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Provisions of the IB Code *w.r.t.* *the* Homebuyers

Remedies at NCLT

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Governing Law

Section 5(8) of the IB Code defines the term “Financial Debt” and (a) to (i) encompass within it the different types of transactions which will fall within the ambit of Financial Debt.

It states:

“Financial Debt” means a debt along with 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;

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 (16 of 2016);

(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-clause (a) to
(h) of this clause;

Section 5(8) of the IB Code

Evidently, Section 5(8) is a catch-all provisions which encompasses within it almost all possible financial transactions of the times.

Section 5(8)(f) is a residuary clause which covers within it all financial transactions which do not fall within any of the other clauses but has the "commercial effect of a borrowing".

Explanation to Section 5(8)(f)

Added *vide* Act No. 26 of 2018 *w.e.f.* 6.6.2018

Clarificatory in nature

The amount raised by a Corporate Debtor from an "Allottee" (includes Homebuyers as well as commercial space-buyers) under a real estate project shall be deemed to have the commercial effect of a borrowing.

Grants the Homebuyers and other Allottees the title of being financial creditors

The terms "Allottee" and "Real Estate Project" to be read as per their definition under the Real Estate (Regulation and Development) Act, 2016

Section 7 of IB Code

Section 7: Initiation of Corporate Insolvency Resolution Process by Financial Creditor:

(1) A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

Provided that for the financial creditors, referred to in clauses (a) and (b) of sub- section (*6A*) of section 21, an application for initiation 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 resolution 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) Act, 2020, 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 Act, failing which the application shall be deemed to be withdrawn before its admission

Explanation. - For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor

(2) The financial creditor shall make an application under sub-section *(1)* in such form and manner and accompanied with such fee as may be prescribed.

(3) The financial creditor shall, along with the application furnish -

(a) record of the default recorded with the information utility or such other record or evidence of default as may be specified;

(b) the name of the resolution professional proposed to act as an interim resolution professional; and

(c) any other information as may be specified by the Board.

(4) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor under sub-section (3):

Provided that if the Adjudicating Authority has not ascertained the existence of default and passed an order under sub-section *(5)* within such time, it shall record its reasons in writing for the same.

5) Where the Adjudicating Authority is satisfied that –

(a) a default has occurred and the application under sub-section *(2)* is complete, and there is no disciplinary proceedings pending against the proposed resolution professional, it may, by order, admit such application; or

(b) default has not occurred or the application under sub-section (2) is incomplete or any disciplinary proceeding is pending against the proposed resolution professional, it may, by order, reject such application:

Provided that the Adjudicating Authority shall, before rejecting the application under clause (b*)* of sub-section (5), give a notice to the applicant to rectify the defect in his application within seven days of receipt of such notice from the Adjudicating Authority.

(6) The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5).

(7) The Adjudicating Authority shall communicate-

(a) the order under clause *(a)* of sub-section *(5)* to the financial creditor and the corporate debtor;

(b) the order under clause *(b)* of sub-section *(5)* to the financial creditor, within seven days of admission or rejection of such application, as the case may be.

Section 7 of IB Code

- Sub section (1) gives a Financial Creditor the right to file either individually or jointly with other Financial Creditors, an application for initiation of Corporate Insolvency Resolution Process ("**CIR Process**") against a Corporate Debtor ("**CD**") before the Hon'ble Adjudicating Authority being the National Company Law Tribunal ("**NCLT**") when a default has occurred in payment of debt due to it/ them
- The Explanation to (1) provides that the default against which an Application under (1) is filed may include the debt owed not only to the Applicant Financial Creditor but also any other Financial Creditor of the Corporate Debtor.

Provisos to Section 7(1) – Added *vide* Act No. 1 of 2020 *w.e.f.* 28.12.2019

The Homebuyers fall under the 2nd proviso

An Application for initiation of CIR Process under (1) by Financial creditors who are Allottees under a Real Estate Project {refer to explanation to 5(8)(f)} can only be filed jointly by atleast 100 Allottees under the same real estate project, or not less than 10% of the total Allottees under the same project, whichever is less.

The third proviso to (1) lays down the effect of the 2nd proviso on pending applications.

Pending Applications which have not been admitted – have to be modified within 30 days from 28.12.2019 to comply with the 2nd proviso

Failure to comply with the requirements given in the 2nd proviso within the 30 days period will result in the non-compliant Applications deemed to be withdrawn before its admission.

Challenge to the Amendment before the Hon’ble Supreme Court of India

- A large number of Writ Petitions challenging the Amendment (original Amendment Ordinance dated 28.12.2019) have been filed before the Hon’ble Supreme Court of India, and have been tagged with W. P. (C) No. 26/ 2020 titled “*Manish Kumar vs. Union of India*”.
- The Hon’ble Supreme Court of India has been pleased to direct that *status quo* be maintained as regards the pending Applications.
- The effect of the same is that the pending Applications shall not be dismissed for non-compliance of the 2nd proviso, or even be admitted.
- As regards the “on the ground” effect of the said order, the Hon’ble Adjudicating Authorities are deferring hearing in such matters, while directing the CD to furnish a list of its Allottees to the Applicant-Allottee

Home Buyers in the Committee of Creditors Post Initiation of CIR Process

- The Homebuyers and other Allottees being Financial Creditors in a class are represented on the committee of Creditors ("**CoC**") of a CD by an Authorised Representative ("**AR**") who her/ himself is an Insolvency Professional ("**IP**").
- Regulation 4(A)(1) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 ("**CIR Process Regulations**") – The IRP shall first ascertain class(es) of creditors in a CD
- Regulation 4(A)(2) – based on the above ascertainment, the IRP shall identify three (3) IPs who are;

  (a) not his relatives

  (b) eligible to be IRP under Regulation 3

  (c) willing to act as the AR for the creditors in a class
- Regulation 6(2)(bb) – The IRP shall, in the Public Announcement (inviting claims) made after admission of an Application u/S 7, 9, 10, offer to the Homebuyers and other creditors in a class a choice of three IPs identified under Regulation 4A to act as the AR for each class
- Regulation 8A – Homebuyers and other Allottees shall submit their claim in FORM CA of the CIR Process Regulations, being the creditors in a class and shall choose one IP from the choice of 3 IPs given in the public announcement by the IRP to act as the AR for their class

Appointment of AR to Represent the Homebuyers in the CoC

- Regulation 16A (1) – After receiving the claims from the creditors in a class, the IRP shall select the IP who has been chosen by the highest number of Financial Creditors in a Class to act as the AR for that class.

- An exception to the same is that any claim received after the stipulated time for submission given in the Public Announcement shall not be considered for the purposes of appointment of AR for that class

- Section 21 (6A)(b) of the IB Code read with Regulation 16A (2) – The IRP shall apply to the Hon’ble Adjudicating Authority for appointment of the chosen AR within two days of verifications of claims received pursuant to the Public Announcement

AR to Represent Homebuyers in the CoC

- Regulation 16B – In cases where the CD has only Homebuyers/ Allottees or other financial creditors in a class, the CoC of such a CD shall be comprised of the AR(s) of the said Financial Creditors in a Class only

- Regulation 16A(7) – The Voting share of a Homebuyer or other creditor in a class shall be in proportion to the financial debt including interest @ 8% per annum unless a different rate has been agreed by the creditor and the CD

- Section 25A(1) – The AR of a class shall have the right to participate and vote in CoC meetings on behalf of the financial creditors she/ he represents in accordance with prior voting instructions of such creditors through physical or electronic mode

- Section 25A(2) read with Regulation 16A(9) – The AR shall circulate the Agenda to the Financial Creditors in a Class and announce the voting window at least twenty four (24) hours before the window opens for voting instructions and keep the window open for at least twelve (12) hours

- Section 25A(3) – The AR shall not act against the interest of the Financial Creditor she/ he represents and shall always act in accordance with their prior instructions.

Voting by Homebuyers in the CoC

Section 25A (3A) – The AR shall cast her/ his vote on behalf of all Financial Creditors she/ he represents in accordance with the decisions taken by a vote of more than 50 % of the voting share of the Financial Creditors who have cast their vote

(3A) was added *vide* Act No. 26 of 2019 to address the grave issue faced in various CIR Processes wherein, the requisite threshold for passing critical resolutions (such as Appointment of RP etc.) were not reached due to staggered voting by the Homebuyers, which was putting the continuance of the CIR Process itself at risk

Proviso to (3A) – However, in respect of an Application u/S 12A, the AR shall cast her/ his vote in accordance with the instructions received from each financial creditor to the extent of her/ his voting share as laid out in the first proviso to Section 25A (3).

Second Proviso to Section 25A(3) – If any Financial Creditor does not give prior instructions, the AR shall abstain from voting on behalf of such creditor

Landmark Judgments

Nikhil Mehta and Sons (HUF) vs. AMR Infrastructure Limited

Company Appeal (AT) (Insolvency) No. 07 of 2017 dated 21.7.2017

- A landmark judgment by the Hon'ble National Company Law Appellate Tribunal ("**NCLAT**") which set aside the view taken by the Principal Bench of the Hon'ble NCLT that the transaction between a Homebuyer and a Developer is a simple agreement of sale and purchase of property and does not acquire the status of a financial debt as the same does not have any consideration for time value of money.

- The Hon'ble NCLAT *vide* its judgment dated 21.7.2017 held that the monies given by a Homebuyer to a developer for allotment of a flat is a Financial Debt, and the assured returns promised to the Homebuyers are the consideration for time value of money

- This judgment opened the floodgates for the Homebuyers to use the highly effective remedy of the IB Code to put a check on defaulting builders and developers

Chitra Sharma & Ors. Vs. Union of India & Ors.

Writ Petition (Civil) No. 744/ 2017 Order dated 11.9.2017

- This Writ Petition came to by filed before the Hon'ble Supreme Court of India by aggrieved homebuyers of Jaypee Infratech Limited ("**JIL**") subsequent to initiation of CIR Process of JIL at the hands of IDBI Bank Limited over a default of approx. Rs. 520 Crores. The Homebuyers thereat sought protection of their interest

- The Hon'ble Supreme Court of India *vide* order dated 11.9.2017 keeping in view the provisions of IB Code and the interests of the Homebuyers directed the IRP therein to immediately take over the management of JIL and make necessary provisions to protect the interests of the homebuyers.

- The Hon'ble Supreme Court also appointed a Senior Advocate as well as an Advocate on record to participate in the CoC meetings of JIL to espouse the cause of the homebuyers and protect their interests

Pioneer Urban Land and Infrastructure Limited & Anr. Vs. Union of India & Ors.

Writ Petition (Civil) No. 43 of 2019 and connected Petitions dated 9.8.2019

- This writ petition along with numerous others came to be filed before the Hon'ble Supreme Court of India by Real Estate Developers challenging the constitutional validity of the amendments made to the IB Code *vide* Amendment Act No. 26 of 2018 which included the explanation to Section 5(8)(f), giving Homebuyers and other allottees the status of Financial Creditors

- The main challenge of the Builders to the inclusion of Homebuyers is discriminatory and treats unequals equally, thus being violative of Article 14 of the Constitution of India. It was further urged that such a categorisation of homebuyers as Financial Creditors has no nexus with the object of the IB Code.

- The Hon'ble Supreme Court of India while rejecting the plea of the Builders upheld the status of homebuyers and other Allottees as Financial Creditors under IB Code, as well as their right to initiate CIR Process

- The Hon'ble Supreme Court of India also held that the remedy available to the Homebuyers under the Real Estate (Regulation and Development) Act, 2016 ("**RERA**") is an additional and not an exclusive remedy

- The judgment of the Hon’ble Supreme Court of India however, also pointed out the possibility of trigger-happy Allottees trying to misuse the proceedings under IB Code to obtain wrongful gain, and observed that a Developer can, in an Application filed by an Allottee point out that:

(a) The Allottee her/ himself is a defaulter and not entitled to any relief, entailing dismissal of the Application

(b) The Application seeking initiation of CIR Process has been filed fraudulently, with malicious intent other than resolution of insolvency

(c) The Allottee is a speculative investor and not a person who is genuinely interested in purchasing a flat/ apartment

(d) The Allottee does not want to go ahead with its obligation to take possession of the flat/ apartment, but wants to get back the monies paid by it by way of coercive measures.

Conclusion

- The remedy of seeking initiation of CIR Process of defaulting developers is a very effective remedy available with the homebuyers who are aggrieved by the failure of the developer to handover possession of their homes within time.

- However, with the recently introduced minimum number of 100 Allottees or 10% of the total allottees required to file an application u/S 7, as well as the increase in the threshold of default u/S 4 from INR 1 Lakh to INR 1 Crore *vide* Notification dated 24.3.2020, the remedy of section 7 has been changed from an individual remedy of each homebuyer to a collective remedy which requires a concerted effort.

- But since the matter is still pending before the Hon’ble Supreme Court of India with a *status-quo* on all pending applications, it remains to be seen whether this latest amendment while pass muster before the Apex Court or will be struck down.

THANK YOU