



The intrinsic right - of Home Buyers or Secured Lenders under the Insolvency and Bankruptcy Code, 2016

The introduction of the most complicated legislature Insolvency and Bankruptcy Code, 2016 (“Code”) was welcomed by the creditors, as well as the debtors in December 2016. Its implementation is raising new issues on its effectiveness which necessitate resolution on an expedited basis. The most discussed issues *inter alia* the others is the place of "property buyers/home buyers" and their standing *visa vis* other creditors order of payment by the entity against whom the Corporate Insolvency Resolution Process has been triggered.

The Code provides strict timelines aiming to speed up the resolution process within a period of 180 days, with a possible extension of 90 days, by appointing insolvency resolution professionals, who will take charge of the company's operations and prepare a resolution plan which shall be binding on the corporate debtor (the company) and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.

The rules do not deal with respect to the treatment to the stakeholders, other than the financial creditors (the banks) and operational creditors, which includes vendors and others who may have dues. The waterfall mechanism providing order of priority in which the proceeds from the sale of liquidation assets are distributed as per Sec.53 of the Code are as follows:

- a. *The insolvency resolution process cost and the liquidation costs paid in full.*
- b. *The following debts which shall rank equally between and among the following:*
 - i. *workmen’s dues for the period of twenty-four months preceding the liquidation commencement date; and*
 - ii. *debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;*
- c. *Wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;*
- d. *Financial debts owed to unsecured creditors;*
- e. *The following dues shall rank equally between and among the following:—*
 - i. *any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;*
 - ii. *debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;*
- f. *Any remaining debts and dues;*
- g. *Preference shareholders, if any and*
- h. *Equity shareholders or the partners as the case may be*



The insolvency proceedings initiated against prominent builders like Jaypee Infratech, Amrapali etc., has impacted more than 31,000 homebuyers. In terms of the aforesaid waterfall mechanism their vulnerability stems from the fact that they figure very low in the creditors order for payment of dues. The Code stipulates that once a defaulting builder's properties are liquidated, the proceeds must first be used to recover liquidation costs, pay workmen such as security guards, settle the dues of banks and financial institutions, pay the salaries of other employees and clear government dues. Homebuyers come only towards the end of the pyramid, which means that after meeting all statutory obligations, there might be no funds left of the insolvency proceeds to settle their dues.

The Supreme Court Bench led by Chief Justice of India Dipak Misra on the basis of the argument made on behalf of over 30,000 home buyers, who have not yet been given the possession of their flats in 27 different projects of Jaypee Infratech stayed insolvency proceedings instituted against real estate giant Jaypee Infratech by the Allahabad Bench of the National Company Law Tribunal (“**NCLT**”). The buyers said the proceedings under the Code gives priority in clearing the debts of secured creditors like banks and financial institutions and leave “unsecured creditors” in this case the individual flat buyers who have invested their hard-earned money for a roof above their heads, in the lurch, penniless.

The petition argues that certain provisions in the Code violates Articles 14 (right to equality) and 21 (right to life) of the Indian Constitution thereby “curtail the legal statutory and vested rights of the flat owners/buyers as consumers” defined under the Consumer Protection Act. One negative leads to another and at the end of the day we need to break the vicious cycle and think of ways and means to revive the real estate sector.

The Insolvency and Bankruptcy Board of India (“**IBBI**”) has amended rules to mandate that any resolution plan for a company has to explicitly state how it has dealt with the interests of all stakeholders. Insolvency experts have said that in case of real estate disputes, this will protect the rights of homebuyers who have invested their hard earned money in housing projects. However, homebuyers are unhappy and have termed it a “cosmetic” modification and say that this does not provide them “meaningful protection.”

The IBBI on 16th August 2017, introduced Form F for those Creditors who do not fall under the category of financial creditors and operational creditors. It is still not clarified whether this third type of creditor can initiate insolvency proceedings before the NCLT. Form F puts home buyers in the category of residuary creditors who do not have precedence over secured financial creditors (banks/financial institutions) in case of liquidation of the real estate company, allege homebuyers.



A 14-member panel, chaired by Mr. Srinivas, is working to identify and suggest ways to address issues faced in the implementation of the Code. Mr. Srinivas stated that “There is a feeling that this law is skewed a little too much in favour of financial creditors. It is not adequately addressing the requirements or expectations of other stakeholders. It is a serious area we have to look at. The committee is looking at all the issues”. Among others, issues such as whether the insolvency process should be governed by liquidation value or enterprise value would also be looked into? What are the rights of home buyers? What is the capacity of insolvency professionals?

What makes real estate in India peculiar is that the builders were funding the project by two means, firstly by the advance money from homebuyers and secondly loan from the Banks secured by the flats to be constructed. In the default scenario by the Builders the money to be repaid to the banks shall be by sale of the under construction flats as the primary security against the loan. This jeopardizes the rights of the home buyers, as the advance money extended by the buyer is unsecured. In India the home buys pay before the completion certificate or a minor percentage is paid after receiving the possession certificate and actual possession, whereas in other countries the homebuyers pay money only after the construction is complete. Though with recent enactment of Real Estate (Regulation and Development) Act, 2016 the home buyers are safeguarded on this front as the advance payment by the homebuyers is directly linked to stage wise construction.

Although safeguard to the financial lenders and speedy recovery of debts is need of the hour, the court and law makers should also bear in mind that the banks and other financial institutions extended finance as a pure commercial transaction having clear projected profits, as well as losses along with other risks. The banks and financial institutions invest in various companies with projected risks whereas the home buyers who have extended finances have invested their hard earned money in the basic civil right to own a home, they have not invested from a commercial angle or accounted for any risks involved. The Banks and financial institutions enjoy the profits in various projects during their peak cycle; they should equally own the losses in case of reverse scenario, while the liability of the home buyers should be limited and secured by the government, as they are customers and not investors thereby having the intrinsic right on the project. Hence, the law makers should come-up with exceptions in the waterfall mechanism by providing highest priority to the homebuyers and similar stakeholders across sectors.

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