

# Insolvency and consumer rights

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# The problem

- ▶ Customers are key stakeholders in firms.
- ▶ In many instances they pay firms in advance for their purchases, and receive goods or services at a future date.

So what happens to these advances if the firm becomes insolvent?

How does this vary if the good or service is: (1) not delivered at all, and (2) partly delivered?

- ▶ This problem is likely to become larger as a firm approaches insolvency.

Firms in distress have the incentive to maximise sales, garner liquidity.

# The problem

- ▶ Part of the answer lies in contracts. Well defined customer contracts can address these issues.
  - ▶ Contracts may have clearly defined points at which their relationship with the firm is akin to a creditor-debtor relationship.
  - ▶ Customer advances are deemed to be “held in trust” till the delivery of goods or service, and not a part of the estate of the debtor.

# Customer vs. consumer

- ▶ How should one think about this issue when the customer is a consumer?
- ▶ Commonly used definition for a consumer:  
*A person who purchases goods and services for personal use.*  
No profit motive, purchase for use by self or by friends or family members.
- ▶ Large value vs. small value advances.  
Large and small in respect to what? Claims on the debtor? Average consumer income/assets?

# Customer vs. consumer

- ▶ Challenges when dealing with consumer claims:
  - ▶ Contracting with consumers may not be as robust as with customers.
  - ▶ Large in number, small in value.
  - ▶ Cost vs. benefit – from the perspective of overall value. Similar to the operational creditor problem.
  - ▶ Problem of aggregating claims. Individual consumers may not have the ability to deal with legal and cost aspects of insolvency process.

# Objective of the paper

- ▶ The BLRC is silent on the subject of treatment of consumers.
- ▶ The issue has come into focus on account of the home-buyers case.
- ▶ The objective: evaluate how policy should think about the claims of consumers in firm insolvency.
- ▶ A possible addition to the workplan: the special case of tort claims.

# Methodology

1. Identify consumer rights which create a creditor-debtor relationship in India.

Key question: when does a consumer become a creditor?

2. Triangulate the status of treatment of consumer claims under various laws.

Evaluate the nature and efficiency of the remedy offered under each.

3. How have other countries dealt with this issue?

Is this an insolvency problem?

US and UK as case studies.

4. Evaluate whether there are “special cases” or carve outs that need to be created?

For instance: home-buyers.

This evaluation should keep in mind the impact these carve-outs will have on the insolvency resolution process.

5. Identify lessons for India based on this analysis.

# Consumer rights creating a creditor-debtor relationship

- ▶ Consumer prepayments;
- ▶ Contractual rights;
- ▶ Rights under consumer protection framework;
- ▶ Rights under sector-specific laws and
- ▶ Rights under the law of torts



# India

# Laws creating consumer rights in India

- ▶ Indian Contract Act, 1872;
- ▶ Sale of Goods Act, 1930;
- ▶ Transfer of Property Act, 1882;
- ▶ Consumer Protection Act, 1986;
- ▶ Sector specific laws, e.g. RERA and
- ▶ Law of torts.

# Consumer rights under the Insolvency and Bankruptcy Code, 2016

- ▶ Initiating insolvency proceedings
- ▶ Rights during and post CIRP
- ▶ Rights under liquidation
- ▶ The curious case of home buyers

# United Kingdom

# Consumer rights in the UK: applicable laws

- ▶ Consumer Rights Act, 2015;
- ▶ Consumer Protection Act, 1987;
- ▶ Supply of Goods and Services Act, 1982;
- ▶ Law of torts and
- ▶ General laws applicable to all contracts.

# Enforcement Mechanisms

- ▶ Alternate Dispute Resolution (ADR)
- ▶ Court procedure

## ADR v. Court process

<b>Parameter</b>	<b>ADR</b>	<b>Court process</b>
Shortest duration	1-4 weeks	upto 4 weeks
% cases disposed off between 3 - 9 months	41%	50%
Longest duration	More than 9 months	More than 9 months
% of orders favouring consumers	61%	60%
% of orders granting financial awards	100%	90%

Source: *Final report on resolving consumer disputes*, Department for Business, Energy and Industrial Strategy (2018)

# Consumers under the insolvency and bankruptcy framework

- ▶ General unsecured creditors under the Insolvency Act, 1986, as amended by the Enterprise Act, 2002;
- ▶ Other remedies
  - ▶ Refunds from credit card companies;
  - ▶ Creation of a trust;
  - ▶ Insurance cover - *real estate sector*;
  - ▶ Bonds - *travel industry*;
  - ▶ Fulfillment of orders by administrator;
  - ▶ When business sold as a going concern, the purchaser may honour prepayments;
  - ▶ Possession when property in goods has passed

*Report on consumer prepayments on retailer insolvency: looking at a regime change?*



# United States of America

# Consumer rights in the US

- ▶ Applicable laws:
  - ▶ Federal Trade Commission Act;
  - ▶ Uniform Commercial Code;
  - ▶ Law of torts
- ▶ Enforcement agencies:
  - ▶ Federal Trade Commission's Bureau of Consumer Protection;
  - ▶ Consumer Product Safety Commission;
  - ▶ Food and Drug Administration

# Consumers under the insolvency and bankruptcy framework

- ▶ Title 11 of the *U.S. Code*;
- ▶ Unsecured creditors;
- ▶ Claims allowed only to the extent of \$1800 per individual;
- ▶ Creation of a constructive trust.

# Lessons for India

- ▶ Strong consumer protection frameworks;
- ▶ Timely and efficient enforcement mechanisms;
- ▶ No preferential rights under insolvency and bankruptcy frameworks.

# Weak consumer protection framework in India

- ▶ Capacity and infrastructure constraints;
- ▶ Judicial delay;
- ▶ Inadequate protection of consumers;

Should IBC be burdened due to inefficiencies in other legal frameworks?

## Future work

- ▶ Review of sample contracts to analyse consumer rights;
- ▶ Specific study on tort claims in the jurisdictions.

**Thank you.**

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