



HOME BUYERS ARE FINANCIAL CREDITORS & CAN TRIGGER DEVELOPER INSOLVENCY

14 August 2019

The Supreme Court, in its much awaited judgment, has upheld the status of home buyers as financial creditors under the Insolvency and Bankruptcy Code 2016. Significantly, while the right of home buyers to trigger insolvency against a developer has been upheld, the Court has also sought to balance the interests of developers by building in reasonable safeguards in favour of genuine developers.

Introduction

On 08 August 2019, the Supreme Court of India ("**Court**") delivered its judgment ("**judgment**") in *Pioneer Urban Land and Infrastructure Ltd. and Anr. v. Union of India and Ors., Writ Petition (Civil) No. 43 of 2019*, wherein it has upheld the amendment made to the Insolvency and Bankruptcy Code 2016 ("**Code**") which confers upon home buyers the status of "financial creditors" under the Code.

Numerous writ petitions were filed before the Supreme Court challenging the constitutional validity of amendments made to the Code pursuant to the Insolvency Law Committee's report dated 26 March 2018. The amendments so made deem allottees of real estate projects as "financial creditors" for them to trigger insolvency proceedings under Section 7 of the Code against the real estate developer ("**developer**"). Additionally, they are now empowered to vote on a resolution plan as part of the Committee of Creditors ("**CoC**"). Importantly, while upholding the validity of the amendments in favour of the home buyers, the Court has also safeguarded the interests of developers against fraudulent and motivated insolvency applications.

Home buyers status as financial creditors upheld

The Court observed that home buyers finance real estate projects by paying amounts in advance to the developers for construction of the project. Therefore, like banks and financial institutions, home buyers should also be classified as financial creditors.

Documentary evidence for amounts being due and payable by the developer is required to be furnished by the developer compulsorily under Real Estate (Regulation and Development) Act, 2016 ("**RERA**"). This information can be used by home buyers to approach the NCLT for initiating insolvency proceedings.



Voting rights of home buyers as members of committee of creditors

The Court upheld the right of home buyers to vote on resolution plans as members of the Committee of Creditors (“CoC”). To assuage concerns that home buyers may not cast votes as one homogenous group, the Court stated that under the Insolvency and Bankruptcy Code (Amendment) Bill, 2019, the home buyers can through their common authorised representative, cast votes only in two ways – either to approve or disapprove a resolution plan. Any decision taken by a vote of more than 50% of the voting share is binding on the group.

Multiple remedies available to home buyers against developers

It is clarified that home buyers can simultaneously proceed against errant developers under the Code, RERA and Consumer Protection Act, 1986. Remedies available under RERA and the Code are independent of each other, however in case of a clash the Code will prevail. This establishes the supremacy of the Code.

Defences to an insolvency application available to a developer

The Court has acknowledged that delay in delivery of possession by developers may, in certain cases, be attributed to factors other than default by developers. Some instances of defences which the developer may plead before the NCLT are:

- the home buyer is itself a defaulter;
- the insolvency resolution process has been invoked fraudulently, or for purposes other than of resolution of insolvency;
- the home buyer is a speculative investor and not a person who is genuinely interested in purchasing a flat;
- in a deteriorating real estate market, the home buyer, does not, in fact, want to go ahead with its obligation to take possession under RERA but wants to use coercive measures to get back the money already paid by it.

No mechanical admission of insolvency petitions by nclt against developers

In a significant departure from the standard procedure adopted while dealing with applications filed by financial creditors under the Code, the Court observed that the hearing of an insolvency application by a home buyer is not expected to be one-sided. The court clarified that the period of 14 days given to the NCLT for



decision making on admission of insolvency applications filed by financial creditors is not mandatory. The NCLT must pass a reasoned order after fully appreciating the facts placed before it by both the home buyers and the developers.

Key Takeaways

Developers should ensure timely and accurate uploading of RERA records to ensure accurate information is made available to the NCLT in case a home buyer seeks to initiate an insolvency proceeding.

Since the NCLT is required to form a preliminary view regarding the default by the developer before admitting a petition, the developers should ensure all defences are placed at the initial hearing stage.

Recognizing that an insolvency application maybe admitted against a developer for reasons beyond its control despite the developer having a strong and stable management, the developer itself could, subject to meeting the eligibility requirements under the Code, offer a resolution plan.

Conclusion

The Supreme Court while continuing to adopt a hands-off approach in matters of constitutional challenges to the Code, has sought to balance equities between home buyers and real estate developers.

The fact that home buyers can now continue to approach the NCLT under the Code would keep errant real estate developers in check. At the same time, by holding that the defences put forth by the developers should be properly considered, the Court has ensured that merely because a home buyer has been classified as a financial creditor, a Section 7 application against a developer is not mechanically admitted, as opposed to applications filed by banks.

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R&I India Flash Report is published by the firm's Restructuring & Insolvency practice group. For further information regarding this publication please do not hesitate to contact restructuring.insolvency@khaitanco.com or any of the following partners who are members of the R&I practice group: <https://www.khaitanco.com/rigroup.aspx>

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