

Supreme Court upholding the status of Homebuyers as Financial Creditors: Paving a Roadmap towards Beneficial Legislative Jurisprudence



The IBC, 2016 makes a decent attempt in consolidating the different laws operating in the field of recovery and resolution of stressed assets. It is hailed as the success story of India's economic reforms¹. Since the law is in its nascent stage, its jurisprudence is developing. Upholding the status of homebuyers as financial creditors by the Supreme Court has come as a cushion to the scores of grieving homebuyers in the country who have invested their life savings for fulfilling their dream of owning a home but had been left in the lurch by the builders. The paper tries to analyse the amendments made to the Code in relation to homebuyers in the light of judgments of the courts and implications thereof.

Read on to Know More...



**Swati Gandhi and
Rama Sharma**

The author is a Ph.D. Scholar and Co-author is faculty at Gautam Buddha University, Greater Noida. She can be reached at swatimihir23@gmail.com

1. Introduction

Enactment of the Insolvency and Bankruptcy Code, 2016 (IBC or Code) is a serious effort on the part of the Government of India to increase the ease of doing business in the country. India is in the process of laying foundations of a mature market economy. This involves well drafted modern laws suitable for the current market scenario and repealing the obsolete ones².

With a view to consolidate and amend various laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such person, the Government enacted the IBC in 2016³. As the law is evolving and developing, the government is keeping a close watch on the outcome of the proceedings in the courts of law, and it has been seen that it is quick in plugging the loopholes. The present article attempts to analyse the position of homebuyers under the IBC regime.

¹ Hon'ble Vice President Mr. M. Venkaiah Naidu at the inauguration of Insolvency Research Foundation on August 2, 2019 quoted in quarterly newsletter of Insolvency and Bankruptcy Board of India Vol.12 Issue July-Sept.2019.

² The Report of the Banking Law Reforms Committee, 2015, Vol.1, available at: ibbi.gov.in/BLRCReportVol1_04112015.pdf (last visited on Nov. 19, 2019).

³ Insolvency and Bankruptcy Code, 2016, No. 31 Acts of Parliament, 2016 (India).

A company has different types of creditors each of whom have different rights and motivations. Accordingly, when insolvency resolution process commences, their concerns are different and have to be differently accounted for. Insolvency regimes make different accommodation for different creditors⁴.

IBC recognises three types of creditors in the order of ranking with respect to rights and powers as Financial Creditor (FC), Operational Creditor (OC) and other creditors.

The Code defines financial debt as a debt including interest which is disbursed against the consideration for the time value of money. It includes borrowed money against interest, issue of bonds, notes, debentures, loan stock, receivables sold or discounted or any amount raised under any other transaction having the commercial effect of borrowing⁵. The amendment made in the section which is under consideration in this article, is by way of explanation attached to the definition of the financial debt⁶ which provides that any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing⁷. The expression allottee and real estate project have been attributed the same meaning as in Real Estate (Regulation and Development) Act, 2016.

Operational debt would include a claim in respect of goods or services including employment or any payment due under any law or payable to the government or any local authority⁸.

2. Judicial Decisions on the Issue of Homebuyers

Court Decisions Before the Amendment in the Code on the Position of Homebuyers

Section 6 of the Code provides in case a Corporate Debtor (CD) commits a default, an FC, or an OC, or the CD itself

can initiate Corporate Insolvency Resolution Process (CIRP)⁹.

In *Col. Vinod Awasthy Vs. A.M.R Infrastructure Ltd.*¹⁰, NCLT rejected the petition for initiation of insolvency proceedings against the developer on the ground that home buyer cannot be considered as OC under the Code. The amount paid to the developer does not fall within the definition of operational debt as the same is not a claim in respect of provision of goods or services, any employment dues, or any statutory dues payable to government or any local authority.

However, in cases where contract between the parties provided home buyers with guaranteed assured returns by the developer, they were held to be financial creditors.¹¹

Given that in most cases, the home buyers were considered neither as financial creditors nor as operational creditors, they could not take any action. Further, the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 initially provided the procedure for filing claim forms by the financial creditors and operational creditors only. Home buyers faced difficulties even in filing their claims as their claims came under the category 'other creditors'. When the plight of the home buyers came to the fore, the Insolvency and Bankruptcy Board of India (IBBI) amended the Regulations with respect to forms for filing claims, to include the claims of 'other creditors'.¹²

2.1. What prompted the Government to Amend the Code and include Homebuyers as Financial Creditors?

Lakhs of homebuyers across the country especially in the NCR region were facing a lot of uncertainty with regard to the delivery of possession of their flats and apartments. In some cases, possession is being delayed by more than ten

⁴ Insolvency and Bankruptcy Board of India Centre for Legal Policy, "Understanding the Insolvency and Bankruptcy Code, 2016: Analysing developments in jurisprudence", (June 2019) www.ibbi.gov.in (last visited Nov. 16, 2019).

⁵ Insolvency and Bankruptcy Code, 2016, s. 5(8)(f).

⁶ Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 No. 26, Acts of Parliament, 2018 (India).

⁷ Ibid. section 5 (8)(f) Explanation added by the Amendment Act.

⁸ Section 5 (21) of Insolvency and Bankruptcy Code, 2016.

⁹ Insolvency and Bankruptcy Code, 2016, s. 6- Persons who may initiate corporate insolvency resolution process.

¹⁰ 2017 SCC OnLine NCLT 16278.

¹¹ *Nikhil Mehta and Sons Vs. AMR Infrastructure Ltd.*, 2017 SCC OnLine NCLAT 859: Company Appeal (AT) (Insolvency) No.7 of 2017; *Anil Mahindroo Vs. Earth Organics Infrastructure*, NCLAT New Delhi, 2017 SCC OnLine NCLAT 216: Company Appeal (AT) (Insolvency) No. 74/2017.

¹² Insolvency and Bankruptcy Board of India (Insolvency Regulation Process for Corporate Persons) 2016, Regulation 9A.

years. Hapless buyers had no rescue except the long-drawn litigations in the consumer forums for the deficiency in service by the builders.

The Supreme Court in *Bikram Chatterji Vs. U.O.I.*¹³ delivered a landmark judgment protecting the interest of distraught home buyers of Amrapali Group in Noida and Greater Noida. The Court in strong words observed that they are the victims of collusion of the statutory authorities, bankers, and the developer. The builder was granted land lease by just paying 10% of the lease amount. The project was financed by the bankers without verifying the status of lease dues. The forensic audit proved diversion of funds by the builder to its other companies and projects. Since the home buyers were not classified into any specific category of creditors under the IBC, they had no rights under the law. It was felt by the court that if in the insolvency resolution process, the home buyers are left in the last category of creditors, this would amount to gross injustice to them. The court, therefore, gave relief to the thousands of home buyers by directing NBCC to complete the remaining projects and cancelled the registration of Amrapali Group under RERA.¹⁴

It was felt by the Supreme Court that if in the insolvency resolution process, the home buyers are left in the last category of creditors, this would amount to gross injustice to them.

In another case similar to the *Amrapali Group*, several home buyers who had invested in the projects floated by the Jaypee Infratech Ltd. (JIL), under the holding company of Jayprakash Associates Ltd. (JAL), had to knock the doors of the Supreme Court to protect their interests against the resolution proceedings initiated by IDBI Bank under Section 7 of the Code¹⁵ in National Company Law Tribunal (NCLT) against JIL's¹⁶ Interim Resolution Professional (IRP), appointed by the court called for submission of claims by the stakeholders. The claim of home buyers was placed under the heading 'claim

by other creditors' which came in the lowest hierarchy after financial creditors, operational creditors, employees, workmen etc. This led to a wide unrest and panic among the home buyers. They challenged the validity of the provisions of the Code concerning to their rights.

The court observed that IBC does not contain an adequate recognition of the interest of home buyers in the resolution process who are the vital stakeholders.

To find a suitable solution, the government constituted an Insolvency Law Committee (ILC) under the Chairmanship of Injeti Srinivas. The Committee was of the view that non-inclusion of home buyers either in the category of financial creditors or operational creditors deprives them of some of their important rights, viz, right to initiate CIRP, right to be represented on the Committee of Creditors (CoC) and in case of liquidation of the CD, the guarantee of receiving at least the liquidation value under resolution plan.¹⁷

The concerns of home buyers were recognised through an Amendment Ordinance, 2018¹⁸ wherein home buyers have been brought within the purview of financial creditors. Being part of financial creditors, made them necessary constituent of committee of creditors (CoC) and will also have voting rights in proportionate to the share of interest in the financial debt owed by the CD. The court in the *Jaypee case* gave relief to the thousands of home buyers by recognising their claims under the amended definition of the Financial Creditor (FC).

2.2. Challenge to the Constitutionality of the Amendment: The constitutional validity of the amendment¹⁹ was challenged in the Supreme Court by a number of real estate companies by filing a large number

¹³ 2019 SCC OnLine SC 901.

¹⁴ Pranav Shroff, IBC amendment gives voice to beleaguered homebuyers, Vol.12 Issue 5 India Business Law Journal 53 (2018).

¹⁵ Initiation of corporate insolvency resolution process by financial creditor.

¹⁶ *Chitra Sharma Vs. Union of India*, (2018) 18 Supreme Court Cases 575: 2018 SCC OnLine SC 874.

¹⁷ The Insolvency Law Committee Report 2018, March 26, 2018.

¹⁸ Insolvency and Bankruptcy (Amendment) Ordinance, 2018: a consensus had emerged among the law makers that further fine tuning of the Code would be required. The Government constituted an Insolvency Law Committee to review the functioning and implementation of the Code. The recommendations of the Committee were examined by the Government and it was accordingly decided to amend the Insolvency and Bankruptcy Code, 2016. Since Parliament was not in session and immediate action was required to be taken, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 was promulgated by the President on the 6th day of June, 2018.

¹⁹ Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, No. 26, Acts of Parliament, 2018 (India), s. 5(8)(f) Explanation: 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.

of writ petitions on the ground of violation of Articles 14 and 19 of the Constitution of India.²⁰

The builders argued that allottees should not be equated to the status of financial lenders as they are not interested in the viability and health of the CD or its business but only with the delivery of their flat or the apartment. A trigger happy allottee aggrieved by the delay in possession of his flat may invoke the process, much to the chagrin of other allottees and stakeholders. A perfectly good management can be removed and replaced at the instance of such allottee and in worst case if resolution is not successful, will eventually lead to the death of the corporate through liquidation. Liquidation of a company can never be in the interest of any one lest the bulk of allottees. The amendment was challenged as arbitrary and discriminatory in nature, being excessive and disproportionate to the ill it seeks to remedy to the ill it may beget.

The builders further argued that the allottees in case of delay of delivery or any other grievance can seek the remedy under RERA²¹ which is a sector specific legislation and provides comprehensive mechanism for adjudication of disputes between builders and buyers.

Legal points in previously decided cases were also referred to by the parties, namely, in *Innovative Industries Vs. ICICI Bank*²² the court had distinguished between FC and OC in terms of scope of their powers within the law. In case of default, the OC has to give a demand notice to the CD who can within a stipulated time period of ten days, bring to the notice of the OC existence of any pre-existing dispute/pending suit or arbitration proceedings. Such pre-existing dispute or litigation is enough to bring the CD out of the clutches of the Code. But in case of default against FC, existence of any pre-existing dispute or litigation will not be a bar for initiating the insolvency proceedings. The Adjudicating Authority (AA) i.e., NCLT, has to merely satisfy itself that the debt is due. This distinction highlights the superiority of financial

creditors over operational creditors.

*Swiss Ribbons Vs. Union of India*²³ was also referred to by the builder lobby, wherein the court had laid down several characteristics of financial creditors and in terms of those features, the builders tried to impress upon the court that real estate allottees can at best be categorised as operational creditors and not as financial creditors.

Giving judgment in favour of the homebuyers, the Supreme Court upheld the validity of the amendment and held that there is no infringement of Article 19 of the Constitution. The amendment is made in public interest and no unreasonable restriction is placed on the fundamental rights of the petitioners under Article 19(1)(g). No person is deprived of his property without the authority of a constitutionally valid law.

Post amendment to the Code, NCLT started the CIRP against the defaulting builder in *Mrs. Rachna Singh. Vs. M/S Umang Realtech Pvt. Ltd.*²⁴ on the application of home buyer treating her as an FC.

Finally, the Supreme Court opined that the amendment is in public interest and no unreasonable restriction is placed on the fundamental rights of the petitioners under Article 19(1)(g).

2.3. Benefits of the Amendment to the Homebuyers

1. Prior to the amendment the home buyers were neither recognised as financial creditors nor as operational creditors. The amendment has upgraded their status to that of financial creditor.
2. The amount raised from a home buyer in a real estate project now comes under the definition of financial debt as a result, they are entitled to invoke insolvency proceedings (irrespective of a dispute between builder and the buyer).

²⁰ *Pioneer Urban and Land Infrastructure Co. Ltd. Vs. Union of India* (2019) 8 Supreme Court Cases 416: (2019) 4 Supreme Court Cases (Civ) 1: 2019 SCC OnLine SC 1005.

²¹ Real Estate (Regulation & Development) Act, 2016, No. 16, Acts of Parliament 2016 (India).

²² (2018)1 SCC 407: 2017 SCC OnLine SC 1025.

²³ (2019)4 SCC 17.

²⁴ C.P. No. (IB) 1564(PB)/2018, ibbi.gov.in/orders/nclt.

3. The home buyers will have due representation in the CoC through their authorised representative and voting rights in proportionate to the amounts due.

4. In the event of liquidation, they will now be placed at par with the financial creditors.

2.4. Further Amendment

The Code has been further amended by adding a proviso in Section 7, which provides the requisite minimum strength of allottees who are eligible to initiate the insolvency proceedings, which is, either minimum hundred allottees of the same real estate project or not less than ten percent of the total number of such allottees under the same real estate project whichever is less, are eligible to file the insolvency resolution process against the defaulting real estate corporate.²⁵ Further, where an application for initiating CIRP against a CD has been filed by such FC and the same has not been admitted by the AA before the commencement of the Amendment Act, such application is to be modified to comply with these requirements within thirty days of this amendment, failing which the application shall be deemed to have been withdrawn before its admission.

The Supreme Court has upheld the validity of this amendment also requiring a minimum threshold limit to initiate the process. The court observed that in a real estate project there can be hundreds or even thousands of allottees and if a single allottee as a FC is allowed to make an application under Section 7, the interests of other allottees may be put in peril.²⁶

2.5. Homebuyers as Secured or Unsecured Financial Creditors

Whether homebuyers are considered as secured or unsecured financial creditors is another important area of concern which needs attention. The term 'secured creditor' as defined in the code means a creditor in whose favour security interest is created.²⁷ Security interest means any



right, title or interest/claim to a property created in a transaction for security of the payment of the debt or the loan amount. It includes mortgage, charge, hypothecation, assignment or any encumbrance on a property.²⁸ The property on which the charge is created is known as the 'security' and the person in whose favour such charge is created is called as 'secured creditor'.

Whether homebuyers are considered as secured or unsecured financial creditors is another important area of concern which needs attention.

In *Flat Buyers Association Vs. Umang Realtech Pvt. Ltd.*²⁹ the NCLAT New Delhi observed that the infrastructure/apartments in a real estate project are constructed for the homebuyers by the CD. These assets which are security for secured creditors cannot be distributed among them. On the contrary, the assets are liable to be transferred to the allottees (homebuyers) who are the unsecured creditors, and not to secured creditors such as banks and financial institutions. Moreover, the banks as secured creditors would not like to take the flats/apartments in lieu of the money disbursed by them, whereas the unsecured creditors (here homebuyers) have rights over these flats and apartments.

²⁵ Insolvency and Bankruptcy Code (Amendment) Act, 2020, No. 1, Acts of Parliament, 2020 (India).

²⁶ *Manish Kumar Vs. U.O.I.* 2021SCC OnLine SC 30.

²⁷ Insolvency and Bankruptcy Code, 2016 s. 3(30).

²⁸ Insolvency and Bankruptcy Code, 2016, s. 3(31).

²⁹ 2020 SCC OnLine NCLAT 1199 see paras 11 & 12.

³⁰ Company Appeal (AT) (Insolvency) No. 1056 of 2019.

The observations of the NCLAT in the above case has been reiterated by it in its another decision in *Rajesh Goyal Vs. Babita Gupta*.³⁰

The Supreme Court in *Union Bank of India Vs. Rajasthan Real Estate Regulatory Authority* while upholding the decision of Rajasthan High Court, held that complaint against the bank can be filed under RERA if the bank takes the possession of the project as a secured creditor under SARFAESI Act, on account of default of the promoter. The court has rightly held that if there is a conflict between RERA and recovery proceedings under SARFAESI Act, the former will prevail.³¹

RERA provisions were discussed in the High Court judgement. In terms of clause (h) of sub-section 4 of Section 11 of the RERA Act, 2016, after a promoter executes an agreement for sale of an apartment, he shall not mortgage or create a charge on such apartment, or building and if any such mortgage is created it shall not affect the right and interest of the allottee who has taken or agreed to take such flat/apartment.

Many a times, homebuyers also take loan for the purchase of their flats. In that case, they mortgage their flat in favour of the bank who has given the loan. Although homebuyers are unsecured creditors, but it should be ensured that their interests are protected. This can be seen through beneficial judicial interpretations of the provisions of the different statutes operating in the field, in the interest of homebuyers.

3. Conclusion

The aim of the IBC is value maximisation of the assets of the CD through time bound resolution. Value-maximisation is often a function of time, as value may tend to erode with passage of time. The process of negotiation in insolvency resolution must be designed in such a way that not too many stakeholders are involved as the same may lead to unnecessary delays. However, at the same time the law must be cautious that it should not ouster those stakeholders who have primary interest. Home

buyers are such primary stakeholders in a real estate project whose rights needed to be safeguarded. If bankers are interested in completion of the project for a return on their investments, then so are the allottees, for they too had invested their lifetime savings in the dream of a house. The minimum threshold limit is rightly prescribed so that the resolution process is not used as recovery mechanism.

The jurisprudence on the law is continuously developing. In a recent judgment of the Supreme Court, it has been held that where proceedings are initiated by the homebuyers under RERA, their rights will prevail over rights of bank as a secured creditor under SARFAESI.³²

If bankers are interested in completion of the project for a return on their investments, then so are the allottees, for they too had invested their lifetime savings in the dream of a house.

Concluding through analysis of various judicial decisions, the homebuyers have thus now been given sufficient safeguards while at the same time legislature has tried to balance the competing interests of the home buyers as well as the real estate developers. The new insolvency regime is designed to reduce the possibility of allowing some stakeholders to benefit at the expense of others. Therefore, the amendments are also in tune with objectives as enshrined in the preamble to the Code.



³¹ Editorial, "Homebuyers, Banks on the Same Side", *The Economic Times*, Feb. 16, 2022.

³² *Union Bank of India Vs. Rajasthan Real Estate Regulatory Authority*, Special Leave to Appeal (C) Nos. 1861-1871/2022.