STATUS OF HOMEBUYERS AS FINANCIAL CREDITORS: STUDYING THE IBC AMENDMENT ORDINANCE, 2018

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ABSTRACT

Delay in the delivery of property despite having paid the money is becoming a common problem nowadays especially for those who have put their hard earned money and limited means into buying a home. Though for a long time there was no direct and concrete solution to this issue, the IBC Amendment Ordinance, 2018 provides a recourse in the form of allowing homebuyers to initiate insolvency proceedings against debtors. However, is merely upholding the validity of such a provision enough to ensure that all what has been lost will find a way back to these homebuyers? Is it possible for lakhs of aggrieved homebuyers to come together to initiate insolvency resolution proceedings against the defaulters? Will such a change be practically viable? These are all questions that still remain unanswered. This paper aims to look at the implications of the recourse at hand and examine whether the amendment undertaken has actually put an end to the woes of these homebuyers.

Keywords: Homebuyers, IBC, insolvency, debtors, default, amendment, ordinance

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 was passed as an attempt to amalgamate all the other existing laws dealing with insolvency and bankruptcy. The code proved to be one of its kind in separating the creditors into two heads, viz. financial and operational creditors.[i] While such distinction was deemed constitutional in the famous *Swiss Ribbons v. Union of India*[ii] judgement, those homebuyers, who were duped off their money by real estate developers, were left out of either of these two categories. The Union Cabinet, via the IBC Amendment Act,

2018 sought to resolve this by allowing the aggrieved homebuyers to initiate insolvency proceedings against the sellers as financial creditors under the code.[iii]

Despite the fact that the nature of transaction between the homebuyers and the real estate developers is essentially one of buyers and sellers rather than creditors and debtors, the move was welcomed.[iv] The homebuyers, who had been robbed of their hard-earned money, had up until now found no recourse under either the IBC or RERA. The only way out of this had been the courts, however, waiting years for a judgement without either money or property in their hands made the situation only worse. The new law, proposed in the amendment, was seen as a deterrent which could go a long way in preventing these real estate developers from committing frauds and robbing the buyers off their rights.

However, as anticipated the amendment was not viewed in the same light by everyone and was challenged in the Supreme Court. The court, nevertheless, upheld it in the recent case of *Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India and Ors.*[v] But what was left unresolved by both the courts and the Amendment act were the gaps that were created as a consequence of designating homebuyers as financial creditors. The insolvency and bankruptcy processes under the IBC are complex and requires a deep knowledge of the code itself. It clearly states who would constitute secured and unsecured creditors, the order in which the creditors shall recover the debt and so on. Now that homebuyers have come under the purview of IBC, not laying down the position of homebuyers with respect to different provisions of the IBC only adds to the confusion. Moreover, if the move would be of any significance in actually recovering all their lost money is itself highly debated.[vi]

It is in this light that this project aims to analyse the Amendment of 2018 along with the recent Supreme Court judgement in August 2019. The article will begin by providing a picture of the insolvency resolution process under the IBC followed by the details of the amendment. It shall then move on to analyse the judgements and the gaps left unanswered by it. Finally, the article shall make an argument as to how the judgement might not go a long way in resolving all the problems of the harassed homebuyers unless additional changes are made to resolve these problems.

THE INSOLVENCY RESOLUTION PROCESS

The Insolvency and Bankruptcy Code has seen its fair share of trials and tribulations since its inception and yet remains one of the most progressive laws of our country. It seeks to resolve insolvency in a time bound process.[vii] It undertakes either a resolution process of a liquidation process keeping in the mind the interest and limitations of the creditors and debtors respectively.[viii] The Code talks about several participants involved in this process including creditors, debtors, insolvency professionals, information utilities, the NCLT, the Board and so on.[ix] Each of these actors perform a role essential to the insolvent process that has been clearly laid down in Code itself.

The insolvency resolution process can be initiated by either the creditor or debtor and is handled by insolvency professionals.[x] During this period which lasts for about 180 days,[xi] the professionals collect financial information of the debtor and provide it to the creditor while managing the debtor's assets.[xii] No legal action is allowed against the debtor during this period. Post this, the financial creditors comprise a Committee of Creditors that votes on the further course of action.[xiii] It can either choose to revive the debt owed to the creditors or go for liquidation i.e. sell the assets of the debtor to repay themselves.[xiv] The time period for all these decisions have been laid down in the Code. Once the process is undertaken, the creditors must be paid back in the order laid down in section 53 of the Code. Section 53 lays down the hierarchy or the sequence in which the liquidated assets of the debtor must be distributed to the creditors.[xv]

Any grievance in this process is addressed by the National Company Law Tribunal set by the act itself for the purposes of dispute resolution process.[xvi] Apart from this the Code defines key terms essential to interpret the Code and the process in a constitutional manner. It lays down what would constitute 'debt', 'creditors', 'secured debt', 'insolvency professionals', 'informational utility', 'default', 'debtor', etc.[xvii] Since the Code is one of its kind, it is very important to keep in mind the legislative intent, the definitions and the objectives of the Code before interpreting it in a certain manner.

THE AMENDMENT AND SC's TAKE

Lakhs of homebuyers have suffered losses due to delay of real-estate projects. Not receiving the possession of property despite having paid the money left these homebuyers with little

option but to go to the court to engage themselves in years long battle. This only led to a further loss of money rather than providing a quick recourse. Homebuyers have long been left unrecognised by the IBC, which allows only financial and operational creditors to initiate insolvency proceedings against the debtors. Since, these aggrieved homebuyers did not find a place in either of these categories, they could never resort to the IBC to protect their interests.

Keeping this plight of theirs in mind, the IBC Amendment Ordinance, 2018 was passed. The ordinance sought to amend the IBC and recognise homebuyers as financial creditors under the code.[xviii] Such a step is revolutionary as it opens up the doors to what earlier was a dead-end. What this meant was that homebuyers as financial creditors could now initiate the process of insolvency against the defaulting real estate developers.[xix] They would also constitute the Committee of Creditors, that takes a call on resolution proposals, making them an integral part of the process.[xx]

The amendment, however, was not left unchallenged. As many as 200 builder companies filed petitions challenging the amendment ordinance with the lead matter being filed by Pioneer Urban Land and Infra Structure Ltd against the Union of India and nearly 400 homebuyers of almost 79 different builder companies.[xxi] The apex court's verdict in *Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India and Ors.*[xxii] in 2019 went on to become a landmark judgement as the SC upheld the constitutional validity of Section 5(8)(f) of the IBC Code that gives these homebuyers to approach the National Company Law Tribunal under the IBC as financial creditors.[xxiii]

The raison d'etre, as provided by the court, was that since money from homebuyers constitute a major portion of the funds that finance these real estate projects, they have to be read into the category of financial creditors.[xxiv] This gives them the power to trigger insolvency proceedings under Section 7 of the code, at the same time having their 'rightful place' in the Committee of Creditors.[xxv] The court further clarified that these homebuyers were always financial creditors within the meaning of section 5(8)(f) of the Code. The problem lied merely with the interpretation that has now been settled by the court in the instant case.[xxvi]

The court also saw it fit to resolve the clash between RERA and IBC stating that although RERA is a legislation specific to real estate, yet the two must be read in consonance with each other.[xxvii] One does not supersede the other in any manner and both must co-exist. In the events

of a clash, RERA must give way to the Code.[xxviii] The court also held that the classification of homebuyers as financial creditors cannot be said to be not based on an intelligible differentia and nor is it arbitrary.[xxix] It therefore does not violate Articles 14 and 19 of the Constitution making it constitutionally valid.[xxx] It further laid down steps to taken by the states, UTs and the centre to ensure that litigation under the IBC are competently dealt with.[xxxi]

The judgement has been received as victorious and is expected to restructure the real estate industry and the Code itself. It will be a remedy against all the fraudulent builders who do not intent to return the hard-earned money of homebuyers and at the same time are not too keen on delivering the property either. This judgement is of utmost significance in serving as a deterrent to fraudulent builders especially after the Insolvency Law Commission has observed that such frauds have become too common now.[xxxii]

THE FLIP SIDE OF THE AMENDMENT

The amendment though puts an end to an injustice being meted out to the buyers, yet it opens up several other doors of inconsistencies that have been left unresolved by the judgement. Designating homebuyers as financial creditors does not end the problem altogether. The process of insolvency that the IBC has laid down requires a little more clarity on their position in order to ascertain their role in the Committee of Creditors and in the insolvency resolution process.

For instance, the SC in the 2019 case has observed that it is fit to provide homebuyers with the title of financial creditors as a major portion of funds for the real estate projects comes from their pocket.[xxxiii] However, any and every amount raised from a creditor cannot fall into the category of a 'financial debt' under section 3(11) of the Code.[xxxiv] The NCLT in *Pawan Dubey & Another v. M/s J. B. K Developers Private Limited* held that where a contract is cancelled and a claim for the return of the principle sum and interest has been made, such an amount does not fall into the category of a financial debt.[xxxv] This view taken in the case remains valid, however the amendment does not recognise it. Such a situation will most likely give rise to objections from the opposing party, pointing out clashes between the two.

As a result of the amendment, the homebuyers will constitute the Committee of Creditors, having capacity to take decisions on the insolvency and liquidation process along with having voting rights. However, there are other details that were left unanswered by the amendment. The IBC feature of distinguishing between financial and operational creditors is a unique one not found in any other Code but it still maintains the distinction between a secured and an unsecured creditor.[xxxvi] This is clear from section 3(10) and 3(30) of the Code. The amendment does not clarify whether homebuyers would constitute secured or unsecured creditors. Such a clarity is essential as the IBC lays down the order or ranks in which the debt must be repaid post the insolvency resolution process under section 53. Section 53 also creates a distinction between secured and financial debts prioritising the former over the latter.[xxxvii]

Section 53 of the Code has seen no amendments as of now to indicate where exactly would the homebuyers be accommodated in the hierarchy. If the present scenario persists, homebuyers will fall under the category of 'financial debts to unsecured creditors' under section 53(1)(d).[xxxviii] In any case, a secured creditor, whether financial or operational, has been prioritised above financial creditors under section 53 which means that the debt owed to a secured creditor would be cleared first followed by that of a financial creditor.[xxxix] In such a case, the noble objective that this ordinance sought to achieve would still leave the homebuyers with much less than their actual share.

Moreover, the amendment is of little help to those who are keen to get their flats rather than just getting their money back. In such a scenario, the amendment to the Code might not be a reliable remedy. However, being a part of the Committee of Creditors might provide a solution to this in the form of voting rights where the homebuyers can vote for resolution in place of the liquidation process.[xl] Nevertheless, this might prove to be a far-fetched solution as the chances of all homebuyers and other creditors agreeing to this are fairly feeble. Hence, whether it is liquidation or resolution, the amendment to the Code does not put the homebuyers in a very advantageous position.

Another unaddressed issue if that of third party interests. Homebuyers who have taken loans from banks in order to kick start the construction process have not received the delivery of the property but are continuing to pay interest to the bank.[xli] They have created a third party interest in favour of a bank in the agreement that exists between the homebuyers and the real estate developers. However, in the case of *Ajay Walia V. M/s. Sunworld Residency Private Limited*,

the NCLT bench had held that those who have subrogated their rights in favour of banks are no longer financial creditors.[xlii] Hence, the position of such homebuyers still remains vague and undecided.

Therefore, all these issues have only added to the woes of the homebuyers. Unless and until the SC or the legislators provide clarity on these issues, the insolvency resolution process initiated by homebuyers will continue to be delayed and hindered at every stage and the amendment will be of little use in serving its purpose.

CONCLUSION

The case, *Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India and Ors.*[xliii] has brought dramatic changes to how IBC was perceived. The amendment and the judgement have paved way for structural changes in real estate business. It provides a recourse to the homebuyers, who had up until now failed to find a solution in both RERA and IBC as well as aims to bring down the number of real estate frauds drastically. However, this is possible only when the changes brought in by the amendment are coherent and consistent in the sense that they leave no gaps or uncertainties that might crawl up at a later stage delaying the resolution process.

Presently, the amendment and the judgement have resulted in the propping up of several issues pointing towards several questions that have been left unanswered. It is important to clearly lay down the position of homebuyers with respect to each and every section of the IBC that deals with creditors. Amending section 53 is of utmost significance in order to remove any doubts regarding the position of homebuyers in the hierarchy. Clarifying whether homebuyers would constitute secured or unsecured creditors is important as this would determine their position when it comes to clearing the debt. It has to be determined whether the 2019 verdict by the SC overrules all the earlier IBC cases that go against the stance taken by the court in this case because there are certainly cases with ratios that contradict the apex court's view.

Therefore, it is extremely important to go through the amendment once again and fill in the existing gaps and resolve the inherent contradictions in the Code. The amendment ordinance is

certainly a landmark one in the history of IBC, however, the unresolved inconsistencies should not become a reason that would render its efforts futile.

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