

Incongruity between creditors and homebuyers under the insolvency and bankruptcy code, 2016

Rudrani Sengupta¹

Abstract

The Insolvency and Bankruptcy Code, 2016 initiated by the Ministry of Corporate Affairs was done with a view to consolidate all the insolvency and bankruptcy laws we had in India. The right for applying for the resolution of insolvency under the Code lies with the creditors of the company and the company itself. Creditors of the company have been classified into two; i.e. Financial Creditors and Operational Creditors. Ideally, creditors of the company are of two kinds only, i.e. Financial and Operational. This paper focuses on the aspect with regard to the standing of the Homebuyers. Whether the advances taken by a real estate company against allotment of properties at a later date and assured returns in the intermittent period qualifies as a Financial Debt for the purposes of invoking the insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 (Herein, the “Code”).

¹Student, 5th Year, KIIT School of Law, KIIT University.

Introduction

The stakeholders welcomed the much awaited move of Ministry of Corporate Affairs to enact the Insolvency and Bankruptcy Code, 2016 (the “Code”) which replaced the liquidation, revival and recovery laws in India. This comes as a major shift from the existing scenario where the corporate actions like insolvency and revival once filed were long pending before the forums and the Code promises a time bound process for resolution of insolvency of the corporates. The right for applying for the resolution of insolvency under the Code lies with the creditors of the company and the company itself. Creditors of the company have been classified into two; i.e. Financial Creditors and Operational Creditors.

On the one hand, where the Code provides a complete overhaul of the liquidation and revival regime for the corporates, there are many challenges which stakeholders may face. One such challenge recently came to light when the National Company Law Tribunal (the “NCLT”) recently decided the issue,

“Whether the advances taken by a real estate company against allotment of properties at a later date and assured returns in the intermittent period qualify as a Financial Debt for the purposes of invoking the insolvency resolution process under the Code?”²

Earlier, to invoke the insolvency, one had to prove the existence of debt due on the company. Now, the Code classifies the debt under two categories, viz, Financial Debt and Operational Debt. Both these kinds have separate pre-requisite and procedures to be complied and followed for invoking resolution of insolvency under the Code. The practice under the Code and NCLT will eventually evolve and we do expect to see further deliberations on the issue of determining the nature of the debts and their practical applications.

Research methodology

The research methodology adopted is Descriptive Analytical.

Through this paper I aim to focus on the importance of covering the rights of the home-buyers to make an insolvency resolution application under the realm of the Insolvency and Bankruptcy Code, 2016.

Objective

This paper will attempt to provide an in-depth study on the protection of the rights of the Home-buyers under the newly implemented Insolvency and Bankruptcy Code, 2016. It must

²Nikhil Mehta & Sons (HUF) & Ors.v. AMR Infrastructures Limited, Company Appeal (AT) (Insolvency) No. 07 of 2017.

be pointed out that the length constraints limit the degree to which the aspects can be explored; however a detailed analysis has been carried out.

Predicament of the homebuyers

Under the Code, in relation to the corporate, two kinds of creditors can apply for resolution of insolvency, i.e. Financial Creditor and Operational Creditor who can apply when they have Financial Debt, or Operational Debt due on the Company. Whereby, the Code has failed to cover within its aspect the difficulties of the home-buyers. As there are several real estate developers who have failed to deliver the possession of the concerned property even after accepting money. The home-buyers through several instances have been trying to apply for an insolvency resolution through the Code, but their applications has been rejected. A “Financial Creditor” means any person to whom a Financial Debt is owed, being a debt along with interest, if any, which is disbursed against the consideration for the time, value of money. On the other hand, an “Operational Creditor” means any person to whom an Operational Debt is owed, being debt in respect of the provisions of goods and services including employment or dues payable to Central/ State government or any local authority under the law. The Code provides provisions for the either the Financial Creditor or the Operational Creditor to initiate the Corporate Insolvency Resolution Process (“CIRP”) against the debtor company. Hence, the home-buyers do not have the ability to initiate the CIRP as they do not fall under either of the categories.

Concerns of the homebuyers

There are mainly two concerns of the Home-buyers;

Pre Liquidation

After the insolvency application has been admitted by NCLT, the Interim Resolution Professional (“IRP”) is appointed who takes over the Corporate Debtor, invites proof of claims and forms the Committee of Creditors (“COC”), which is comprised of Financial Creditors and in their absence of the Operational Creditors. The Financial Creditors have the right to vote in the COC on a resolution plan, on the other hand, the Operational Creditor can only vote in the absence of the Financial Creditor. If the COC does not approve the resolution plan with the given time or is of the opinion that the company cannot be revived, then the company goes for liquidation. There are namely 3 concerns during this stage for the home buyers;

1. Once the insolvency application has been admitted by NCLT, there is no alternative legal recourse left for the home buyers;

2. They do not have the right to participate in the CIRP;
3. They are left at the mercy of the COC.

Liquidation Stage

Once the liquidation stage commences and the liquidator takes charge of all the assets and starts liquidating it. The distribution of the assets is as per the position of the stakeholders in the liquidation waterfall, as under the Code. The dilemma lies on the fact whether the home buyers would constitute as secured creditors or unsecured creditors at the time of liquidation. The concern being that the secured/ Financial Creditors would take away the substantial portion, therefore leaving behind possibly no money for the home buyers. Where, there are still plenty of the home buyers who have taken loans for the property, and are having to pay their monthly instalments thereto.

Judicial interpretations

PawanDubey&Anr.v. J.B.K Developers Pvt. Ltd.³

A perusal of section 9 of the Code would show that in order to maintain an application as an ‘Operational Creditor’ the petitioner has to satisfy the requirements of section 5(20) and 5(21) of the Code;

“5. In this Part, unless the context otherwise requires.-

(20) Operational Creditor means a person to whom an Operational Debt is owned and includes any person to whom such debt has been legally assigned or transferred

(21) “Operational Debt” means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the central Government, any State Government or any local authority”

It is evident from the perusal of the aforesaid definition of Operational Debt that it is a claim in respect of provision of goods or services including dues on account of employment or debt in respect of repayment of dues arising under any law for the time being in force and payable to Centre or State Government or local Authority. It is thus clear that debt may arise out of provisions of goods or services or dues arising out of employment or dues arising under any law for the time being in force and payable to Centre or State Government. The framer of the Code have also defined the expression Financial Debt in section 5(8) to mean a debt which is disbursed against the consideration of time value of money. However, the framer of the Code has

³Company Appeal (AT) (Insolvency) No. 40 of 2017.

not included in the expression of Operational Debt, as any debt other than the 'Financial Debt'. It is thus confined to the aforesaid categories like goods, services, employment and Government Dues. The refund sought to be recovered in this case is necessarily associated with the delivery of possession of immovable property which has been delayed. The petitioner in the present case has neither supplied any goods nor has rendered any service to acquire the status of an 'Operational Creditor'. The case had thrown light on the fact that it is not possible to construe section 9 with section 5(20) & 5(21) of the Code so widely to include within its scope even the cases where dues are on account of advance made to purchase the flat or a commercial site from a construction company like the Respondent in the present case especially when the petitioner has remedy available under the Consumer Protection Act, 1986 and the general law of the land.

Nikhil Mehta and Sons v. AMR Infrastructure Ltd.⁴

The concept of Financial Creditor has been enumerated in the present case, the opening words of the definition clause would indicate that a Financial Debt is a debt along with interest which is disbursed against the consideration for the time value of money and it may include any of the events enumerated in sub-clauses (a) to (i). Therefore the first essential requirement of financial debt has to be met viz, that the debt is disbursed against the consideration for the time value of money and which may include the events enumerated in various sub-clauses. A Financial Creditor is a person who has right to a Financial Debt. The key feature of financial transaction as postulated by section 5(8) of the Code is its consideration for time value of money. In other words, the legislature has included such financial transactions in the definition of 'Financial debt' which are usually for a sum of money received today to be paid for over a period of time in a single or series of payments in future. It may also be a sum of money invested today to be repaid over a period of time in a single or series of instalments to be paid in future. In Black's Law- Dictionary (9th edition) the expression 'Time Value' has been defined to mean "the price associated with the length of time that an investor must wait until an investment matures or the related income is earned". In both the cases, the inflows and outflows are distanced by time and there is a compensation for time value of money. However, while examining the nature of transactions of the present case the learned Adjudicating Authority (NCLT) came to a conclusion that the appellants do not come within the meaning of 'Financial Creditor', as in the case in hand "Assured Returns"

⁴Company Appeal (AT) (Insolvency) No. 07 of 2017.

is associated with the delivery of possession of the properties and has got nothing to do with the requirement of Section 5(8), the time value of money which is mercifully missing in the transaction in hand. Whereas, when before the National Company Law Appellate Tribunal (“NCLAT”), they were of the opinion that the applicants were to obtain a position of commercial borrowers as they had invested and had chosen a committed return plan. In lieu of which, the applicants were considered to be ‘Investors’ and the amount of money invested were to take the stand of a ‘loan’, thereby coming within the definition of ‘Financial Creditor’ as under Section 5(8)(f). Furthermore, to satisfy the essence of ‘Time value of money’, the NCLAT considered the sale and purchase agreement which contemplated the completion of construction and subsequent handover of the shops before the specified date. For every calendar month, the Corporate Debtor undertook to pay a fixed amount by way of a sale purchase agreement, having the commercial effect of borrowing, thereby the NCLAT allowed the appeal and admitted the petition.

JaypeeInfratech Limited Case⁵

Subsequently in this case, the bench vide its order dated 09.08.2017 in *Ibdi Bank Limited v. JaypeeInfratech Limited*,⁶ in respect of the Corporate Debtor Company (JaypeeInfratechLimited) had already initiated Corporate Insolvency Resolution Process and appointed an interim resolution professional, directing him to take over the management of the company and manage the affairs of the company. Therefore the Bench in this case is of the view that in order to provide substantial justice to the party concern, the position of the petitioners are to be considered as that of a stakeholder, and the interests are to be taken care of along with the other creditors. In lieu of which there is no necessity to delve into the merits of the case and determine the status of the applicant either as a Financial Creditor or Operational Creditor.

Subsequent to seeing the intervention of the Supreme Court with regard to the Insolvency Resolution Process, the petitioners (Home buyers) has challenged the constitutional validity of several provisions of the Code. In lieu of which there has been the Introduction of a new class of creditors on 16 August 2017 – Initially for the initiation of the Insolvency Proceedings would include only the Financial Creditor, Operational Creditor or the workmen or employees of the Corporate Debtor itself. Whereas, the aftermath of this new development would also include a forth category called “other creditors”.

Development of the concept of creditors with regard to homebuyers

⁵Prabodh Kumar Gupta &Ors.v. JaypeeInfratech Ltd., 2017 SCC NCLT 10507.

⁶CP(IB) No. 77/ALD/2017.

While there is lack of adequate clarity for home buyers, the picture is not entirely grim. Soon after the admission of the applications of the home buyers in the *JaypeeInfratech Limited Case*⁷ a 14-member panel was set up to review the Insolvency and Bankruptcy Code (IBC) which would likely recommend such an amendment to the IBC. This means, in case of liquidation of a stressed real estate firm, the homebuyers will be third in the preference order to get proceeds — after the clearance of the cost of resolution and workers’ dues. The Government has now amended the Insolvency and Bankruptcy Code, 2016 allowing home buyers to be Financial Creditors of the company, in the garb of section 8(F) of the IBC, 2016 wherein “Financial Debt” means a debt along with interest, if any, which is “disbursed against the consideration for the time value of money and includes any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing”.⁸

Therefore once the homebuyers get the status of Financial Creditors, their representatives will be part of the committee of creditors (“COC”) that approves an insolvency resolution plan, failing which a stressed firm goes for liquidation. Their voting rights will be proportionate to the value of their advances. Thereby curbing the issues that they were subjected to pre-amendment. Corporate Affairs Secretary Injeti Srinivas said, “Even if one homebuyer moves the NCLT, the company can go for insolvency. That is the intention of bringing them into the creditors fold”⁹

Critical analysis

However, having considered the judicial precedents, prior to the amendment of the Code it becomes difficult to approach the NCLT for appropriate actions against the defaulting builders (who have promised assured returns for attractive bookings) under the Code. To bring under the umbrella and certain light of hope in consonance to the provisions of the Code prior to the Amendment, we can take into consideration Section 36 of the IBC, 2016 which elucidates the liquidation estates. This provision rightly so, specifies that the assets of the third party which are held by the Company as a trust shall not be a part of the liquidation process. Therefore in the light of which, we can construe the homebuyers to be the partial

⁷Supra note 6.

⁸Changes to IBC: Homebuyers to get financial creditor tag, FINANCIAL EXPRESS (March 22, 2018 5:36 AM),

<https://www.financialexpress.com/industry/changes-to-ibc-homebuyers-to-get-financial-creditor-tag/1106936/>.

⁹Just one homebuyer is all that is needed drag a rogue builder to bankruptcy court, THE ECONOMIC TIMES (Jun 07, 2018, 01:55 PM), https://economictimes.indiatimes.com/news/economy/policy/more-power-to-homebuyers-amended-ibc-will-ensure-builders-think-twice-before-defrauding/articleshow/64491470.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

owners of the flat and the Company holding it on their behalf in trust. Therefore as mentioned in the Code itself, it cannot be a part of the liquidation estate, thereby should ideally be utilised for the repayment of the homebuyers (Or, Creditors). By virtue of which, even the makers of the Insolvency and Bankruptcy Code, 2016 had in their mind protecting the interests of the helpless homebuyers. Consequently, throwing light into the intention and the aspiration of the legislator, the Homebuyers coming within the category of stakeholders should be given the utmost right of application before the Adjudicating Authority with regard to the claims.