsory registration of projects as per the RERA regulations, operating distinct bank accounts for individual real estate projects, and allowing the Committee of Creditors (CoC) to examine distinct resolution plans for

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<sup>27</sup> Discussion Paper, "Real-Estate Related Proposals- CIRP and Liquidation", IBBI (November 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).

individual projects. The proposals also extend to executing transfer deeds during the Corporate Insolvency Resolution Process (CIRP) and excluding property under the possession of homeowners from the liquidation estate. Each of these measures is discussed below, highlighting their significance and potential impact on the resolution process.

One of the primary suggestions is that registration under RERA should be compulsory for all real estate projects going through CIRP. This is consistent with the requirements of § 3 of the RERA, 2016<sup>28</sup>, which requires the developmental projects to be registered if the land exceeds 500 square meters or involves the construction of more than eight apartments. It has also been proposed that the Insolvency Resolution Professional (IRP) should register projects under RERA to bring more transparency and accountability. Although this step is vital to ensure frauds like Amrapali cannot be repeated at a later date, it does put an additional workload on insolvency professionals, especially in scenarios where the developer has multiple projects. The project would place an extra workload on administrators; however, the advantages over transparency are substantial — it could save unsuspecting homebuyers and enable better regulatory oversight in insolvency proceedings<sup>29</sup>.

The IBBI proposes that a distinct bank account should be maintained for every real estate project undergoing insolvency proceedings. This is in line with RERA's requirements and is designed to prevent the mixing of funds from different projects, which is a common issue that complicates the resolution of distressed real estate companies. This proposal is a much-needed measure, as the failure to separate project funds has led to the mismanagement of resources and delays in project completion. The use of separate bank accounts will further streamline the insolvency process and bring more accountability to project-level finances that can be monitored easily by all stakeholders including homebuyers<sup>30</sup>.

One of the key issues faced by homebuyers is the delay in the transfer of

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<sup>28</sup> Real Estate (Regulation and Development) Act, No. 16 of 2016, § 3, India Code (2016).

<sup>29</sup> *Supra* note 28.

<sup>30</sup> *Id.*

ownership of their apartments or homes, even after they have paid the full amount. The IBBI's proposal seeks to address this situation by allowing the IRP, with the CoC's approval, to execute transfer or sublease deeds during the CIRP process<sup>31</sup>. This proposal is aimed at expediting the resolution process and protecting homebuyers who have already fulfilled their financial obligations. By formalizing the transfer of ownership during the insolvency process, the proposal seeks to safeguard the interests of homebuyers, many of whom face uncertainty due to pending registrations. However, the execution of such deeds during CIRP must be carefully monitored to avoid any conflict with the claims of other creditors<sup>32</sup>.

The IBBI also proposed that the CoC should be empowered to invite separate resolution plans for individual projects since the construction companies have various projects at different stages of completion. Such an approach allows for a more flexible approach so that only the projects that are distressed should be under liquidation and not the completed projects of the developer. In real estate insolvencies, having a blanket approach towards all projects has a degrading effect on other solvent projects<sup>33</sup>. Project-specific resolutions give flexibility to the resolution professional and attract more bidders leading to a successful resolution. However, there is a risk that developers may misuse this provision to siphon off funds or divert resources from troubled projects. Such a concern should be addressed through stringent oversight mechanisms. To protect the homebuyer's possessions from being liquidated, IBBI has also proposed excluding such possessions from the liquidation process. This aligns with the NCLAT judgment in *Alok Sharma & Ors. v. M/s. I.P. Construction Pvt. Ltd.*<sup>34</sup>, where it held that properties in possession of homebuyers should not be considered part of the liquidation estate. The inclusion of homebuyers' properties in the liquidation estate has historically led to long delays and legal battles, depriving them of their

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<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Alok Sharma & Ors. v. M/s. P Construction Pvt. Ltd., Company Appeal (AT) (Insolvency) No. 350 of 2020, NCLAT, Principal Bench, New Delhi.*

homes. By formally excluding these properties, the IBC framework takes a significant step in aligning with consumer protection goals. However, the practical implementation of this provision may face challenges, especially in cases where the sale deed has not been executed before the insolvency proceedings commence<sup>35</sup>.

However, all these proposals are under consideration due to concerns raised about possible misuse by errant developers to divert funds from one project to another<sup>36</sup>. Furthermore, the government believes that the requirement under RERA to maintain separate accounts for each project is sufficient to prevent fund diversion. The government also considers the risk associated with relaxing certain safeguards under IBC, mainly related to avoidance transactions (Sections 43–51), where you can reverse fraudulent transactions. Any dilution of these provisions runs the risk of opening the insolvency processes to more significant opportunities for misuse, thereby reducing value realisation for creditors<sup>37</sup>.

The challenges associated with this sector and the specificities of project-based insolvencies reflect that merely introducing these amendments (as proposed by IBBI) may need to be revised to serve this complex labyrinth. It is welcome that the government has initiated a re-think of relieving provisions such as project-wise insolvency and exclusion of homebuyer properties from liquidation estates, but a more comprehensive framework that considers unique financial structures and stakeholders in the sector is a must. The Australian insolvency model, in particular its application to the so-called construction and real estate-oriented sectors, offers a useful guide.

#### **IV. PROPOSAL FOR A SPECIALIZED FRAMEWORK: INTEGRATING THE AUSTRALIAN MODEL FOR REAL ESTATE**

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<sup>35</sup> *Supra* note 28.

<sup>36</sup> Verma, P. (2023, December 18). Rethink likely on project-specific plans for real estate insolvency. FINANCIAL EXPRESS. <https://www.financialexpress.com/business/industry-rethink-likely-on-project-specific-plans-for-real-estate-insolvency-3340755/>, accessed on August 10, 2024.

<sup>37</sup> Priyansh Verma, Rethink likely on project-specific plans for real estate insolvency, FINANCIAL EXPRESS (December 18, 2023), <https://www.financialexpress.com/business/industry-rethink-likely-on-project-specific-plans-for-real-estate-insolvency-3340755/>.

## **INSOLVENCY IN INDIA**

A complete overhaul of India's insolvency framework would essentially be similar to those practised internationally, giving much-needed reform in the Indian real estate sector. Australian construction insolvency model brings new and innovative ways to counter issues that the construction sector is confronting in India. By mechanisms such as Project Bank Accounts (PBAs) and security of payment regime, Australia has endeavoured to remedy the chronic issue of unpaid subcontractors, insolvency of the contracting chain, and fund mismanagement. If legislators tailor these features to suit the Indian context, they can enhance the efficacy of IBC in resolving real estate insolvencies.

### **A. KEY FEATURES OF THE AUSTRALIAN MODEL**

The Australian model suggests a national reform involving the introduction of its *Uniform Security of Payments Regime* — by which everyone involved in the construction supply chain, from head contractors to subcontractors, is paid on time for work they complete. This mechanism prevents smaller firms from facing financial distress due to delayed payments and restricted cash flows from further up the chain, which affects the sub-contractors disproportionately.

The Australian model also proposes a rapid adjudication process, which provides an expedited route for resolving disputes using the same legal infrastructure. This is intended to reduce the time required to hold up projects and grants due to disputes over funding amounts. Unlike traditional proceedings, the rapid adjudication process uses a pool of qualified adjudicators who can render enforceable decisions in days or weeks. This does not require the establishment of fast-track tribunals but is instead processed through existing administrative structures via expedited procedures that circumvent formal litigation. A faster process would seem to be more efficient and intrinsically practical compared to the current enforcement time, balancing efficacy with minimal disruption for ongoing projects yet keeping most full-fledged remedies intact and higher appellate relief in place if required.

There is an urgent need for the real estate business in India to adopt a similar strategy. Such payment disputes amongst developers, contractors, and sub-

contractors often lead to stalled projects, protracted insolvency proceedings & disenchantment among various stakeholders including homebuyers. For example, when Jaypee Infrastructure Limited entered insolvency in 2017<sup>38</sup>, many stakeholders were awaiting the completion of the corporate insolvency resolution process. Section 12(1)<sup>39</sup> of the IBC, 2016, requires that a corporate insolvency resolution process be completed within 180 days. However, due to numerous proceedings in the Supreme Court along with the challenge to NBCC's resolution plan, there was a considerable delay in the completion of the resolution process. It caused severe financial strain to all stakeholders. The current framework of resolution of disputes lacks efficient disposal of disputes, leading to cascading delays and financial instability across the sector.

Another important feature trialled in Australia is the *Project Bank Account (PBA)* for government-funded projects over \$10 million, which places funds for each project into a separate retention trust account. The PBA system is instrumental in safeguarding subcontractors and other stakeholders as it prevents payments for construction work from being diverted to some other purpose by the head contractors. Thus, the aim is to avoid situations where the funds are used for other purposes, which has caused so many insolvencies in the construction industry. In particular, the PBA works as a trust account through which money is channelled from clients to sub-contractors without passing through the head contractor. Another benefit of early payment instruments is that they guarantee that all the subcontractors are paid without much risk of payment default and, therefore, financial pressure down the supply chain.

The Australian model also encompasses a *retention trust* to protect subcontractors against non-payment. This measure requires the contractors to place such payment amounts into a trust account as would go to the subcontractors concerning the work that the subcontractors have performed. That kind of structure also helps correct the asymmetry in the contracting

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<sup>38</sup> JeevanPrakash Sharma, Five years of Jaypee Infratech insolvency case: Why do homebuyers end up as the biggest losers?, *OUTLOOK BUSINESS* (2022), <https://www.outlookbusiness.com/news/five-years-of-jaypee-infratech-insolvency-case-why-do-homebuyers-end-up-as-the-biggest-losers--news-218988>, accessed on August 15, 2024.

<sup>39</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, § 12(1), India Code (2016).

relationship because, whereas subcontractors are most vulnerable to risk, their bargaining power is the least.

From an analytical perspective, the Australian PBA model does not just strive to create transparency but to safeguard stakeholders at various tiers. The fact that project funds are placed in a legally protected account that is separate from other funds means that, structurally, there is a non-trivial barrier to owing to misuse of funds that has all too often set off a chain of insolvencies. Contractors and subcontractors are no longer left exposed to cash deficits, which are realised due to poor financial management by head contractors. The system also provides the means of making timely payments to subcontractors; this is one of the major contributors to insolvency in the construction business.

From an analytical standpoint, the Australian PBA model goes beyond merely ensuring transparency; it seeks to protect stakeholders at multiple levels. Isolating project-specific funds in a legally protected account creates a structural safeguard against the misuse of funds, which has often triggered cascading insolvencies. Contractors and subcontractors are no longer left vulnerable to cash shortages arising from financial mismanagement by head contractors. The system also ensures that subcontractors get paid promptly, thus reducing one of the primary drivers of insolvency in construction.

Thus, the incorporation of a PBA model would be particularly advantageous for the Indian real estate business. Arguably, one of the classic issues that plague the Indian construction business is the ability of developers to embezzle funds from one project to another, leaving some of the projects partially or wholly uncompleted with an awful lot of stakeholders, particularly homebuyers, contractors and all manner of creditors severely financially compromised. For instance, the Amrapali group<sup>40</sup> transferred a sum of Rs 2,765 crore to complete other projects<sup>41</sup>. It could be used to transform the PBA system by making possible

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<sup>40</sup> *Supra* note 26.

<sup>41</sup> Diversion of funds by builders a “malady”, want to stop this “nonsense”: SC, BUSINESS STANDARD (2018), [https://www.business-standard.com/article/pti-stories/diversion-of-funds-by-builders-a-malady-want-to-stop-this-nonsense-sc-118080101149\\_1.html](https://www.business-standard.com/article/pti-stories/diversion-of-funds-by-builders-a-malady-want-to-stop-this-nonsense-sc-118080101149_1.html), accessed on August 15, 2024.

the protection of such funds from mismanagement through the application for funding for a specific project for which the funding was raised. This would enhance financial accountability while mitigating the risk of insolvency at the level of several projects experiencing deficient cash flows.

Unlike the IBBI's proposal for a separate bank account for each project, whose primary intent is to ensure that funds for specific real estate projects are not misused during the CIRP, the Australian PBA model introduces a more comprehensive, trust-based legal framework that addresses deeper issues related to insolvency and payment security. The PBA's objective is not solely to ensure transparency but also to prioritize the financial well-being of contractors and subcontractors by securing payments for completed work. This is particularly critical in an industry where delayed payments often lead to cascading insolvencies and project disruptions. The Australian model guarantees that funds deposited in the PBA are allocated first and foremost for subcontractor payments, thereby insulating them from the financial instability of head contractors or developers. This proactive approach protects smaller players in the construction chain, who are often most vulnerable to insolvency.

The comparison of the two systems shows the difference in coverage and efficiency of the measures. The proposal by the IBBI guarantees the separation of funds to ensure order in payment when insolvency occurs but falls short in addressing the core issue of payment security for subcontractors and smaller contractors. The same approach used by the Australian model of paying such actors first helps avoid insolvencies because the money for the completed project cannot be used elsewhere. This protection significantly reduces the likelihood of projects being trapped by cash deficits, which is a common reason for insolvency in both the Australian and Indian property markets. Unlike most of the supply chain finance models, the PBA model ensures that funds are channelled only to those who are owed so that they can be paid directly, thereby easing their financial constraints and thus reducing the impact of one troubled company on the rest of the chain.

Furthermore, incorporating PBAs into India's regulatory landscape, particularly under the existing RERA Act, would enhance current financial

safeguards. RERA already mandates that 70% of project funds be held in an escrow account<sup>42</sup>, but this provision has faced numerous implementation challenges, particularly concerning fund diversion. A PBA-based system could bolster RERA's effectiveness by introducing a more rigorous and legally enforceable mechanism for managing funds. While RERA's focus is on transparency and ensuring that funds are available for construction, the PBA and retention trust models add an additional layer of security by protecting payments to subcontractors and securing project-specific financing. This would mitigate the risk of financial mismanagement, which has been a major contributor to insolvency in the real estate industry.

## **V. THE WAY FORWARD**

The case for a specialized insolvency framework for India's real estate sector is not just a legal argument—it is an economic imperative. The numbers lay bare the challenges: with over 35% of real estate insolvencies unresolved, and a 64% success rate as of June 2024, it is clear that the existing mechanisms are failing a sector projected to contribute 15.5% to India's GDP by 2047.<sup>43</sup> This data underscores a deeper structural issue: a framework designed for general corporate insolvency cannot accommodate the unique challenges of the real estate industry, where multiple projects, complex stakeholder interests, and chronic fund mismanagement create systemic risks.<sup>44</sup>

At the heart of the problem is the sector's deeply fragmented nature. Developers juggle multiple projects at varying stages of completion, while homebuyers, contractors, and lenders are left vulnerable to the cascading effects of insolvency. The sheer magnitude of these challenges calls for a radical rethink, one that moves beyond incremental reforms and toward a specialized framework

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<sup>42</sup> Real Estate (Regulation and Development) Act, No. 16 of 2016, § 4(2)(l)(D), India Code (2016).

<sup>43</sup> Indian Real Estate Industry Analysis Presentation | IBEF, India Brand Equity Foundation (Nov. 2024),

<https://www.ibef.org/industry/indian-real-estate-industry-analysis-presentation>.

<sup>44</sup> Ravichandra Rao, N. and Kasture, J. (2024), "Sectoral insights into corporate insolvency: a comprehensive analysis of Corporate Insolvency Resolution Process (CIRP) outcomes in India", *INTERNATIONAL JOURNAL OF LAW AND MANAGEMENT*, Vol. ahead-of-print No. ahead-of-print. (December 17, 2024) <https://doi.org/10.1108/IJLMA-08-2024-0291>.

that acknowledges and addresses the sector's intricacies.

The Australian model offers a powerful blueprint for reform. Its Project Bank Account (PBA) system directly addresses one of the prominent issues in India's real estate business, which is, fund diversion. Unlike the IBBI's proposal for separate bank accounts, which focuses on transparency, the PBA system is built around trust and prioritizes payments to contractors and subcontractors, ensuring that funds are securely allocated to their intended purpose. This approach not only curbs fund mismanagement but also prevents cascading insolvencies within the supply chain—one of the biggest contributors to project delays and financial distress in India. The model's focus on rapid adjudication also offers an efficient mechanism to resolve payment disputes, reducing the costly delays that often plague India's real estate projects.

Including such procedures in India's legislative framework, especially in relation to RERA<sup>45</sup>, would create a cohesive and robust system that secures payments, protects stakeholders, and accelerates project completions. While RERA has made strides in promoting transparency, its enforcement remains inconsistent. A PBA-based model would not only strengthen these existing safeguards but also offer an enforceable, trust-based system that guarantees that homebuyers' and contractors' investments are protected.

In conclusion, the stakes for India's real estate industry are too high to rely on a one-size-fits-all insolvency framework. The sector's projected growth, its critical contribution to the economy, and the large-scale financial risks it poses all demand a tailored, specialized approach. Drawing on international best practices, such as the Australian model, offers a way forward. This is not just about resolving insolvency cases more efficiently—it's about ensuring the future stability and growth of one of India's most vital industries. Without such reform, the sector will continue to face financial instability, dragging down not just stakeholders but the broader economy. A specialized insolvency framework is no longer a suggestion; it is an essential next step for India's legal and economic landscape.

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<sup>45</sup> Real Estate (Regulation and Development) Act, No. 16 of 2016, India Code (2016).