[**HOMEBUYERSUNDERINSOLVENCYBANKRUPTCYCODEEVOLUTIONOFLAWPRESENTPOSITION**](https://www.livelaw.in/know-the-law/explained-homebuyers-under-insolvency-bankruptcy-code-evolution-of-law-present-position-154304)**[[1]](#footnote-2)**

This article is an attempt to trace the origin and process as to how home buyers were introduced under the umbrella of “financial creditor” given in the Code as a creditor.

Home-buyers apart from civil remedies were approaching the consumer forums under the Consumer Protection Act, 1986, subject to them proving that there was no “commercial purpose” attached to such investment.

To provide additional relief, RERA has been introduced and the same has concurrent jurisdiction with the Consumer Forums. In brief, Real Estate Regulatory Authority (RERA) is a special law with the object of providing speedy redressal to the home-buyers’ grievances as well protecting the interest of the homebuyers in the real estate sector. As per Section 18 of RERA, if the builder/promoter/developer fails to complete the project or is unable to give possession of the apartment, he is liable to return the amount received by him from the home-buyer on demand. The Home-buyer may also chose to claim delayed payment interest from the developer if he does not wish to withdraw from the project. The Home-buyer is further allowed to claim compensation in case of any loss caused to him due to non-compliance by the builder/promoter/developer of any of the provisions of RERA.

After the advent of the Code, many real estate giants were dragged to NCLTs. However, there was no clarity given in the Code as to whether the transactions of home-buyers would fall under the definition of a financial or operational debt. The Code did not fathom the consequences on the stakeholder to this extent and further owing to confusion as to whether the home-buyers were operational creditors or financial creditors, many applications of the Homebuyers were rejected, because of the lack of clarity.

In a case filed by the home-buyers before any forum, the reliefs are generally of three kinds, depending on the contracts:

- Possession

- Cancellation/refund of monies (principle and interest component)

- Raising a demand of assured returns as promised by the builder/promoter/developer

In NCLT, only two types of debts are entertained: Financial Debt and Operational Debt.

The Code defined financial debt under Section 5(8) as follows:

*“"financial debt" means a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes—*

*(a)money borrowed against the payment of interest;*

*(b)any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;*

*(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;*

*(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;*

*(e) receivables sold or discounted other than any receivables sold on non-recourse basis;*

*(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;*

*(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;*

*(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;*

*(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause; “*

And operational debt under section 5(21) is defined as :

*“operational debt" means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority;“*

Considering the nature of reliefs sought by the homebuyer in their applications, description of debt needed judicial interpretation to clear the position. The difficulty faced by the Home buyers was taken note of by the Hon’ble Supreme Court in Chitra Sharma & Ors. v. Union of India (Writ Petition (Civil) No.744 of 2017).

During the pendency of the writ petition, the Hon’ble NCLAT in Nikhil Mehta v. AMR Infrastructures Ltd. clarified the position and observed as follows:

*“24. Learned Adjudicating Authority has rightly highlighted the opening word of the definition clause which indicate that a 'financial debt' is a debt along with interest which is disbursed against the consideration for the time value of money and may include any of the events enumerated in sub-clause (a) to (i). Therefore, it is to be seen whether the amount paid by the appellants to the Corporate Debtor, fulfil the other condition of "disbursement against consideration of time value and money", to come within the definition of "Financial Creditor" having satisfied that the Corporate Debtor raised the amount through a transaction of sale and purchase of agreement having commercial effect of a borrowing (Section 5(8) (f)).*

...

*26.Learned Adjudicating Authority while rightly interpreted the provisions of law to understand the meaning of expression 'financial creditor' at paragraph 12 of the impugned judgement as quoted above, but failed to appreciate the nature of transactions in the present case and wrongly came to a conclusion "that it is a pure and simple agreement of sale and purchase of a piece of property and has not acquired the status of a financial debt as the transaction does not have consideration for the time value of money".”*

The judgment covered one of the three nature of reliefs i.e., real estate agreements having a clause of “assured returns”. It held that the amounts raised by developers under the assured returns schemes had the “commercial effect of a borrowing” therefore such debt are in the nature of financial debt and therefore, such home-buyers/allottees were held to be regarded as financial creditors.

After 2 months, vide an interim order dated 11.09.2017, the Hon’ble Supreme Court in Chitra Sharma & Ors. v. Union of India (Writ Petition (Civil) No.744 of 2017) directed appointment of a representative of home-buyers i.e., the allottees, to participate in meetings of the Committee of Creditors. Vide order dated 21.03.2018, the Hon’ble Supreme Court in Chitra Sharma (Supra) case, restricted the case only to those home-buyers who intend to obtain a refund of amounts advanced by them specific to the Jaypee project.

Pursuant to such orders of the Hon’ble Supreme Court, the Insolvency Committee Report, 2018 suggested few amendments to the Insolvency Bankruptcy Code, following which an amendment dated 17.08.2018 was introduced w.e.f. 06.06.2018. The belowmentioned explanation was added to the Section 5(8)(f):

*“Explanation.—For the purposes of this sub-clause,— (i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and*

*(ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016;';”*

The judgment in Chitra Sharma (Supra) dated 09.08.2018 noted the lack of recognition of home buyers in such IBC cases and also took note of the amendment dated 17.08.2018. The Hon’ble Supreme Court observed that:

*“...*

*27. The IBC, as it was originally enacted, did not contain an adequate recognition of the interests of home buyers in real estate projects. Home buyers are vital stake holders. The process of corporate insolvency resolution directly impacts upon their rights and interests. Yet the IBC, as initially crafted, did notprotect them. The concerns of the home buyers have been sought to be assuaged by the Insolvency and Bankruptcy (Amendment) Ordinance, 2018 which came into force on 6 June 2018. As a result of the Ordinance, home buyers are brought within the purview of financial creditors under the IBC.*

*..*

*As a result of the amendment brought about in the definition of ‘financial debt’, amounts raised from allottees under real estate projects are deemed to be amounts “having a commercial effect of a borrowing”. Hence outstandings to allottees in real estate projects are statutorily regarded as financial debts. Such allottees are brought within the purview of the definition of ‘financial creditors’. ”*

Being financial creditors, the Home Buyers shall have the valuable right of participating in the Committee of Creditors and importantly, shall have the right of voting in a class proportional to the financial debt through an authorised representative.

The above explanation was challenged before the Hon’ble Supreme Court in Pioneer Urban Land and Infrastructure Limited and Anr. Vs. Union of India & Ors. Bearing WP (C) No. 43/2019. However, while upholding the constitutional validity of the explanation vide its judgment dated 09.08.2019,, the Hon’ble Supreme Court further observed and clarified the position that:

*“18. It can be seen that the Insolvency Law Committee found, as a matter of fact, that delay in completion of flats/apartments has become a common phenomenon, and that amounts raised from home buyers contributes significantly to the financing of the construction of such flats/apartments. This being the case, it was important, therefore, to clarify that home buyers are treated as financial creditors so that they can trigger the Code under Section 7 and have their rightful place on the Committee of Creditors when it comes to making important decisions as to the future of the building construction company, which is the execution of the real estate project in which such home buyers are ultimately to be housed.*

The Hon’ble Supreme Court further clarified that both RERA and the Code are concurrent remedies addressing rights in personm and rights in rem respectively. Therefore, both legislations with the help of harmonious interpretation, must be held to co-exist and in case of any conflict, Code being the latest and special law will prevail over RERA.

One very important aspect was clarified by the Hon’ble Supreme Court which was that Home-buyers were always included under the definition of “financial creditor” and the explanation was more to clarify the position.

Post the Pioneer Judgment, the NCLTs were flooded with cases and after a short span of time, vide Insolvency and Bankruptcy Code ordinance dated 28.12.2019, a further amendment was introduced wherein the following proviso was added to Section 7(1):

*“Provided that for the financial creditors, referred to in clauses (a) and (b) of sub-section (6A) of Section 21, an application for initiating corporate insolvency resolution process against the corporate debtor shall be filed jointly by not less than one hundred of such creditors in the same class or not less than ten per cent of the total number of such creditors in the same class, whichever is less:*

*Provided further that for financial creditors who are allottees under a real estate project, an application for initiating corporate insolvency process against the corporate debtor shall be filed jointly by not less than one hundred of such allottees under the same real estate project or not less than ten per cent of the total number of such allottees under the same real estate project, whichever is less:*

*Provided also that where an application for initiating the corporate insolvency resolution process against a corporate debtor has been filed by a financial creditor referred to in the first or second provisos and has not been admitted by the Adjudicating Authority before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019, such application shall be modified to comply with the requirements of the first or second provisos as the case may be within thirty days of the commencement of the said ordinance, failing which the application shall be deemed to be withdrawn before its admission.”*

There is no doubt that consequences of a company being wound up under the Code is drastic, and even though the Code’s objective is to find a resolution of the company’s debts, none can deny its effects on the promoters and indirectly on the various other stakeholders. Its trite that RERA too provides remedies to the Homebuyers. To understand the issue better, what is that a real estate developer is offering to the Homebuyer under such agreement ?

- is it an investment opportunity?

- is it an allotment of a flat for a consideration within a fixed time period?

- is it a commitment that if the allotment is not given to the home buyer within the promised time, a delayed payment interest would be given?

- is it an assurance that if the allotment is not given to the home buyer within the promised time, the home buyer may seek refund of the money paid to the real estate developer?

The claims of each home buyer under different scenarios depends on the nature of the agreement and ultimately it depends on the relief that the Home Buyer is seeking from the court. By bringing a “threshold” in the picture, the ordinance is trying to bring the concept of “right in rem” since IBC operates in that domain. The Home buyer still has the option to approach other forums apart from the Hon’ble NCLT to seek redressal. The Hon’ble NCLT, however, does not and cannot provide any civil remedy to the home buyers in case the home buyer is misled to understand that NCLT is the forum to receive money consideration, refund amount or possession. Any application not looking for a resolution of debt of the company will be hit by Section 65 of the Code. In Navin Raheja v. Shilpa Jain and Others (Company Appeal (AT) (Ins.) No. 864 of 2019), the Hon’ble NCLAT vide order dated 22.01.2020 has held that in spite of offer of flat, the allottees still wanted refund of the amount with more interest and refused to take the actual amount in terms of agreement. Therefore, it was held that the application under Section 7 was filed fraudulently with maliciously intent for the purpose other than for the resolution or liquidation. In fact, even if there is an admission of debt under a decree awarded to a home-buyer, even then the homebuyer cannot file an application since, NCLTs are executing courts. In SH. G Eswara Rao v. Stressed Assets Stabilisation Fund & Anr. (Company Appeal (AT) (Ins.) No. 1097 of 2019), it has been held by the Hon’ble NCLAT vide order dated 07.02.2020 that by filing an application under Section 7 of the I&B Code, a Decree cannot be executed. In such case, it will be covered by Section 65 of the I&B Code, which stipulates that the Insolvency resolution process of liquidation proceedings, if filed, fraudulently or with malicious intent for any purpose other than for the resolution of insolvency, or liquidation, attracts penal action. Therefore, the Home-buyer’s claim plays a key role for the initiation of the resolution process.

At present, the constitutional validity of the ordinance dated 28.12.2019 has been challenged before the Hon’ble Supreme Court in Manish Kumar v. Union of India & Anr. bearing W.P. (C) No. 26 of 2020. Vide order dated 13.01.2020, the Hon’ble Supreme Court in Manish Kumar v. Union of India & Anr. bearing W.P. (C ) No. 26 of 2020 has passed the following order:

*“Issue notice.*

*Status quo, as of today, with respect to the pending applications, shall be maintained in the meanwhile.”*

On 13.03.2020, the said ordinance has received Presidential assent and therefore, at present any fresh filing by any home buyer would require the compliance as introduced by the ordinance dated 28.12.2019 which is basically:

- filing jointly by not less than one hundred of such creditors in the same class or

- less than ten percent of the total number of such allottees under the same real estate project.

However, all other pending applications are not being proceeded, by the NCLT owing to the above status quo order.

In the meanwhile, the Hon’ble NCLAT in Flat Buyers Association Winter Hills v. Uman Realtech Pvt. Ltd. (Company Appeal (AT) (Ins.) No. 926 of 2019) introduced a unique concept of **Reverse Corporate Insolvency Resolution Process.** The Hon’ble NCLAT in this concept allowed the following liberty to the Homebuyer:

- if allottees (Financial Creditors) of one project initiates Corporate Insolvency Resolution Process against the Corporate Debtor (real estate company), it is confined to the particular project. This interpretation is in view to maximise all the asset of the company (Corporate Debtor).

- Any other allottees (financial creditors) cannot file a claim before the Interim Resolution Professional of other project and such claim cannot be entertained.

- Corporate Insolvency Resolution Process against a real estate company (Corporate Debtor) is limited to a project as per approved plan by the Competent Authority and not other projects which are separate at other places for which separate plans approved.

- ‘Secured Creditor’such as‘ financial institutions/ banks’, cannot be provided with the asset (flat/apartment) by preference over the allottees (Unsecured Financial Creditors) for whom the project has been approved.

- one or other allottee may agree to opt for another flat/apartment or one tower or other tower if not allotted to any other. Agreements can be modified by the Interim Resolution Professional/ Resolution Professional with the counter signature of the Promoter.

- It is also open to an allottee to reach agreement with the Promoter (not Corporate Debtor) for refund of amount.

- after offering allotment it is open to an allottee to request the Interim Resolution Professional/Promoter, whoever is in-charge, to find out a third party to purchase said flat/apartment and get the money back.

The above judgment is a divergence from the provisions of the existing Code. As per the provisions, once moratorium is imposed on a real estate company, there is no bifurcation of the debts of the company separately. However, this bifurcation is something new which has been introduced by the abovementioned judgment. Further, the judgment dated 04.02.2020 of the Hon’ble NCLAT is yet to be challenged before the Hon’ble Supreme Court.

However, keeping the ongoing judicial interpretations of the Code and the numerous amendments aside, one must not forget the purpose of the Code which is solely made to redress the economic mess of the Company and the home-buyers ought to understand that the reliefs that one might be looking at are nothing but a by-product when the company’s debt issues are being resolved in the process.

1. This article has first been published in LiveLaw on 25.03.2020 and can be accessed at <https://www.livelaw.in/know-the-law/explained-homebuyers-under-insolvency-bankruptcy-code-evolution-of-law-present-position-154304> [↑](#footnote-ref-2)