THE CURIOUS CASE OF HOME BUYERS: ALL IS WELL?

- ***Sikha Bansal***

Editor's Notes: *IBC does not confer a right to initiate application, to creditors other than financial and operational creditors. Home buyers, who made prepayments to real estate promoters were thus unable to take recourse to IBC, as NCLTs, in majority cases, held that the home buyers are neither financial nor operational creditors. Though, where the home buyer was assured a guaranteed return, the same was considered to be a financial debt. In view of the concerns surrounding safeguarding the interests of home buyers, the definition of 'financial debt' was amended vide Insolvency and Bankruptcy Code, (Second Amendment) Act, 2018, to create a deeming effect that any amount raised from a real estate allottee shall be 'deemed' to be having 'commercial effect of borrowing'.*

Therefore, having being conferred the status of 'financial creditor', the home buyers are in a position to initiate corporate insolvency resolution process in respect of the defaulting real estate entities and be a part of the CoC therein – however, is this a happy ending? This critique examines the potential effectiveness of the amendment.

All the hullabaloo surrounding the inclusion of "home-buyers" in the category of financial creditors was put to rest by the promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 ("the Ordinance"). The Ordinance amends the definition of "financial debt" u/s 5 (8) of the Insolvency and Bankruptcy Code, 2016 ("IBC") so as to include in clause (f):

"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*"

The Ministry of Corporate Affairs, in a statement released in respect of the Ordinance, stated:

"The Ordinance provides significant relief to home buyers by recognizing their status as financial creditors. This would give them due representation in the Committee of Creditors and make them an integral part of the decision making process. It will also enable home buyers to invoke Section 7 of the Insolvency and Bankruptcy Code (IBC), 2016 against errant developers."

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At the outset, it might be interesting to note that the amounts raised from the allottees, in every case, might not be classifiable as financial debts in substance. For instance, where allotment/contract is *cancelled* by the home-buyer and there is a claim of return of principal sum with interest, the NCLT in *Pawan Dubey & Another v. M/s J. B. K Developers Private Limited* held that such an amount cannot be claimed as a financial debt. The

Ordinance makes no distinction for these cases and creates a "deeming" provision, by using the words "*deemed to be an amount having the commercial effect of a borrowing".*

Is this happy ending? A pensive thought refuses accepting that all is well.

What about the priority?

Been accorded the status of "financial creditors", the home-buyers will get a seat on the CoC. As such, they can exercise their voting rights to decide on resolution or liquidation of the entity.

However, being a financial creditor and being a secured one, are two different things. The Code, while introducing the differentia as to operational and financial creditors has retained the conventional classification of secured and unsecured creditors too. The same is evident from the definition of "financial debt" and "secured debt" and also priority enlisted under section 53 of the Code. As such, a financial creditor need not be a secured creditor.

While the Ordinance postulates home buyers as financial creditors, there has been no clarification as to such creditors being secured or unsecured. No changes have been made in section 53 to allot a specific priority to the home-buyers. As such, the monies of home-buyers will fall under clause (d), i.e. financial debts to unsecured creditors.

A secured creditor, irrespective of whether financial or operational, occupies second priority at par with workmen's dues. However, financial debts owed to unsecured financial creditors rank after the dues of secured creditors, workmen, employees [for specified periods].

Therefore, the benevolent Ordinance seems to have performed the job partly. The home-buyers might still be left in a dry.

Home, Sweet home?

The entire exercise will very much depend upon whether the home-buyers are keener to get their flats ready or just get refund of their money. Say, if the objective of home-buyers is to get their flats ready, the recourse under the Code will not be of much help. The only feeble way in which they can ensure this is to utilize their voting rights to stall liquidation and get the corporate debtor in resolution mode, so that their flats can be completed and handed over to them.

On the other hand, if the objective of the home-buyers is to get their money back, as stated earlier, they do not seem to be at an advantageous position. The liquidation value ascribable to them would be very low in view of their sub-ordinated priority in the waterfall. As such, whether resolution or liquidation, there are fragile chances of home-buyers regaining their hard-earned money.

Why not RERA?

Section 18 read with section 19 (4) of the Real Estate (Regulation and Development) Act, 2016 already provides for refund of amount of allottees if the promoter fails to complete or is unable to

give possession of the property. Several provisions of RERA stipulate adjudication of compensation and penalty for non-compliances by promoters.

In situations where the promoter fails to deliver the flats as well as refund the said amounts, and for some reasons also goes into insolvency before NCLT; there seems no benefit for the home-buyers to be a part of CoC, for reasons cited above. That is, in any case, the monies they would get would be limited to the extent of "liquidation value".

Hence, the home-buyers are in no better situation, so far as return of their own money is concerned.

In search of a better deal . . .

For reasons as above, it seems that IBC is not a holistic shelter for the home-buyers.

Instead of awarding the status of financial creditor to the home-buyers, a better solution would have been to define the priority of home-buyers such that they could get their refunds alongside the dues of secured creditors and workmen.

There would have been another probable solution: RERA provides for maintaining a separate account for depositing the amounts realized for the real estate project from the allottees, from time to time, to cover the cost of construction and the land cost. Such a provision, in a manner, implies that the moneys so obtained by the promoters would be in the nature of money held in trust. Applying the analogy, if the money taken from home-buyers is accorded the status of "money held in trust", the corpus will not be a part of the "assets" or "liquidation estate" of the promoter entity, and therefore would be out of the purview of section 53.

However, for the time being, the possible solution before home-buyers is either RERA or the amendment brought in by the Ordinance. The efficacy of this amendment will be pronounced only in times to come.

In the news....

Despite rule-making, confusion still prevails regarding voting by home buyers.

The insolvency process of Jaypee Infra has been in the news ever since its commencement. While the role of Jaypee Infra has been immense in recognizing Home Buyers as a class of creditors, most recently, the Hon'ble National Company Law Tribunal, Principal bench has rejected a plea by a group of homebuyers to treat them as a separate.

The plea was made in light of the fact that any home-buyers were not present at the CoC meeting due to which despite having claims of upto 58.2% voting share, the votes constituted only around 31% of the votes casted at the meetings and as such has acted as a setback for plan to shore up votes for NBCC bid.

The appellate bankruptcy court on June 10 declined to pass an order on Jaypee Infratech's prime lender IDBI's petition opposing NBCC's bid to take over the embattled firm and said that its lenders are free to vote for or against the bid. Earlier, on the bankers' plea, the NCLAT had on May 17 annulled voting by homebuyers and lenders on NBCC's bid and allowed a renegotiation on the offer by May 30