

RERA ALLOTTEES' RIGHTS UNDER THE IBC



The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 gives allottees, as defined in the Real Estate Regulation and Development Act, 2016 (**RERA**), the same rights as financial creditors under the Insolvency and Bankruptcy Code, 2016 (**IBC**); the amounts paid by allottees are

deemed to have the commercial effect of a borrowing.

The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2018, issued on 04 July 2018, clarify the process by which allottees can exercise their rights as financial creditors (i.e., through authorised representatives).

Property purchasers' position pre IBC amendment

Before the amendment of the IBC, property purchasers (including home buyers) were neither operational creditors nor, save in exceptional circumstances, financial creditors under the IBC and therefore were not entitled to initiate IBC proceedings. In addition, if IBC proceedings were initiated against a property developer entity by a third party, property purchasers were not adequately protected. As “other creditors” under the IBC, they had no right to representation on the IBC “committee of creditors”, and low priority in the liquidation waterfall.

They also could not continue to pursue RERA or consumer or civil proceedings against the property developer during the IBC process – the IBC states that once insolvency resolution proceedings are initiated against a company, there will be a moratorium prohibiting (among other things) the institution of suits or continuation of pending suits or proceedings against the company and even the recovery of any property by an owner where such property is occupied by or in the possession of the company. The moratorium possibly even restricts the ability of the

RERA authorities to direct, on a developer's default, that a defaulting project be taken over and completed by a third party.

The vulnerable position of property purchasers in IBC proceedings was recognised in the case of *Chitra Sharma and Others v. Union of India and Others* filed in the Supreme Court with respect to the insolvency resolution of Jaypee Infratech Limited. One of the grounds taken in this public interest litigation on behalf of property purchasers was that property purchasers were disadvantaged because they were neither operational creditors nor financial creditors under the IBC.

Property purchasers' position as IBC financial creditors

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The IBC amendment ordinance has significantly changed this position, deeming property purchasers to be financial creditors by amending the definition of financial debt to state that any amount raised from an allottee under a real estate project will be deemed to be an amount having the commercial effect of a borrowing. With the inclusion of this new provision in the IBC, property purchasers have been put on a much better footing. The IBC rules and regulations relating to financial creditors will now also apply to property purchasers.

Initiation of IBC proceedings

The inclusion of property purchasers as financial creditors gives them the right to initiate insolvency proceedings under the IBC against developer companies and LLPs. Whether or not to actually exercise this right in any individual case will be a strategic decision for each property purchaser; property purchasers may prefer to initiate RERA proceedings over which they may have more control and in which they may be more likely to actually obtain the property paid for rather than just getting back the amount they had paid, along with interest, as a financial debt.

Participation and voting in "committee of creditors" meetings

On account of property purchasers being financial creditors, they will be entitled to participate and vote, in most cases through a single authorised representative, in "committee of creditors" meetings under the IBC. The "committee of creditors" is the body that takes important decisions regarding the insolvency resolution process of a particular corporate debtor, including the decision of whether or not to approve a proposed insolvency resolution plan. Each member of the committee has a vote equivalent to the proportion of the debt owed to it. The recently amended IBC regulations describe the procedure to be followed for the appointment of the authorised representative and the manner in which the representative is to collect the votes of the creditors they represent.

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Protection as "dissenting financial creditors"

In case property purchasers are not protected by the resolution plan adopted, as financial creditors, they will now have the right to dissent to the resolution plan in the "committee of creditors" and will be protected as "dissenting financial creditors"; dissenting financial creditors have to be paid at least the liquidation value due to them *before* any recoveries are made by the financial creditors who voted in favour of the resolution plan.

Property purchasers vis-à-vis other financial creditors

The inclusion of property purchasers as financial creditors under the IBC could be of concern to other financial creditors, including banks and NBFCs, who may be apprehensive that their rights under the IBC have been diluted.

It is true that the inclusion of an increased numbers of creditors in the "committee of creditors" will mean that the voting share of creditor banks and NBFCs will be proportionately reduced. As mentioned above, each member of the committee has a vote equivalent to the proportion of the

debt owed to it. However, the IBC amendments provide voting rights to each property purchaser, and not to property purchasers as a collective. Creditor banks and finance companies will therefore generally maintain significantly more influence in any “committee of creditors” than any individual property purchaser, subject of course to the facts of each case.

The amendment ordinance has also reduced the voting percentages required for important decision-making by the “committee of creditors” from 75% to 66%. Financial creditors will therefore need a lower majority on the committee to drive through a resolution plan. In addition, the IBC protections with respect to “dissenting financial creditors” will be equally applicable to banks and NBFCs as they will now be to property purchasers.

Secured or unsecured creditors and liquidation waterfall

One area that the amendment ordinance does not clarify is the rights of property purchasers in case the corporate insolvency resolution is unsuccessful and the provisions of the IBC with respect to company liquidation are triggered. When liquidation is triggered, the IBC provides that the assets of the corporate debtor are sold through the liquidator and the proceeds distributed to the creditors in a specified order of priority, after which the company or LLP may be dissolved.

In this liquidation waterfall, secured creditors are given a higher position than unsecured creditors (they are paid back before unsecured creditors). In addition, they also have the option to opt out of the liquidation process entirely and directly realise their security interests to recover the debts due to them.

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Generally, bank and NBFC financial creditors of a company will be secured creditors. The IBC amendments do not clarify whether property purchasers will be treated as secured or unsecured financial creditors. The March 2018 report of the Insolvency Law Committee, on which the IBC amendments are based, merely provides that, in the event of liquidation, property purchasers “will fall within the relevant entry” in the liquidation waterfall. This does not clarify whether or not property

secured or unsecured
financial creditors.

purchasers will be treated as secured creditors under the waterfall mechanism.

Interestingly, even if property purchasers are treated as unsecured creditors, as unsecured *financial* creditors they will have a higher priority in the distribution of money at liquidation as compared to other unsecured creditors.

It is likely that the answer to this question will depend on the terms of the agreements for sale executed by individual property purchasers. The agreements may be worded so as to treat the advances paid by the property purchasers to developers as secured against the properties they are paid towards. However, this will be a matter that the courts will undoubtedly be called upon to decide.

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