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The Impact of Insolvency and Bankruptcy Law on the Home Buyers: A Critical Analysis

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ABSTRACT

In India, Real Estate Sector has developed at an escalating pace. The common man puts in all of his efforts in the form of his savings and loans to look forward to getting into his dream home, where he can spend the rest of his life peacefully. However, studies have shown that housing sales have gone through a downtrend by about forty percent in the last few years. More so this sector was going through a transitional phase during the past few years. To acknowledge this issue, the Government of India came up with an Amendment in the Insolvency and Bankruptcy Code, 2016 i.e. THE INSOLVENCY AND BANKRUPTCY CODE (SECOND AMENDMENT) ACT, 2018. The main objective of the Government to bring up this amendment was to provide the homebuyers the status of that of a financial creditor. This would safeguard the interests of all those people who spend lakhs of rupees but are harassed due to delay in possession and incomplete real estate projects. The paper aims at critically analyzing the very aim of the legislature to amend the Insolvency and Bankruptcy Code, 2016; focusing on the misery faced by the home buyers. The paper also explains how the home buyers are on an equal footing with all the other stakeholders by entitling them to be a part of the Committee of Creditors.

Keywords: *Committee of Creditors, Financial Creditor, Home Buyers, Insolvency and Bankruptcy, Real Estate Sector.*

I. INTRODUCTION

Imagining a situation wherein a home buyer has put in all of his hard-earned money in a form of investment into a real estate project, which guaranteed him the delivery of possession of his flat within a certain time period. But, due to all the delay caused by the real estate companies, puts the home buyers into an extremely unworthy and critical situation. In such situations, the home buyers have a fair right to approach the civil courts for seeking the necessary redressal. In addition to that, the home buyers can also approach the consumer forum under the Consumer Protection Act, 2019. Seeking remedy before the consumer forum is subject to the fact that the home buyer is ought to establish that there was no sort of

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commercial purpose attached to his investment. Also, the harsh reality is that the home buyers would be able to get the desired remedy after a long period of time due to the non-availability of competent members and continuous pendency of matters before the concerned forum. Apart from the above-mentioned dispute resolution methods, the home buyers also have an option of approaching the competent authority for redressal of their dispute under the Real Estate (Regulation and Development) Act, 2016 (hereinafter referred to as RERA). Amongst the number of objectives of enacting this particular act, one of the objectives was that with the help of this act, the interest of such aggrieved home buyers would be protected to a larger extent. And it would definitely be beneficial in creating a more transparent database in terms of the real estate company and the concerned home buyers. Although the RERA provided the home buyers with speedy redressal of their grievances. The advent of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as IBC) marked a significant shift of the consumers from RERA to IBC. Most of the home buyers now dragged the real estate companies before the company law tribunals (NCLTs). To throw some more light onto IBC, 2016, this code was enacted with a view that it would consolidate all the existing laws on reorganization and insolvency resolution of different corporate entities including corporate persons, partnership firms, and even individuals in a time-bound manner, which would, in turn, maximize the value of assets of such persons to promote entrepreneurship, availability of credit and help to strike a balance between the interests of all the stakeholders. Despite this, the biggest challenge which was still faced by the home buyers for choosing the company law tribunal as the appropriate forum for seeking redressal was that they did not have an appropriate clarity on the fact that whether they fall into the category of operational creditors or financial creditors. The tribunals and courts in most of the cases did not find the home buyers deem fit in either of the above categories. And the home buyers would in turn fail to maintain the *locus standi*.

II. INSOLVENCY AND BANKRUPTCY CODE (SECOND AMENDMENT) ACT, 2018.

For the readers to achieve more clarity on the reasons why the lawmakers took to a decision of amending the code in favor of the home buyers, at this stage it is pertinent to mention a short pretext concerning the same.

As we know that it was getting extremely difficult for the home buyers to maintain *locus standi* before the company law tribunals. This was because most of the applications filed by such home buyers claimed three major kinds of reliefs namely; timely possession, cancellation or refund of advanced money, and lastly raising the demand of assured returns as

promised by the builder/promoter/developer. These reliefs sought by the home buyers were totally dependent on the type of contract which they had with the real estate companies. But the issue which was of major concern is that the IBC only classified the claims into either operational debt or the financial debt. And these claims did not fall in either of the categories and so the home buyers were neither classified as a financial creditor or an operational creditor. The essentials of the provisions according to the Code were that it has to be disbursed against consideration of time value of money and should have the commercial effect of borrowing.[2] And the operational debt should be for the provision of goods or services.[3] Now, if we compare the essentials of the Code with the type of reliefs sought by the home buyers, it can be clearly seen that the word debt strictly needed judicial interpretation to come into usage more effectively. The Supreme Court of India very wisely took into consideration the problems faced by the home buyers while dealing with the cases which came before it. At this point, it is pertinent to introduce the readers to the case of Chitra Sharma and Ors. V. Union of India[4], while the matter was still pending before the adjudicatory authority, the National Company Law Appellant Tribunal (hereinafter referred to as NCLAT) clarified in a case[5] that one of the reliefs amongst the three reliefs ought by the home buyers, i.e. the contracts of the buyers with the real estate companies have a clause of assured returns. The NCLAT held that this clause of assured returns has a commercial effect on borrowing. This means that such claims are now classified into the head of financial debts. And because of which the home buyers would also fall into the category of financial creditors for their claims while approaching this forum. With the NCLAT passing such a clarification order, the Supreme Court of India, in the above-concerned case also passed a judgment in which it "directed appointment of a representative of home-buyers i.e., the allottees, to participate in meetings of the Committee of Creditors." The court further clarified that "it is restricted to only those homebuyers who intend to obtain a refund of amounts advanced by them specific to the project." After passing of such orders by the forum and court, the Insolvency Committee Report 2018[6], suggested amendments to the IBC, 2016. And these judgments' earmarked a significant amendment[7] to the code, which put the home buyers on an equal footing with that of the other stakeholders and held them to be termed as financial

[2] Insolvency and Bankruptcy Code, 2016; § 5(8).
[3] Insolvency and Bankruptcy Code, 2016; § 5(21).
[4] Writ Petition (Civil) No.744 of 2017 (India).
[5]Nikhil Mehta v AMR Infrastructure Ltd., 2018, Company Appeal (AT) (Insolvency) No. 07 of 2017 (India).
[6]Insolvency Law Committee, *Report of the Insolvency Law Committee*, (March, 2018), available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf.
[7] Insolvency and Bankruptcy (Second Amendment) Act, 2018; §7.

creditors.[8] Additionally, the sum invested by the allottees into the real estate company will now categorize as a financial debt; which would, in turn, ease out the process of filing an insolvency proceeding against such defaulting real estate company. This amendment further brought in many issues before the courts and the forums concerning its constitutional validity and more. However, it is interesting to note that, the Hon'ble Supreme Court has held that the IBC, 2016 is constitutional in entirety[9].

III. A SIGNIFICANT PARADIGM SHIFT

The aim of the lawmakers to bring in such an amendment to the Code, the very reason which could be taken into account at the outset would be that it is the home buyers who invest their hard-earned money into such real estate projects as a form of investment. They choose to invest their money in the real estate sector over other forms of investments, say for that matter investing their earnings in liquid funds. Although, it is a fact that the real state sector witnessed exponential growth in the last two decades, in the last four to six years there is a huge dip in its popularity because of stagnation due to delayed possession, etc. Because of such delayed possession, the home buyers are unable to unlock into their dream homes. Hence, due to such difficulties faced by the home buyers, the decision of the lawmakers to treat them at par with other stakeholders and guarantee them the position of financial creditors via such amendment was totally appropriate.

But sooner it was seen that since the amendment of 2018 till September 2019, the home buyers filled a total of 1,821 cases[10] under the IBC, 2016 which constituted to be 17% of the total number of cases filed before the tribunals. And it is interesting to note that most of the cases were filed by home buyers individually. In fact, the court held that the real estate developer would have to return the money invested by the home buyers in the cases wherein the project isn't handed over on the date guaranteed in the agreement.[11] Keeping into account this situation, aiming to prevent the potential abuse of the Code by certain classes of financial creditors, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 was promulgated in December 2019. The Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019 was scrutinized by the Standing Committee of Finance and has been passed by the Parliament. The Bill also received the assent of the President in February 2020. At present, if

[8] *Id.*
[9] Swiss Ribbons Pvt Ltd. & Anr. v Union of India, Writ Petition (Civil) No. 99 of 2018 dated 25.01.2019 (India).
[10] *Unstarred Question No. 32*, Ministry of Corporate Affairs, Lok Sabha, available at http://164.100.24.220/loksabhaquestions/qhindi/172/AU32.pdf.
[11] Neeraj Gupta v Emmar MGF Land Ltd, (IB) – 1403(PB)/2018 (India).

any home buyer has to apply to the NCLT for initiating corporate insolvency resolution process against a real estate company has to abide by the provisions enumerated in this bill. The major changes which were brought in by this ordinance were that the home buyers have to now abide by a prerequisite which is, the application should be filed jointly by at least 100 home buyers, or 10% of their total number.

IV. CRITICAL EVALUATION

The imposition of such a prerequisite for initiation of the insolvency process does no good to the home buyers. The addition of such a kind of threshold is totally inappropriate. Most importantly, such a threshold is initiating class discrimination within the financial creditors as a whole and within the class of home buyers as well. Firstly, awarding the home buyers with the same status as a financial creditor, then again imposition of thresholds on them isn't doing any justice to the Amendment Bill of 2018. Rather it is simply frustrating the objective to amended Section 7 of the Code. The threshold has been implemented only on the home buyers and not any other financial creditors. This is clear-cut proof of discrimination under the same class i.e financial creditors as well as amongst the class of home buyers. For instance; concerning a real estate project of 1500 flats. There is a contract between the real estate company and the home buyers to hand them over the possession by a certain month of a particular year. It may so happen that amongst the home buyers 20 such home buyers are going to have their superannuation just by or post a month or two from the date which has been promised by the real estate company for handing over them the possession of their flats. But as and when the due date of handing over the possession arrives and amongst those 1500 flats, there are 500 fats of which the construction has been completed and 1000 flats are still not ready to move in. And amongst those 1000 flats which are not yet ready to move 20 flats are of those persons who are now in utmost need to have the possession to their flats. And rest of the 500 flats which are ready to be occupied do not have their owners to take in possession immediately. Now, the imposition of such thresholds completely frustrates the idea of initiation of corporate insolvency resolution process by these 20 aggrieved home buyers. This would now create a lot of difficulties to abide by the set threshold. In addition to the above points, individual home buyers may not also always have the details of the other allottees, which are only available with the real estate company. Now this will again impose a huge problem for filing a joint application. Similarly, the other class of financial creditors or for that matter the operational creditors are not expected to maintain a threshold. The only

thing that concerns them is a debt incurred which is one lakh rupees or more[12]. The home buyer's interest is overlooked irrespective of the amount of debt that has been incurred and is due. The lawmakers before suggesting to amend the code and add this threshold believed that it would certainly prevent the abuse of code which have been talked about in the above paragraphs. But they completely forgot to look into the matter that adding such thresholds would also highly affect the genuine cases of default. It would prove as a major barrier for those homebuyers who are genuinely facing a lot of issues by investing their hard-earned money into this sector and are not yielding any benefit but only losses in the form of delayed possession from the same. If the lawmakers have to genuinely prevent the abuse of code, they can certainly take a step ahead. This has been taken care of by the Supreme Court in a case[13] that, "any fraudulent intention behind the filing of an application can be proven by the developer before NCLT at the stage of examining the application. That NCLT can impose a penalty of up to one crore rupees on person filing applications with fraudulent or malicious intent for any purpose other than insolvency resolution or liquidation".

The Allahabad bench of NCLT has held that "merely being a homebuyer would not automatically bring the homebuyer within the purview of the term 'financial creditor'. There has to be an actual debt that is owed to such homebuyer, payable by the infrastructure/ builder company for the Code."[14]

Currently, the constitutional validity of the 2019 Ordinance was still in question. The Supreme Court of India has agreed to listen to the pleas of the home buyers concerning the ordinance passed. It has been challenged by the home buyers before the Supreme Court of India[15].

The unprecedented COVID-19 pandemic has shattered the world economies. In India, there have been several economic stimuli. Amongst these, an increased threshold for initiation of corporate insolvency resolution proceedings (CIRP) from Rupees 1 lakh to 1 crore was guaranteed to the Micro and Small Scale Enterprises (MSME). Secondly, Sections 7, 9, and 10 of IBC, 2016 were deferred until September 2020. But owing to the continual plunge in the economy, the following provisions have been further deferred until December 24, 2020. Although this stimulus would prove to be easing on the real estate companies, it is a prejudice to the home buyer who is being pestered daily due to delay in handing over the possession of

[12] *The Insolvency and Bankruptcy Code, 2016,* Ministry of Corporate Affairs, November 2019.
[13] Pioneer Urban Land and Infrastructure Limited and Anr. v Union of India & Ors., W.P. (C) No. 43 of 2019, Supreme Court of India, August 9, 2019.
[14] Ajay Walia v M/s. Sunworld Residency Private Limited, CP (IB) 11/ALD/2018 (India).
[15] Manish Kumar v Union of India & Anr., W.P. (C) No. 26 of 2020 (India).

their dream home.

V. CONCLUSION AND A WAY FORWARD

It is surely a fact the IBC has empowered home buyers the status equivalent to that of the financial creditors. But its extent is still questionable. On one hand, we have the real estate companies and developers who are aggrieved from the fraudulent applications of initiation of the corporate insolvency resolution process. On the other hand, we have the home buyer who has been now aggrieved for a significant period of time from those developers or real state companies who are wasting these home buyers hard earned money and are making the home buyers face a tough time. Currently, all the eyes are on the Supreme Court's decision and justification as to whether it would be the home buyers or the real state companies who will be on an upper hand.

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