



IBC 2018 AMENDMENT, A VIABLE SOLUTION TO THE HOME-OWNERS PROBLEM?

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The introduction of the Insolvency and Bankruptcy Code (IBC) is considered as one of the most important developments in the history of Indian Corporate law. Before the inception of the IBC, there was a lack a single and unified law dealing with insolvency and bankruptcy of corporate working across different fields, which led to a distressed credit market. In fact, individual bankruptcy laws for different corporate sectors have existed in India since 1874. Some of the past legislations which aimed at regulating insolvency include the Transfer of Property Act, 1882, The Companies Act, 1956, The Sick Industries Companies Act, 1985, The Recovery of Dues to Banks and Financial Institutions Act, 1993 and the SARFAESI Act, 2002. By the year 2010, it had become clear that a single and comprehensive framework would be required to effectively tackle the delay which was being noticed in the insolvency and bankruptcy proceedings due to a lack of clarity on the applicable legislations and the processes to be followed. The average time to resolve an insolvency proceeding in India had reached 4.3 years, a record far worse than in any developed nation.¹ As a result, the government of India introduced the IBC, which aims at consolidating and amending

the laws relating to re-organization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner. It was first introduced in the Lok Sabha in December 2015 but was passed only by the 5th of May, 2016.² The president gave his assent to the code on the 28th of May 2016.³ The Code has been touted as a uniform and comprehensive piece of legislation which guarantees a simplistic and speedy method for corporate insolvency.

This process of insolvency under the Code can be initiated by either a corporate debtor, a financial debtor or by the corporate debtor itself.⁴ The differentiation of creditors is done as per the definitions of the same laid down in section 5(8) and 5(21) of the Act. However, anyone outside of the definitions provided in the aforementioned section cannot initiate such proceedings, even if they have invested their hard earned money into the projects of any corporate debtor. Further, once the proceedings have been initiated under the IBC, the first step in the corporate insolvency resolution proceedings is the suspension of the board of directors and the appointment of the interim resolution professional, who would, from this point onwards, have total control over the activities of the company. Along with the handing over of the control to the IRP, a moratorium takes effect, prohibiting, among other things, the initiation of any suits

² ET Bureau, *Lok Sabha passes bill to fast track debt recovery*, The Economic Times (Aug. 2, 2016), <https://economictimes.indiatimes.com/news/economy/lok-sabha-passes-bill-to-fast-track-debt-recovery/articleshow/53495364.cms>.

³ The Insolvency and Bankruptcy Code, No. 31, Acts of Parliament, 2016. (Hereinafter "IBC")

⁴ *Id.* at §§ 7, 9, 10.

¹ Ashish Pandey, *The Indian Insolvency and Bankruptcy Bill: Sixty Years in the Making*, 8(1) IMJ 26, 28 (2016).



against the debtor, the transfer of its assets and the recovery of any property from it by any known lessor.⁵ The IRP then verifies the claim made by the creditors and forms the Committee of Creditors within a month of his appointment. The Committee of Creditors consists of all the financial creditors of the Corporate Debtor. This Committee of Creditors, along with a resolution Professional appointed by them then devises a resolution plan for the revival of the insolvent company which then needs to be approved by creditors holding at least 75% of the financial debt. If the Plan is Accepted, it is sanctioned by the NCLT and is adopted, thus becoming binding on all the stakeholders involved in the CIRP. If the resolution plan is not approved, the distribution is made in accordance with a “priority waterfall” of creditors set out in Section 53 of the Act which provides for money to be returned to Secured creditors, wages, unsecured creditors and other financial and operational creditors, in that order.

As can be seen from the above process, the IBC is not a sectoral law i.e. it has a wide scope and application and doesn't cater to the demands of any particular industry. This unique feature of the IBC has become a double edged sword. Since it caters to no particular industry, the models and practice of certain industries like the real estate industry has shown the existence of certain lacunae in the provisions of the IBC. This has forced the government to enact various amendments to the Code to cover the various grey areas that have surfaced since the inception of the code. Among these

amendments are the 2017 amendments to deal with the issue regarding the eligibility of certain classes of promoters to bid for projects, which also put certain safeguards to prevent persons from misusing the provisions of the code. Another more recent amendment to the Code has been forced by the case of Chitra Sharma vs. the Union of India.⁶ The same was a PIL filed by thousands of aggrieved home owners against a decision taken by the Ahmadabad bench of the NCLAT in the insolvency proceedings initiated by IDBI bank against the Jaypee group for its Wish city project. The decision taken in these cases led to the recent amendments of 2018 which will be analysed in this paper. But before we get to an analysis of the amendment, it is important to understand the facts of the Jaypee case and problem in the IBC highlighted by the same.

In the aforementioned case, two subsidiary groups of the Jaypee groups had undertaken the Jaypee infratech project, aimed at the construction of its wish-town city project in Noida. The allocation letters were sent to homebuyers against the payment of an advance which totaled to approximately 15000 Crores from around 35,000 homebuyers. Even years after its inception, the project still remained in its early stages and this fact paired with the recent allegations that the project was just a means to siphon money by Jaypee to its other projects led the IDBI bank, which had advanced to the company a loan of Rs. 526 Crores (approximately), to initiate Insolvency proceedings under Section 7 of the Code. Aggrieved by the slow pace of the projects,

⁵ *Id.* at § 24.

⁶ Chitra Sharma v. Union of India, Writ Petition (Civil) No. 744/2017 (Supreme Court).



the homeowners aimed at getting their grievances redressed through the National Consumers Disputes Redressal Commissions (NCDRC) which however, refused to adjudicate on the same since the issue raised did not come within the ambit of the jurisdiction provided to the NCDRC as a result of the moratorium declared by the NCLT under Section 14 of the Code. The same was the case with any relief promised to the home-owners under the RERA, 2016. Having all other recourses blocked, the home-owners finally approached the Supreme court under article 32 of the Constitution seeking an appropriate remedy. The Supreme Court ordered a stay on the insolvency proceedings of the Jaypee group, acknowledging the fact that if the proceedings were allowed to go through, it would be huge violation of the rights of the home-owners. The Supreme Court further ordered a committee to look into the issues being faced by the home-owners community as a result of the provisions of the Code. It was then realized and decided by the Supreme Court to consider the impact of merely looking the other way at a huge community contributing their life savings to a project and not being given justice. Taking a look at the present market, the growth of real estate projects are on a ever time high and if home buyers continued to be considered in the ambit of unsecured creditors, justice would not be adequately rendered to all.

The case of *Chitra vs. Union of India*⁷, brought forth two main issues in the provisions of the IBC with respect to the home owners as a community of investors.

⁷ *Id.*

The first among these was the fact that even though most of the finance for the completion of such projects came through the advance payments made by the home owners, the community in itself is not included within the ambit of a creditor as defined by the IBC in Section 5. Section 5(7) of the Act defines a financial creditor as anyone to whom a financial debt has been owed. The act goes on to define financial debt in section 5(8) but this section does not account for advance payment by consumers hence keeping the home buyers outside the purview of a financial creditor. The rationale behind this was deliberated in the case of *Pawan Dubey and Ors. Vs. J.B.K developers*⁸ wherein it was held that the agreement between the home owners and developers was merely a purchase sale agreement and cannot be deemed as a loan or advancement of credit. Furthermore, the NCLAT⁹ held that the home owners could not be considered as within the definition of operational creditors either. This has a very adverse effect on the rights of the home owner's community. The fact that they do not stand as either financial or operational creditors means that not only can the home owners not initiate insolvency proceedings against the builders¹⁰, but it also ensures that they have no representation in the Committee of Creditors which decides the resolution plan and votes on whether the company should be declared insolvent or not. This means that the community most affected by the outcome of the resolution process is given no say in the matter.

⁸ *Pawan Dubey and Ors. v. J.B.K developers, Company Appeal (AT)(Insolvency) No. 40 of 2017 (Aug. 3, NCLAT).*

⁹ *Id.*

¹⁰ IBC at § 7.



Furthermore, the exclusion of the home-owners as creditors of the company ensures that they fall dead bottom in the waterfall envisaged for the distribution of assets once the company is declared bankrupt. Thus they would not only face severe haircuts, but would also lose the allotted units which would have to be sold off as assets of the construction company. The only exception to this is seen in cases of agreements where the unit is bought under as “assured return” plan. The NCLAT in the case of Nikhil Mehta vs. AMR Infrastructure¹¹ ruled that the as assured-return purchase is to be considered as an investment into the project being developed. Emphasis was laid on to the fact that the buyers were investors as they had “chosen” the committed return plan and as per the agreement, the developers had in turn agreed to pay a monthly committed return on such investments. The same was upheld by the NCLAT in the decision on Anil Mahindroo And Ors. Vs. Earth Iconic Infrastructure Pvt. Ltd.¹² However, in both these decisions, no clarity has been given to the situation of home owners who have not included such clauses in their contract thus holding up their exclusion from the realm of creditors under the IBC.

The second issue highlighted by the Jaypee case was the lack of representation provided to the community of home-owners against developers undergoing proceedings under the IBC. Before the inception of the IBC, even when insolvency proceedings were

going on against developers, the home owners as consumers could approach forums like the NCRDC to safeguard their rights and interests. Apart from the consumer forums, the government had also enacted the RERA or the Real Estate (Regulation and Development) Act, 2016 which provided aggrieved home-owners with some security against defaulting developers. However, since the passing of the IBC, it has become impossible for the home-owners to take shelter under any of these legislations once insolvency proceedings begin against defaulting developers. Section 238 of the Act specifically states that “*The provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.*” Further, Section 14 of the Code prohibits the “*institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority*”. Under this section, at the onset of any insolvency proceedings, the NCLT orders a moratorium on the debtor's operations for the period of the IRP. This operates as a 'calm period' during which no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can take place against the debtor. The provisions of section 14(1)(a) of the Code are very wide and appear to be a complete bar against the institution or continuation of suits or any legal proceedings against a corporate debtor on the declaration of moratorium by the adjudicating authority. This moratorium

¹¹ Nikhil Mehta v. AMR Infrastructure, Company Appeal (AT) (Insolvency) No. 7 of 2017 (July 21, NCLAT).

¹² Anil Mahindroo And Ors. v. Earth Iconic Infrastructure Pvt. Ltd., Company Petition no. (IB)-16(PB) 2017 (Feb. 20, 2017).



period is till the life of the resolution proceedings goes on or till liquidation occurs. When read with one another, Sections 14 and 238 basically bar any other form of redressal that can be availed by the home-owners against such defaulting companies and as can be seen above, the IBC in itself does not provide any sort of representation to the home owners, thus leading to a lack of even basic remedy to the community. This provides the defaulting company a loophole to avoid a large chunk of their debt as whenever a suit is initiated against such a company, the debtor would just initiate insolvency proceedings which in itself will quash any cases faced by it in any other forum. Looking from another angle, the burden of the NCLT also multiplies as decisions that could be adjudged by another court that also has jurisdiction would reduce the burden of NCLT's and increase the efficiency of the code in initiating insolvency proceedings. Whereas, here there is just a blanket provision provided under the code that makes the proceedings initiated under this code supersede any other proceeding initiated in another court of law. In most cases of insolvency the recovery rate of debts vary from case to case but predominantly all cases, the debts are all not cleared off. Unsecured creditors being last in line of the creditors to be paid upon passing of the resolution tend to lose all the money they were bound to be paid. With the moratorium in place and then extent of power given to it by the code under Section 14, no other recourse can be opted by approaching a different forum. The economy is taking a hit with home-buyers, ie, effectively a large chunk of the average income groups of the country investing in property and projects are losing out of their

investments without even a scope of a considerable recovery which leads to drain of money from the hands of the people which directly affects the economy of the country. For money to remain in the hands of the people, their investments need to be protected and need to be given an effective redressal in cases where there is any infringement.

To overcome these issues brought up during *Chitra vs. Union of India*, the Government of India enacted the IBC amendment ordinance which was green-lighted by the president on the 24th of June 2018. The amendment aimed at tackling the issues faced by the home-owners by firstly changing the definition of financial debt under section 5 of the Code. The definition has been altered to include any amount raised from home-owners under a real estate project. This has been achieved by classifying the home-owners as a 'allottees' under 'real estate projects'. These two terms have their respective meanings as defined by the Real Estate (Regulation and Development) Act, 2016 (RERA)¹³, according to which, any such amount raised will be deemed as having a commercial effect of a borrowing and hence, the allottee will now be treated as 'financial creditors'. This change in itself was touted to be the solution for half of the problems faced by the home-owners as a community. Since they now come within the ambit of financial creditors, home-owner can now initiate the Corporate Insolvency Resolution Proceedings under section 7 of the code. Furthermore, it grants them the right to be

¹³ Real Estate (Regulation and Development) Act, No. 16, Acts of Parliament, 2016 at §§ 2, 14(3), 18, 19(4).



represented at the Committee of Creditors and guarantees them the receipt of at least the liquidation value agreed upon on the resolution plans. Though the ranking of the homebuyers have been upgraded, there is no clear demarcation as to if adequate representation will be provided to the homebuyers. Perhaps the initial dilemma of having representation is resolved albeit the extent of representation is not specified. The problem is a practical one. As per the IBC, the representation in the committee of creditors is based on the class of creditors. If more than 10 classes of creditors are there, then the IRP/RP must appoint three more Resolution Professionals to represent each class of creditors. With homebuyers being raised to the pedestal alongside other financial creditors, the representation of homebuyers will still be as a group of financial creditors and will not be specific. Each financial creditor can have voting rights in the committee of creditors depending upon the extent of financial debt owed to him.

There is no real clarity with regard to how the representation made in the committee of creditors, or how the voting rights are granted. The real reason the ordinance included homebuyers within the ambit of financial creditors is to increase the power of the homebuyers in the pecking order of creditors during the initiation of resolution proceedings, as mentioned in the preamble of the ordinance. If the insolvency proceeding is initiated against a developer, the financial creditors other than homebuyers would be significantly smaller. If the extent of representation is not clearly demarcated then the homebuyers again are put to a disadvantage. If the representation

of homebuyers is as a whole, then again the representation would not be adequate in certain cases. When looked upon from a critical perspective, the Ordinance needed to do away with the evil of this ambiguity within the IBC, especially since the ordinance aimed at promoting the rights of homebuyers, a more clear, distinct and particular position of representation in the committee of creditors should have been a suggested inclusion.

In cases where the number of homebuyers is a huge figure, there is no relief or recourse that clearly states the safety protection provided to each homebuyer that his individual and personal rights will be upheld. Here again representation comes into the fore. When each and every homebuyer has distinct claim, each person's right will not be adequately represented thereby not tendering justice uniformly. Furthermore, even though they have been included as financial creditors in the 2018 amendment, the class of financial creditors they belong to has not been mentioned. A look at section 53 of the Code shows us that in the payment waterfall, the first ones to get paid are secured creditors, followed by employees, unsecured creditors, operational creditors and sundry. In this scheme of events, unless the home-owners are not put into the class of secured creditors, they will be the community that faces the biggest haircut amongs all the creditors. Taking the Jaypee infratech insolvency case in hand, the company going through insolvency owed around 600 crores to secured creditors like the IDBI bank whereas the home-owners community had advanced to them as much as 1500 crores. If the home-owners do not rank as financial creditors, they will



receive the money due to them only after the insolvent company has paid back the money owed to banks and their employees. The remainder of the assets left, will have to be shared by the home-owners as a return on their 1500 crore investment. This clearly shows that there isn't much of an improvement in the situation of home-owners even after the enactment of the 2018 ordinance to the code.

The second issue, relating to the moratorium and alternate remedies available to the home-owners in case of liquidation proceedings has not been addressed by the amendment at all. The ordinance also merely excludes the corporate guarantors from the moratorium as per Section 14(3) but has avoided allowing the continuation of ongoing disputes in alternate forums. The only exception to this rule was provided by the appellate tribunal in the case of *Canara Bank vs Deccan Chronicles Holdings Limited*¹⁴ wherein it was held that the moratorium will not affect any proceedings initiated or pending before the Supreme Court under Article 32 of the Constitution of India or where an order is passed under Article 136 of the Constitution of India. The NCLAT also concluded that the moratorium will not affect the powers of any High Court under Article 226 of the Constitution of India.

The one positive thing to take away from the amendment is that the ordinance has amended section 28 of the act to reduce the voting threshold for all activities during the insolvency proceedings from 75% to 66% of

the total voting share.¹⁵ This comes as a welcome change keeping in mind that the main aim of the Code was to ensure that alternate solutions to winding up can be pursued. It also helps the home-owners avoid the haircuts they would face by allowing them to stop the defaulting company from going into bankruptcy proceedings. This amendment to section 28, when allied with the fact that home-owners will be a part of the Committee of Creditors and will have voting rights, gives a spark of power to the home-owners community to have a say in projects they have invested their life's earnings in. However even this shred of power is shrouded in ambiguity regarding the amount of representation being actually afforded to the home-owners community.

A cursory look into the amendments brought about by the 2018 ordinance makes it clear that the same is nothing but an eye-wash, aimed at providing momentary respite to the government from the agitated home-owners community. The ordinance has barely improved the situation of the home-owners from earlier as, in effect, the only change that has been brought about is that now, home-owners can initiate insolvency proceedings against defaulting companies in the scope of financial creditors and a substantial hope for recovery of money. The rest of the changes brought about are either ineffective towards solving the problem or are shrouded in too much ambiguity to be of any actual help to the home-owners. The

¹⁴ *Canara Bank v. Deccan Chronicles Holdings Ltd., Company Appeal (AT) (Insolvency) No. 147 of 2017 (Sept. 14, NCLAT).*

¹⁵ Rahul Jain, *An overview of the Insolvency and Bankruptcy Code (Amendment) Ordinance 2018*, **TAXGURU** (June 12, 2018), <https://taxguru.in/corporate-law/overview-ibc-amendment-ordinance-2018.html>.



ordinance has failed to deal with any of the issues brought up in the Chitra vs Union of India in a scenario where finding solutions to the problems should've been relatively easier with legislations like the RERA, 2016 already in place. One of the most basic solutions to the problems faced by the home-owners has already been provided in the IBC. As per the recent judgment in the dispute of Alpha & Omega Diagnostics (India) Limited Vs Asset Reconstruction Company of India Limited¹⁶, the honorable judges in the NCLT held that the term it's used in the section would denote only those properties that are owned by the Corporate Debtor. Any properties that are not on the books of accounts of the Corporate debtor would not come under the ambit of the moratorium imposed under the IBC. One way of using this for the advantage of the home-owners is by treating the properties for which advance has been paid as properties owned by the home owners in possession of the corporate debtor. This would provide the home-owner with security against the abuse of the moratorium by the corporate debtors as litigations against the slow development of these properties can be initiated even after the initiation of insolvency proceedings against the corporate debtor. This would open the doors to allowing the home-owners the protection promised to them under acts like the Consumer Protection Act, 1986 and the RERA, 2016. Another small change that would go a long way in solving the problems of the home-owners would be to lay down a section governing the

composition of the committee of creditors and clarifying the position regarding the representation of the same in a meeting thereof. The voting rights of each creditor should also be clearly demarcated and some light should be shed on the provisions of Section 21(6A) which talks about the appointment of a authorized representative appointed by the adjudicating authority who will be representing a class of creditors "exceeding the number as may be specified."

Unless the aforementioned concerns regarding the moratorium, the representation and the classification of home-owners in the scheme of the IBC are dealt with in a better manner, the Code will not be able to achieve its objective of providing for a faster and more efficient method for dealing with corporate insolvency. Rather, these issues will lead to a backlog amongst the cases in the NCLT and other forums since the smooth and effective functioning of the NCLT will be hampered with corporate debtors trying to run away with a quick buck while the proceedings against them in all other forums are stayed. The changes introduced by the ordinance of 2018 was aimed at fine tuning some of these issues and ambiguities caused by the original provisions of the IBC, but, have failed to do so, especially in the context of the home-buyers. Having overburdened the NCLT with litigation, the legislation owed the duty to the judiciary to simplify its working by laying down a more certain and less ambiguous construction of the letter of the law but has instead gone for changes that seem to be nothing but an eye wash aimed at quick diffusion of a unstable situation.

¹⁶ Alpha & Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd., Company Appeal (AT) (Insolvency) No. 116 of 2017 (July 31, NCLAT).
