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Homebuyers under the Insolvency and Bankruptcy Code, 2016

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Homebuyers, who invest their hard-earned money into real estate projects, form an integral part of the real estate sector, but the sector has been plagued by issues like delays in construction, delays in delivery of possession of allotted properties, and financing issues. While homebuyers can seek relief under the RERA or the Consumer Protection Act against real estate developers who fail to deliver, they have also been recently granted protection under the Insolvency and Bankruptcy Code, 2016, against defaulting developers. This article examines the provisions for homebuyers under the Code and how they came to be incorporated into it. It also looks at the implications of the provisions and recent developments and trends relating to the rights of homebuyers under the Code.

Keywords: *insolvency, real estate, homebuyers, financial creditors, financial debt.*

INTRODUCTION

The Insolvency and Bankruptcy Code (IBC) was enacted in 2016 to consolidate and amend the provisions concerning insolvency and bankruptcy resolution that were scattered across multiple laws in the country. The Code provides a mechanism for efficient and time-bound insolvency resolution of insolvent entities, freeing debtors from their debts and letting creditors receive the irrepay mentor a part of it. Insolvency is a state wherein an individual, a firm, or a company defaults in the payment of their outstanding debt and financial obligations

as and when they become due. Debt is defined under the Code as a liability or obligation in respect of a claim that is due from the debtor, and which can also be in the nature of the financial or operational debt[1]. The Code further describes creditors as persons to whom a debt is owed, including financial creditors, operational creditors, secured creditors, unsecured creditors, and decree holders[2].

Under the Code, both the creditors and the debtor are allowed to apply to the relevant Adjudicating Authority to have the debtor declared insolvent and to initiate insolvency resolution proceedings[3]. While Part III of the Code(which deals with insolvency resolution and bankruptcy for individual partners and firms)does not make a distinction between financial and operational creditors, Part II contains separate provisions for the two types of creditors to initiate the corporate insolvency resolution process (CIRP). Creditors are classified as financial or operational based on the nature of the debt owed to them. Generally, persons who advance sums that are characteristic of loans are financial creditors, whereas persons to whom certain sums are owed for the provision of goods and services are operational creditors[4].

Claims in respect of the provision of goods or services or debts in respect of payment of dues arising under any law payable to the government or local authorities are operational debts for the purpose of insolvency resolution and liquidation of corporate persons[5]. A financial debt, on the other hand, is a debt, along with any interest that is payable on it, which is disbursed against the consideration for the time value of money[6]. Additionally, the definition of financial debt under the Code contains a list of othertransactions that lead to a financial debt, and it is through this provision that homebuyers have been given the status of 'financial creditors' and incorporated within the scope of the Insolvency and Bankruptcy Code.

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[1] Insolvency and Bankruptcy Code 2016, s 3(11)
[2] Insolvency and Bankruptcy Code 2016, s 3(10)
[3] Insolvency and Bankruptcy Code 2016, ss 7 and 8
[4] Roshni Sinha, 'Report Summary Insolvency Law Committee' (*PRS Legislative Research,* 30 April 2018) <https://prsindia.org/files/policy/policy_committee_reports/ILC%20Summary.pdf> accessed 20 August 2022
[5] Insolvency and Bankruptcy Code 2016, s 5(21)
[6] Insolvency and Bankruptcy Code 2016, s 5(8)

RECOGNITION OF HOMEBUYERS AS FINANCIAL CREDITORS

The Code originally did not contain any reference to homebuyers or their rights against defaulting real estate project developers. The groundwork for including provisions related to homebuyers in the Code was gradually laid down through various judicial pronouncements, although initially, even the Courts were reluctant to adjudge homebuyers' as creditors. For instance, in ***Col. Vinod Awasthy v AMR Infrastructure Ltd.***[7], the NCLT rejected the Applicant's application for initiating the CIRP as an operational creditor against the Respondent Company, in whose project the former had booked a flat. The amount he sought to recover was stated to be connected to the delayed delivery of possession of the booked flat, and therefore he could not be considered an 'operational creditor' as he had not supplied any goods or services to the Respondent Company, nor were any dues payable to him in connection with employment or under any law. The Tribunal went on to state that there was no remedy available for the Applicant homebuyer under the Code, but he has recourse to the Consumer Protection Act and other laws[8].

In another order[9] against the same Respondent Company, the Applicants who had booked immovable properties under the Respondent Company's project were held not to be financial creditors under the Code. This was, however, overturned by the NCLAT in appeal[10], wherein it was observed that though the NCLT had correctly interpreted the provisions of the law, it had failed while applying them to the facts of the case. The Respondent Company had entered into agreements with the Appellants in respect of the immovable properties under construction in the project, stating that on payment of a significant part of the total sale consideration, the purchasers would receive certain monthly amounts as 'assured returns' until actual physical possession of the property was delivered. The NCLAT held that the Appellants were treated as 'investors' under this transaction, which in turn could be treated as a 'debt' under S.3(11) of the Code. Furthermore, as the amount disbursed by the Appellants was against the consideration of the time value of the money (an essential requirement for

[7] *Col. Vinod Awasthy v AMR Infrastructure Ltd.* CP No. (IB)-10(PB)/2017
[8] Insolvency and Bankruptcy Code 2016, s 5(8)
[9] *Nikhil Mehta and Sons v AMR Infrastructure Ltd.* (*2017) Company Appeal (AT) (Insolvency) No. 07/2017*
[10] *Ibid*

classification as 'financial debt') and the Respondent Company had raised it through a sale-purchase agreement that had the commercial effect of borrowing, the Appellants were held to be 'financial creditors' under the Code.

However, there was no definitive acceptance of homebuyers as 'financial creditors' under the Code, and they continued to be grouped as 'other creditors' who were not on par with the operational or financial creditors[11]. Thereafter, having received various suggestions and references from stakeholders since the commencement of the corporate insolvency resolution and liquidation provisions in 2016, the Ministry of Corporate Affairs constituted the Insolvency Law Committee in November 2017 to examine the suggestions and references for enhancing the efficiency of the corporate insolvency and liquidation framework and ensuring effective implementation of the Code[12]. In its Report, the Insolvency Law Committee recommended that homebuyers or allottees under a real estate project be treated as 'financial creditors' under the Code, as the amounts raised from contracts among them and the developers of real estate projects served the purpose of raising finance, and would thus fall within the definition of 'financial debt' – specifically under S.5(8)(f)[13].

Pursuant to the Committee's recommendations, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 was promulgated on 6th June 2018 and was subsequently replaced by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, through which an explanation was added to the definition of financial debt under S.5(8)(f)[14], effectively giving homebuyers the status of financial creditors under the Code.

SECTION 5(8)(f) OF THE IBC

As stated previously, financial debt is defined under the Code as a debt, along with any interest that may be payable on it, which is disbursed against the consideration for the time value of money. The definition also contains a list of entries noting other transactions that give

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[11] *Chitra Sharma and Ors. v Union of India and Ors.* (2018) 5 AWC 4829 SC para 3

[12] Ministry of Corporate Affairs, Government of India, *Order: Constitution of Insolvency Law Committee* (No. 35/14/2017- Insolvency Section) <https://www.mca.gov.in/Ministry/pdf/constitutionOrder_17112017.pdf> accessed 19 August 2022

[13] Insolvency Law Committee, *Report of the Insolvency Law Committee* (2018, 18) <https://ibbi.gov.in/ILRReport2603_03042018.pdf> accessed 19 August 2022

[14] Insolvency and Bankruptcy Code (Second Amendment) Act 2018, s 3(ii)

rise to financial debt, but the list is not exhaustive. Clause (f) indicates an amount raised under any transaction that has the commercial effect of borrowings, such as a forward sale or purchase agreement[15]. The Insolvency Committee Report describes this clause as a 'residuary entry' that covers debt transactions that do not fit under any other entry in the definition[16].

The explanation to Clause (f) clarifies that any amount raised from an allottee under a real estate project is deemed to have the commercial effect of borrowing. An 'allottee', as defined under the Real Estate (Regulation and Development) Act, 2016, is a person to whom a plot, apartment, or building has been allotted, sold, or transferred by the promoter of a real estate project, or a person who subsequently acquires the allotment through sale, transfer or otherwise – but not one who has rented the plot, apartment or building[17]. Similarly, a 'real estate project' refers to the development of a building (also an apartment building), conversion of an existing building into apartments, or development of land into plots or apartments, with the aim of selling some or all of these plots or apartments, or even the building[18]. Homebuyers have thus achieved the status of financial creditors under the Code, which means they can initiate the CIRP under S.7 against a defaulting real estate developer, and they are eligible to be a part of the Committee of Creditors (CoC) through an authorized representative.

Chitra Sharma and Ors. v Union of India and Ors.[19] broached the issue of homebuyers' exclusion from the Code, as it was filed before the 2018 Amendment was enacted. Though homebuyers were vital stakeholders in building projects, they were disregarded under the Code and had no role in the CIRP. They had no means of recovering the amount invested by them in building projects when the developers failed to fulfill their contractual obligations. Following the 2018 Amendment, homebuyers were granted statutory status in the insolvency resolution process, and to reflect this, the Supreme Court, in this case, directed that the CIRP against the Corporate Debtor be revived and the CoCbe constituted afresh to include an authorized representative of the homebuyers as financial creditors.

[15] Insolvency and Bankruptcy Code 2016, s 5(8)(f)
[16] Insolvency Law Committee (n 13)
[17] Real Estate (Regulation and Development) Act 2016, s 2(d)
[18] Real Estate (Regulation and Development) Act 2016, s 2(zn)
[19] Chitra Sharma and Ors. (n 11)

When the validity of the 2018 Amendment was challenged in ***Pioneer Urban Land and Infrastructure Limited and Anr. v Union of India and Ors.***[20], the Supreme Court declared it to be constitutionally valid, stating that it did not violate Articles 14, 19(1)(g) read with Article 19(6), or Article 300-A of the Constitution of India. Besides, S. 5(8)(f) being a residuary provision, allottees (homebuyers)had always been incorporated within it since the commencement of the Code. The explanation added through the Amendment and the deeming fiction contained in it was only meant to clarify the position in law.

In ***Alka Agarwal and Ors. v Parsvnath Landmark Developers Pvt. Ltd.***[21], the NCLT deduced that as a result of the 2018 Amendment, allottees under a real estate project would be regarded as financial creditors irrespective of whether they were promised any 'assured returns' by the developers. It further noted that the Respondent Developer had committed default when it had failed to deliver possession of the allotted properties to the Applicants under their agreement within 36 months of the commencement of construction, and further when it had failed to repay the principal amount paid by the Applicants even after considerable time had elapsed. In a subsequent case[22], the NCLT clarified that an allottee under a real estate project could allege default on the part of the corporate debtor only when it did not complete the work in time, or when it failed to repay the allottee the amount paid by them for the allotment. The allottee could not claim the corporate debtor had committed default when he had not paid the full amount as agreed upon to the corporate debtor.

THE INSOLVENCY AND BANKRUPTCY (AMENDMENT) ACT, 2020

When the Insolvency and Bankruptcy (Amendment) Bill of 2019 could not be passed in the parliament, the Insolvency and Bankruptcy (Amendment) Ordinance was promulgated in its place on 28th December 2019. This Ordinance was replaced by the Insolvency and Bankruptcy (Amendment) Act in March 2020, but with retrospective application from 28th December 2019. Through this amendment, amongst other things, certain provisos were inserted under S.7(1) of the Code, prescribing a minimum threshold for certain classes of financial creditors to initiate

[20] *Pioneer Urban Land and Infrastructure Limited and Anr. v Union of India and Ors.* (2019) Writ Petition (Civil) No. 43/2019
[21] *Alka Agarwal and Ors. v Parsvnath Landmark Developers Pvt. Ltd.* (2018) CP No. IB-1229(PB)/2018
[22] *Anil Kumar Tulsiani v Rakesh Kumar Gupta & Anr.* (2019) Company Appeal (AT) (Insolvency) No. 35/2019

and maintain the CIRP[23]. The second proviso inserted under S.7(1) pertains to the allottees under a real estate project, and it lays down the condition that an application for initiating CIRP against the corporate debtor can be filed by financial creditors who are allottees under a real estate project as long as it is filed jointly by not less than 100 of them as allottees under the same project, or as long as it is filed by not less than 10% of the total number of such allottees under the same project – whichever of the two happens to be less[24]. Moreover, the third proviso states that pending applications filed by individual allottees, or financial creditors who do not meet the requirement, have to be modified to meet the threshold requirement within 30 days of the commencement of the Amendment Act, or risk being withdrawn before admission.

The direct fallout of this amendment is that an individual allottee can no longer file an application for initiating CIRP against real estate developers – instead, they have to file the application as a class of financial creditors. In a way, it is seen as a hurdle for the allottees in the overall framework of the insolvency resolution process against the developers, since they first will have to mobilize the required number of allottees before filing the application for CIRP. A homebuyer wishing to initiate the process may face further difficulty since he may not necessarily possess details of the other allottees.

Despite this, the Supreme Court has upheld the constitutional validity of the 2020 Amendment in ***Manish Kumar v Union of India and Anr.***[25]. The reasoning adopted by the Court, particularly in terms of the allottees, was that a single allottee under a project could not individually be allowed to move an application under S.7 when it could be prejudicial to the interests of the multiple other allottees under the same project. Moreover, the numerosity of the allottees under a project would act as an intelligible differentia and justify the additional condition put upon the allottees, unlike the other financial creditors.

[23] Insolvency and Bankruptcy (Amendment) Act 2020, s 3
[24] Insolvency and Bankruptcy Code 2016, s 7
[25] *Manish Kumar v Union of India and Anr.* (2021) Writ Petition No. 26/2020

RECENT DEVELOPMENTS

The judiciary has tried to actively recognize and protect the interests of homebuyers, especially when issues pertaining to them arise under the insolvency laws. A recent example is the issue of submission of claims that arose in ***Puneet Kaurv K.V. Developers Pvt. Ltd. and Ors.***[26], wherein the NCLAT directed the Resolution Professional to submit details of the homebuyers, including their claims, to the resolution applicant, despite the stipulated period for submission already being over. The Courts have previously allowed the submission of claims even beyond the maximum period of 90 days stipulated in the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016[27] – for instance, in the matter of ***Twenty-First Century Wire Rods Ltd.***[28], the Resolution Professional was directed to consider the claims of the Applicants beyond the maximum period stipulated, during the pendency of the CIRP and before the approval of a resolution plan by the CoC. But in *Puneet Kaur*[29], the resolution plan had already been approved by the CoC and was awaiting the NCLT's approval. The homebuyers were filing their claims after a delay of 8 months from the day prescribed by the Resolution Professional, and they had been omitted from the Resolution Plan submitted to the NCLT for failing to submit their claims in time. However, it was held that their claims could not be extinguished merely because the CoC had approved the Plan when the NCLT was yet to give its approval to the same. The Resolution Professional has access to the records of the Corporate Debtor, and although he was not obliged to do so, he ought to have collated the claims of the homebuyers as reflected in the Corporate Debtor's records. He was also required to include the liability of the Corporate Debtor towards the homebuyers in the Information Memorandum prepared by him[30], for the CIRP could be effectively completed only when all the liabilities of the Corporate Debtor were included in it. The Resolution Professional was thus directed to provide all the details of the homebuyers and their claims as reflected in the Corporate Debtor's records to the Resolution Applicant, who

[26] *Puneet Kaurv v K.V. Developers Pvt. Ltd. and Ors.* (2022) Company Appeal (AT) (Ins.) No. 390/2022
[27] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016, reg 12(2)
[28] *Twenty First Century Wire Rods Ltd.* CP Item No. 3, (IB)-737(PB)/2018
[29] Puneet Kaur (n 26)
[30] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons)Regulations 2016, reg 36(2)(a)

was to incorporate them in an addendum to the Resolution Plan and place it before the CoC again for approval.

The line of thought adopted by the NCLAT in *Puneet Kaur*follows the reasoning in the similar case of ***Amit Goel and Ors. v Piyush Shelters India Private Ltd. and Ors.***[31], wherein the Resolution Plan approved by the CoC had categorized the financial creditors into two groups and treated them in a discriminatory manner: Claimants who filed their claims in time received possession of their allotted properties, whereas 'non-claimants' who failed to file their claims in time received only 10% of their booked amount after their claims were verified within one month, after which all such claims stood extinguished. Besides this, out of the total allottees, 251 allottees had been unable to file their claims because the initiation of the CIRP against the Corporate Debtor was not widely publicized and the public notices were published in New Delhi while the Corporate Debtor's registered office and the project itself were situated in a different location. The NCLAT observed that there could be no discrimination between financial creditors who were a part of the same class, and thus, the Resolution Plan could not make dissimilar provisions for 'claimants' and 'non-claimants', having already accepted the claims filed after a delay. Furthermore, the exclusion of more than 53% of the total homebuyers rendered the resolution of the Corporate Debtor inequitable and unjust, and contrary to the spirit of the IBC.

The NCLAT has quite recently considered the position of an individual homebuyer in comparison with the rest of the class of homebuyers in ***Sandeep Kumar Jain v Anil Tayal, Resolution Professional of AVJ Developers (India) Pvt. Ltd.***[32]. In this case, the NCLT had dismissed intervention applications filed by the Appellants when applications against rejection of claims were still pending before it. The NCLAT upheld this order, stating that the decision taken by the homebuyers as a 'class' is binding on individual homebuyers. The Appellants, as homebuyers, have to follow the decisions of the class of homebuyers.

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[31] *Amit Goel and Ors. v Piyush Shelters India Private Ltd. and Ors.* (2022) Company Appeal (AT) (Insolvency) No. 700/2021

[32] *Sandeep Kumar Jain v Anil Tayal, Resolution Professional of AVJ Developers (India) Pvt. Ltd.* (2022) Company Appeal (AT) (Ins.) No. 446/2022

CONCLUSION

Homebuyers have come a long way under the insolvency framework. Their lack of recognition as stakeholders under the insolvency resolution process was a source of great consternation and misery, especially since inordinate delays in receiving possession of allotted properties were a rampant occurrence in the real estate sector, and homebuyers who had purchased such properties had to contend with waiting to receive delivery while continuing to pay the consideration under their agreements with the developers without an end in sight. They had limited options to seek relief, and their exclusion from the provisions of the IBC meant that they could not initiate insolvency resolution proceedings against defaulting developers, nor were they eligible to participate in the Committee of Creditors. Treated as 'other creditors', they could submit their claims, but they were not on par with the financial and operational creditors. Even liquidation proceedings would prove to have an adverse impact as their exact position as a creditor was uncertain, and considering the order of priority according to different stakeholders in the distribution of liquidated assets[33], they would hardly be able to recover even a small fraction of the money they had invested.

The recognition of homebuyers, or 'allottees' under real estate projects, under the IBC, brought about a welcome change, and their classification as financial creditors has enabled them to participate equitably in the insolvency resolution process. Homebuyers now have participation and voting rights in the CoC through their authorized representative, and they can also participate in the distribution of assets, providing them with an opportunity to recover the amount they have invested in the project. The inclusion of homebuyers within the ambit of the IBC has ended up expanding its scope.

However, the scene with homebuyers and the IBC is not yet perfect. Some suggest that homebuyers are closer in nature to operational creditors than financial creditors. Generally, only financial creditors are a part of the CoC since they tend to possess the technical expertise and capability to assess the viability and manage the affairs and liabilities of the corporate debtors. Homebuyers may not necessarily possess the same qualifications, and yet they have

[33] Insolvency and Bankruptcy Code 2016, s 53

been made a part of the CoC.[34] Additionally, it is unclear whether homebuyers are secured or unsecured creditors. Though they are closer to secured creditors in their nature[35], they are treated as unsecured financial creditors[36], which affects them in terms of the priority of payments in liquidation proceedings. When all is taken into account, however, it should not be forgotten that the IBC was not originally drafted as a law to focus on the rights and interests of the homebuyer. The Courts adopted innovative methods (and still continue to do so) to bring homebuyers under the fold of the IBC for giving them better protection. The law, therefore, still has to evolve further before it can be said to provide a comprehensive protective scheme for homebuyers' rights in insolvency matters.

[34] Aastha, Debopam Dutta & *et. al.*, 'Homebuyers as Financial Creditors' (*Argus Partners,* 26 June 2018) <https://www.argus-p.com/uploads/blog_article/download/1530878091_homebuyers_as_financial_creditors.pdf> accessed 20 August 2022

[35]Aditya Khadria & Sivaprakasam Babu, 'Are home buyers secured financial creditors or unsecured creditors under IBC?' (*The Economic Times,* 10 August 2018) <https://economictimes.indiatimes.com/wealth/real-estate/are-home-buyers-secured-financial-creditors-or-unsecured-creditors-under-ibc/articleshow/65332287.cms> accessed 20 August 2022

[36] 'Unity amongst Home-buyers Is Important in Insolvency Cases' (*Moneylife*, 16 August 2021) <https://www.moneylife.in/article/unity-amongst-home-buyers-is-important-in-insolvency-cases/64874.html>accessed 19 August 2022