'IT TAKES A VILLAGE TO RAISE A CHILD!' - THE DEVELOPMENT OF CORPORATE INSOLVENCY LAW IN INDIA FOR REAL ESTATE COMPANIES

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I. Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) came into effect on 28 May 2016.[1] Before this Code, there was no single law in India that dealt with insolvency and bankruptcy. The provisions pertaining to insolvency and bankruptcy were scattered across separate statutes like the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Recovery of Debt due to Banks and Financial Institutions Act, 1993 (RDDB Act), the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) and the Companies Act, 2013. While remedies were available under different legislations, to add to the chaos, these statutes provided for creation of multiple fora, such as Board of Industrial and Financial Reconstruction (BIFR), Debt Recovery Tribunal (DRT) and National Company Law Tribunal (NCLT), and their respective appellate tribunals. On the contrary, the liquidation process used to be concluded under the judicial supervision of the High Courts, and bankruptcy and insolvency of an individual was dealt by courts under the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. In simple words, the pre-existing framework was ineffective, inadequate and resulted in undue delays.

As per the long title of the IBC, it was enacted with an objective to consolidate and amend the laws relating to the reorganization and resolution of insolvency of corporate persons, partnership firms and individuals in a time-bound manner tilted towards maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interest of all stakeholders. It was deemed to provide an effective legal framework for timely resolution of insolvency and bankruptcy, which would, in turn, support the development of the credit market in India. The incidental benefit that comes with the Code cannot be discounted, which is that it promises to improve the ease of doing business in India and facilitate more investment, leading to higher economic growth and

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1 The Insolvency and Bankruptcy Code 2016.

development.

However, the Code as it was enacted, found it difficult to cater to the ground-level realities of the real estate industry. The business model of real estate companies is such that the allottees (generally termed as homebuyers), despite being crucial stakeholders, had no say in the corporate insolvency resolution process (CIRP). This paper aims to highlight the peculiar issues faced in the CIRP of a real estate company and how the legislature, judiciary and the stakeholders have worked together to develop a practical mechanism under the provisions of the Code, which could accordingly assist the CIRP of a real estate company. The author, while traversing the genesis of the industry-specific provisions in the Code, argues that to attain the objectives of the Code, every stakeholder must work in a concerted manner.

II. The Genesis of Real Estate Industry-specific Provisions in Code

The controversy was first highlighted when in June 2017, the Reserve Bank of India identified a list of the top 12 defaulters in the country, including one real estate company – Jaypee Infratech Limited, that were declared to be in default of an amount approximately of Rs. 8,000 crores to their lenders (the dirty dozen).[2] The RBI issued an advisory to the lenders of dirty dozen who, subsequently, initiated actions under Section 7 of the Code. The debt owed by the dirty dozen originated from the public deposits of the banks and financial institutions, who are answerable to their stakeholders. The Parliament thereafter enacted the Banking Regulation (Amendment) Act, 2017[3] to amend the Banking Regulation Act, 1949 (BR Act). This amendment introduced Section 35AA and Section 35AB in the structure of BR Act, empowering the Central Government to authorize the RBI, by an order,[4] to issue directions to any banking company to initiate CIRP in respect of a default as understood under the Code. The RBI constituted an Internal Advisory Committee (IAC) consisting primarily of its independent directors. The IAC took up for consideration accounts which were classified as either partly or wholly non-performing from amongst the top 500 exposures in the banking system, as on 31 March 2017. As a first step, the IAC recommended all such non-performing asset accounts with fund and non-fund based outstandings exceeding INR 5,000 crores. The IAC had initially taken up twelve accounts involving total exposure of INR 1,79,769 crores.[5] The dirty dozen consisted of these twelve accounts, against which directions were issued for banks to initiate CIRP under the Code.

While Jaypee Infratech Limited was undergoing proceedings under Section 35AA of BR Act read with section 7 of the Code, two separate cases under the Code concerning

2 N Kulkarni, S Jain and K Khandelwal, 'Market Reaction to the Banking Regulation (Amendment) Ordinance, 2017' (2017) RBI Mint Street Memo Series No. 03. See also GK Nidugala and A Pant, 'Lessons from NPAs crisis in Indian banks' (2017) 17(4) Journal of Public Affairs.

3 Banking Regulation (Amendment) Act 2017.

4 Banking Regulation Act 1949, s 35AA.

5 *Chitra Sharma v Union of India & Ors* (2018) 18 SCC 575.

the peculiarities posed by CIRP for real estate companies puzzled the NCLT and National Company Law Appellate Tribunal (NCLAT). These were the cases concerning *AMR Infrastructure Ltd*. and *Earth Organics Infrastructure*. The controversy emanated around the term '*financial debt*' as defined under section 5(8) of the Code. The Code defines 'financial debt' to mean a debt along with interest, if any, which is disbursed against the consideration for the time value of money[6] and *inter alia* includes money borrowed against payment of interest, etc. The confusion was whether the payments made by homebuyers to these companies fall within the definition of financial debt under the Code.[7] In both these cases, the NCLAT categorized the homebuyers as financial creditors due to the 'assured return' scheme in the contract, which was an arrangement wherein it was agreed that the seller of the apartments would pay 'assured returns' to the homebuyers till the possession of the property was given. It was held that such a transaction was in the nature of a loan and constituted 'financial debt' within the Code. However, it must be noted that these judgments were rendered, considering the terms of the contracts between the homebuyers and the seller/real estate company, making it a fact-specific categorization where a majority of the contracts entered into by homebuyers do not have clauses like those in the two cases. Nonetheless, these cases did bring to light the importance of homebuyers as vital stakeholders in a CIRP of a real estate company.

The substantial discussion on the importance of the homebuyers in the CIRP of real estate companies was catapulted by the proceedings emanating from the Jaypee Infratech Limited case. IDBI Bank Limited initiated an action against Jaypee Infratech Limited (Jaypee), which was admitted by NCLT, Allahabad Bench, unopposed by Jaypee and its management.[8] Resultantly, an interim resolution professional (IRP) was appointed and order of moratorium under section 14 of the Code was also issued.[9] The effect of a moratorium is such that it prohibits the institution of suits and the continuation of pending proceedings, including execution proceedings against the corporate debtor.[10]

This moratorium created a cacophony among the homebuyers of Jaypee, which included approximately 25,000 families.[11] The financial distress of Jaypee had been apparent for quite some time by then, as it regularly defaulted in its payments to the banks and failed to construct and deliver flats to the homebuyers in time. Many of these homebuyers had obtained loans from financial institutions as well. As a result of the delay in handing over

6 Insolvency and Bankruptcy Code 2016, s 5(8).

7 *Col Vinod Awasthy v AMR Infrastructure Ltd* 2017 SCC OnLine NCLT 16278; *Nikhil Mehta v AMR Infrastructure* 2018 SCC OnLine NCLAT 219; *Anil Mahindroo & Anr v Earth Iconic Infrastructure (P) Ltd* 2017 SCC OnLine NCLAT 216.

8 *IDBI Bank Ltd v Jaypee Infratech Ltd* 2017 SCC OnLine NCLT 12613.

9 ibid.

10 Insolvency and Bankruptcy Code 2016, s 14.

11 The Constitution of Committee of Creditors, as available on the website of the Corporate Debtor <http://www.jaypeeinfratech.com/communication/2019/Constitution_of_CoC-18_06_2019.pdf> accessed 27 August 2020.

possession, numerous homebuyers had filed consumer complaints before the State and National Consumer Disputes Redressal Commissions. Such consumer complaints were subjected to a moratorium imposed under Section 14 of the Code.

Aggrieved by the order, various homebuyers approached the Hon'ble Supreme Court of India in a batch of petitions invoking its jurisdiction under Article 32 and Article 136 of the Constitution of India, to protect the interests of homebuyers who had been left in the lurch. The lead matter in the batch petitions was captioned as *Chitra Sharma & Ors. v. Union of India & Ors*.[12] While the matter was still pending before the Supreme Court, two key things were happening at around the same time, which would go on to become a refined CIRP for real estate companies.

Firstly, The Hon'ble Supreme Court acted akin to an adjudicating authority under the Code, and supervised the CIRP of Jaypee, formulating a workable solution via its interim orders that later found substantial replication in the Code by the means of amendments. For example, the Hon'ble Supreme Court directed the IRP to proceed with the CIRP and appointed a representative to attend meetings of Committee of Creditors (CoC) on behalf of homebuyers and assist the CoC in their interest. This was later seen as an amendment to the Code[13] wherein a position of authorised representative was inserted to participate in the CoC meetings on behalf of a class of creditors.

Secondly, the legislature worked simultaneously to assuage the grievances of the homebuyers. For example, on 18 August 2017, the Insolvency and Bankruptcy Board of India (IBBI) released a press note clarifying that the homebuyers could fill Form-F for their respective claims, as they then did not fall strictly within any class of operational creditors or financial creditors.[14] Furthermore, the Insolvency Law Committee, 2018 provided substantial recommendations in this regard, which culminated into the Insolvency and Bankruptcy (Amendment) Ordinance, 2018.

Section 5(8) of the Code has been amended by the Insolvency and Bankruptcy (Amendment) Ordinance, 2018 with effect from 06 June 2018.[15] The real estate allottees (comprising both homebuyers and commercial structure buyers) were brought to the stature of a financial creditor under the Code. The amendment added an Explanation to section 5(8)(f) to state that "any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of borrowing". It further provides that the expressions, "real estate project" and "allottee" shall have the same meaning assigned to them under section 2(zn) and 2(d) of the Real Estate (Regulation and

12 *Chitra Sharma* (n 5).

13 Insolvency and Bankruptcy Code 2016, s 21 (6A).

14 CIRP Regulations, reg 9A.

15 The Insolvency and Bankruptcy (Amendment) Act, 2018 on 17 August 2018, deemed to be in effect from 06 June 2018 <https://www.ibbi.gov.in/webadmin/pdf/whatsnew/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20(Second%20Amendment)%20Act,%202018_2018-08-18%2018:42:09.pdf> accessed 27 august 2020.

Development) Act, 2016 (RERA).

This amendment provided the homebuyers with three important rights under the Code: (i) Right to initiate CIRP; (ii) Right to be on the CoC; (iii) The guarantee of receiving at least the liquidation value, under the resolution plan. This was done because most of the funding in real estate projects is done by the homebuyers, and it was imperative to protect their rights under the Code.

The amendment was enforced, even before the Supreme Court could finally decide the case of *Chitra Sharma & Ors. v. Union of India & Ors*. Hence, the Supreme Court allowed Jaypee to undergo another round of CIRP, under the provisions of the amended Code.

At first blush, this seemed to be the conclusion of the peculiar problems faced during the CIRP of a real estate company. However, the amendment proved to be far from perfect in its ground-level application. There exist several arenas of the CIRP, which warranted further amendments, or a holistic intervention of NCLT, NCLAT and the Supreme Court. In subsequent parts, the authors will bring to light such pitfalls, which are posed by using the current mechanism of CIRP for real estate companies.

III. The Confidentiality Conundrum

Regulation 13 of Insolvency And Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) states that the IRP or the resolution professional (RP), as the case may be, shall verify every claim, as on the insolvency commencement date, within seven days from the last date of the receipt of the claims, and thereupon maintain a list of creditors containing names of creditors along with the amount claimed by them, the amount of their claims admitted and the security interest, if any, in respect of such claims, and update it.[16] It further states that such a list should be available for inspection and also be displayed on the website, if any, of the Corporate Debtor.[17] The obvious corollary of this regulation is that the details of the homebuyers, who have invested in a real estate project, would also be available on the website of the Corporate Debtor, after them becoming a financial creditor. However, when data of a large number of homebuyers is sought to be uploaded on a website of a Corporate Debtor, it poses confidentiality concerns, as the details of such homebuyers would be available for the world at large, and leave it vulnerable to be misused. In such a scenario, there can also be a situation, wherein, certain individual allottees would not wish their name to be published in the list.

However, it is the authors' view that there exists a difference between "privacy" and "confidentiality". An information which is confidential does not necessarily have to be private, and vice versa. Confidentiality refers to personal information shared with an

16 CIRP Regulations, reg 13 (1).

17 CIRP Regulations, reg 13 (2) (c).

attorney, banker, physician, therapist, or other individual that generally cannot be divulged to third parties without the express consent of a person. On the other hand, privacy refers to the freedom from intrusion into one's personal matters, and personal information, such as if someone is homosexual or HIV positive. While privacy is a fundamental right, a right to confidentiality arises from a fiduciary relationship.[18] It is trite law, that any confidential information can be sought to be disclosed through a statutory provision. For example, under the Bankers' Books Evidence Act, 1879, confidential data of a person with the bank can be disclosed.

The fundamental right to privacy cannot be read in isolation. The application of Regulation 13 of the CIRP Regulations, in the present scenario is fair, just and reasonable, which would provide effective resolution of the insolvency of Corporate Debtor. It is concerned with data that is minimal information pertaining to authentication of claims by creditors only, which is retained only for a certain period, and no other personal data is published. Since, the mandatory requirement under Regulation 13 of the CIRP Regulations fulfils the "three-fold test" as laid down in *Justice K S Puttaswamy (Retd.) and Anr.* v. *Union of India*[19], such publication of data does not violate the fundamental right of privacy of the homebuyers. The NCLT, Allahabad bench was faced with a similar conundrum when the matter of Jaypee was relegated back to have a supervised CIRP before this adjudicating authority. The IRP was hesitant to publish the list of homebuyers on the website of the Corporate Debtor. However, in a detailed order from NCLT, the IRP was directed to publish such list.[20]

IV. The Voting Mechanism

Once insolvency has been admitted against a Corporate Debtor, the management of the Corporate Debtor vests completely with the IRP/RP.[21] The affairs of the Corporate Debtor are monitored by the CoC.[22] Furthermore, the approval of CoC is mandatory for a majority of the actions under CIRP.[23] Section 28 of the Code read with regulations 25, 25A and 26 of the CIRP Regulations, currently provide for the mechanism of how the view of the CoC has to be taken on, by way of voting, on agendas before the CoC. The Code, across its provisions, states that for any resolution/decision to be implemented, such decision should either be assented to by sixty-six per cent of the CoC[24] or else fifty-one per cent of

18 K Vipul, 'Relationship Between Privacy and Confidentiality' (*The Centre for Internet and Society*, 30 December 2014) <https://cis-india.org/internet-governance/blog/relationship-between-privacy-and-confidentiality> accessed 27 August 2020.

19 *Justice K S Puttaswamy (Retd) v Union of India* (2017) 10 SCC 1.

20 *IDBI Bank Ltd* (n 8).

21 Insolvency and Bankruptcy Code 2016, s 17.

22 Insolvency and Bankruptcy Code 2016, s 21.

23 Insolvency and Bankruptcy Code 2016, s 28.

24 For important matters.

the CoC.[25] While amending the Code, to cater to the real estate companies, the legislature had mindfully inserted regulation 25A in the CIRP Regulations, wherein the authorised representative had to vote as per the class of creditors she/he represented.

However, ground-level realities posed practical problems in implementing such a mechanism of voting. Homebuyers are a class of financial creditors distinct from well-organized financial creditors such as Banks, Financial Institutions, Asset Reconstructions Companies and others like non-banking financial companies. These institutions are managed by a systematised, hierarchical set of managers with properly compiled documentation. Homebuyers, numbered in thousands and scattered all across India and abroad, are largely unorganised, while financial creditors consisting of financial institutions would always have high voting shares. It is also pertinent to note that all homebuyers may not have a proper understanding of or access to the voting mechanism; some of the homebuyers may be old and infirm, while others might not be well conversant with computers and the internet and at times unaware of their rights. Thus in a non-ideal scenario, it is very difficult to ascertain the exact will of the CoC, wherein the homebuyers constitute a lion's share of the CoC. Frequent abstinence and lack of commercial wisdom in homebuyers, therefore, leaves the CIRP decisions vulnerable to failure.

To find a workable solution, it becomes important to interpret section 25A of the Code purposively, in particular, section 25A(3) and the first proviso therein.[26] Purposive interpretation of section 25 has to be in line with the objects and the preamble of the Code. The IBC in its preamble makes it clear that it is 'An act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and <u>balance of interest of all the stakeholders</u>' (emphasis added).

The long title of the Code itself stipulates that the interest of all stakeholders must be balanced. Thus, where there are different classes of stakeholders, the interest of each stakeholder must be balanced. It follows that homebuyers must be viewed as a distinct class of creditors. Furthermore, regulation 16-A(1) of the CIRP Regulations makes it clear that the authorised representative is to be chosen by the highest number of financial creditors in the class. Moreover, the IRP is required to provide to the authorised representative appointed by the Adjudicating Authority the list of creditors in each class under regulation 16-A(4). In other words, the regulation intrinsically suggests that the authorised representative can represent several classes. Therefore, section 25(3) and the proviso too have to be read in that manner. Another indication in the Code for such an interpretation was provided by

25 For routine matters.

26 It states: 'Provided that if the authorised representative represents several financial creditors, then he shall cast his vote in respect of each financial creditor in accordance with instructions received from each financial creditor, to the extent of his voting share'.

section 21(6A)[27] which, through its sub-section (b), makes it clear that where a financial debt is owed to a class of creditors exceeding the number specified, other than those under section 21(6) can appoint an authorised representative. Pursuant to this, regulation 2(1)(aa) of CIRP Regulations provided that a class of creditor means a class with at least 10 financial creditors for the purpose of section 21(6A)(b). Section 21(6A) also states that the authorised representative can represent different classes of creditors as stipulated under clause a, b and c of section 21(6A).

It is the authors' view that the net effect of the aforesaid provisions, particularly in the view of the Amendment Act 26 of 2018 read with the amendment to the regulation, is that the Code inherently permits and facilitates voting as a class. The authorised representative can thus represent diverse classes as discussed above. It is in this context that section 25 and Section 25A can be interpreted. If read thus, the proviso would have to be understood that each financial creditor would vote as a class. The sequitur of the aforesaid argument is that in the case of class of creditor they would vote based on a majority. Therefore, it cannot be contented that the authorised representative would vote for each person in a class separately. Individual votes may be recorded by the authorised representative to reach a majority in the class, but ultimately the authorised representative would vote based on a class in the CoC. Voting has always been understood in law to be an affirmative action signifying acceptance or rejection. Even though a provision may be made (for abstention) that cannot be counted as against, a positive indication of rejection. They have to be ignored as null votes.

Furthermore, merging of categories of all financial creditors (organised financial institutions and spread-out individual homebuyers) and treating them as one would also amount to treating unequals as equals, which may result in a violation of Article 14 of the Constitution. Therefore, providing the same threshold for both categories may result in a declaration that those provisions are ultra vires the Article 14 of the Constitution. However, the Hon'ble Supreme Court in a catena of judgments has laid down that the court should adopt an interpretation that sustains the provisions, rather than leaning towards a declaration that the provisions violate Article 14 of the Constitution. The Hon'ble Supreme Court has provided extensive guidance, prompting that the principle of construction that should be adopted is one that sustains the constitutional validity of a statute rather than that which results in the declaration of ultra vires. It follows that in such a scenario, the Code was necessitated to be construed in a manner so as to make it effective and operative.

The Legislature, though belatedly, recognised such a conundrum faced in the practical implementation of the provisions of the Code and the regulations therein. It amended the Code, yet again in 2019 to insert section 25(A)(3A) which states:

> Notwithstanding anything to the contrary contained in sub-section (3), the authorised representative under sub-section (6A) of section 21 shall

27 Inserted via the Insolvency and Bankruptcy (Amendment) Ordinance 2018.

> cast his vote on behalf of all the financial creditors he represents in accordance with the decision taken by a vote of more than fifty per cent. of the voting share of the financial creditors he represents, who have cast their vote.

The Legislature finally implemented, by way of an amendment, the same conclusion that the authors' intended to draw in the paragraph above. Hence, the conundrum faced in a CIRP of real estate company was yet again addressed by the legislature with a welcome amendment.

V. Should The Debt of The Homebuyers Accrue Interest?

It is the obligation of the IRP, under regulation 14 of the CIRP Regulations to determine the amount being claimed by a financial creditor and subsequently, assign a voting percentage to each financial creditor proportionate to their claims, which mandatorily has to include the interest component, as per the regulation 16(A)(7) of the CIRP Regulations. However, the wordings of regulation 16(A)(7) appears to be problematic and amenable for equivocal interpretation, it states '[t]he voting share of a creditor in a class shall be in proportion to the financial debt which includes an interest at the rate of eight per cent per annum unless a different rate has been agreed to between the parties'.

A reluctant interpretation of the above provision can be that the interest component on the debt of the homebuyers should only be for the purposes of assigning voting share in the CoC, rather than providing a positive right to claim interest on the debt of the homebuyers. Such an interpretation, in view of the authors, should not hold ground.

One of the major factors prompting the legislature to include homebuyers as financial creditors, through the Amendment to IBC, was that the builder utilises the disbursements made by the homebuyers towards the construction of the flats in the future. The amount so raised by the builder is used as the cheapest means of financing the real estate project and is thus in effect a tool for raising finance, and on the failure of a project, money is repaid based on the time value of money. Such a transaction unequivocally has the commercial effect of borrowing.[28]

Thus, if a forward sale or purchase transaction is structured as tools or means of raising finance, there is no doubt that the amount raised is classified as financial debt under section 5(8)(f) of the Code. Therefore, in the case of the homebuyers, since the monies raised from them are means of finance in a real estate project, they fall squarely within the entry (f) of section 5(8).

Moreover, the definition of 'financial debt' under section 5(8) of the Code uses the words "includes". Thus the kinds of financial debts illustrated are not exhaustive. The phrase "disbursed against the consideration for the time value of money" has been the

28 Ministry of Corporate Affairs, *Report of the Insolvency Law Committee* (2018) paras 1.1 to 1.9.

subject of interpretation in a few instances. The words 'time value' have been interpreted to mean compensation or the price paid for the length of time for which the money has been disbursed. This may be in the form of interest paid on the money or factoring of a discount in the payment.

The import of the above argument is that the most important factor to qualify the disbursement by homebuyers as financial debt is that there has to be a compensation for the monies paid to the homebuyers for the length of the time such money stands disbursed. Resultantly, it is mandatory to accord a just rate of interest on the money disbursed by the homebuyers and/or provide for a mechanism to factor in an equivalent just discount on the subsequent payments expected from the homebuyers. This is to say that a just interest is the most integral component of 'time value of money'. This argument is buttressed by regulation 16A(7) of the CIRP Regulations, which unequivocally states that 'The voting share of a creditor in a class shall be in proportion to the financial debt **which includes an interest**…'. Hence, in the view of the authors, there is no doubt that the admitted claims of the homebuyers must mandatorily include a just and fair interest on top of the monies disbursed by them.

This issue has yet not received the traction it should have. Also, while properly adjudicating the interest component, the respective clauses of the agreements entered by the homebuyers would also play an important role. However, the authors wish that either the legislature or the judiciary would soon provide an appropriate solution to this conundrum.

VI. Are Homebuyers, Secured Financial Creditors?

The real estate industry, on the whole, has been financially distressed. Considering the capital intensive nature of this industry, it is generally not a viable option for a resolution applicant to take over a distressed real estate company unless and until it can, in the near future, make a profit on such a huge investment. So in a hypothetical scenario wherein a real estate company fails the CIRP and is going to be liquidated, the secured financial creditors such as the bank will end up exhausting the assets of such Corporate Debtor, thus leaving the homebuyers in the lurch. To avoid such a scenario, the authors believe that a compelling case can be made to state that the homebuyers are secured financial creditors.

Section 3(30) of the Code defines the term "secured creditor" to mean a creditor in favour of whom security interest is created. Subsequently, section 3(31) defines the term 'security interest' to mean right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, '**charge**', hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person.

The import of the above two definitions is that, if any right of a home buyer on the flats allotted to them can be qualified under the definition of 'security interest', the homebuyers would fall squarely within the definition of a 'secured creditor'. For such qualifications, an enquiry into the nature of rights of the homebuyers is warranted.

Homebuyers become financial creditors because they provide most of the funding for real estate projects through their payments. Such payments are made by the homebuyers in an anticipation of the delivery of the flats. In such scenarios, section 55(6)(b) of the Transfer of Property Act, 1882 (TP Act) is applicable, which provides that unless the buyer improperly declines to accept the delivery of the property, the amount of purchase money paid by the buyer in anticipation of the delivery and for interest on such amount shall remain as a '**charge**' on the property (the flats sought to be bought by the homebuyers), as against the seller (real estate companies). There will be no question of the creation of any other special charge on such properties as the provisions of the TP Act, would automatically apply in the present case.[29]

Furthermore, where there is part payment of purchase price, there is a charge created for such portion of the money that has been paid and charge certainly is an interest in the immovable property.[30] Section 55(6)(b) of the TP Act creates a statutory charge and not a mere charge that can be said to have been created by the conduct of the parties. A charge under section 55(6)(b) of the TP Act arises, when it is shown, that the buyer has not improperly declined to accept the delivery of the property.[31] Hence, in an absence of any declination at the behest of the homebuyers, it can be strongly argued that there exists a statutory charge in favour of the homebuyers because where a buyer in an agreement for a sale does not improperly decline to accept the delivery of property, a charge is created over the property by operation of section 55(6)(b) of TP Act for the averment of advance sale consideration.[32]

It is to be noted that the nature of the contract entered between the homebuyers and real estate companies is that of an executory contract, i.e. where the sale deed has not been executed yet. In such a scenario, where an executory contract is in force, the statutory charge created under section 55(6)(b) of the TP Act would be applicable, till the time an actual sale deed stands executed in favour of the homebuyers.[33]

Under section 55(6)(b) of the TP Act, the buyer has got the charge for the price pre-paid, in anticipation of the completion of the agreement.[34] This charge attaches from the

29 *Anchi v Maida Ram* AIR 1987 Raj 11.

30 *K Mahalakshmi v Venkata Bhaskara* AIR 1964 AP 334.

31 *Abdul Satar v Manilal,* AIR 1970 Guj 12.

32 *Puthiya Purayil Ramakrishnan v Pullani Prabhakaran* AIR 2016 Ker 66.

33 *Sunderaramier v Krishnamachary* AIR 1966 Mad 330; *Adikesavan Naidu v Gurunatha Chetti* AIR 1918 Mad 1315; *Kathmuthu v Subramania Chettiar* AIR 1926 Mad 569; *Krishnaswami Rao v Srinivasa Desikan* AIR 1937 Mad 261.

34 *Meppallipoyli Ibravi v Poolakkandiyil Pokkan* AIR 1990 Ker 169; *Pati v Kunhi Raman Nair* AIR 1959 Ker LT 491.

moment the buyer pays any part of the purchase money.[35] Such a charge is enforceable not only against the seller, but also against any person claiming under him. Furthermore, as it is clear from article 62 of the Limitation Act 1963, the period of limitation for such enforcement of the statutory charge created under section 55(6)(b) of TP Act is twelve years from the date on which it becomes due.

The Hon'ble Supreme Court in the case of *Videocon Properties Ltd*. v. *Bhalchandra Laboratories and Ors.*[36] held:

> … The principle underlying the above provision is a trite principle of justice, equity and good conscience. The charge would last until the conveyance is executed by the seller and possession is also given to the purchaser and ceases only thereafter… This charge is a statutory charge in favour of a buyer and is different from contractual charge to which the buyer may become entitled to under the terms of the contract…

As depicted above, homebuyers have a statutory charge on the flats allotted to them by operation of section 55(6)(b) of the TP Act. A statutory charge differs from a contractual charge and is based upon the principles of justice, equity and good conscience.[37] What should be analyzed now is what the effect of such a charge would be and what rights would a home buyer have by way of such a charge. In such a scenario, section 100 of the TP Act should be investigated. According to section 100, where an immovable property of one person is by act of parties or operation of law made security for the payment of money to another and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property, and all the provisions which apply to a simple mortgage shall, so far as may be, apply to such charge.

Hence, under section 100 of the TP Act, a charge is an obligation to make payment out of the property specified.[38] In order to create a charge, it is not necessary to employ any technical or any particular form of expression. All that is required is that there should be a clear intention to make a particular property as a security for the payment of money. Creation of enforceable security is the essence of the charge with respect to immovable property.[39] The form of the expression or the literal sense is not to be regarded as much as the real intention of the parties which the transaction discloses. If the transaction discloses

35 ibid.

36 *Videocon Properties Ltd v Bhalchandra Laboratories* AIR 2004 SC 1787.

37 *MV Krishnamachari v Dhanalakshmi* AIR 1968 Mad 142; for contractual charge: An example of contractual charge can be seen from Section 2(16) of the Companies Act, 2013, wherein the company has subsequent liability to report such charges under Section 77 of the Companies Act, 2013.

38 *Muthuswami Gounder v N Palaniappa Gounder* (1998) 7 SCC 327.

39 *Hindustan Machine Tools Ltd v Negdugandi Bank Ltd* AIR 1995 Kant 185; *Gangamoni Devi v Kumud Chandra Mazumdar* AIR 1950 Pat 478.

an intention to make property security for payment of a debt, a charge arises.[40]

What is also to be borne in mind, is that it is not necessary that there should be a pre-existing liability. Such a charge can be validly created for the discharge of future or contingent liability.[41] It is not a condition precedent that there should be a pre-existing liability.[42] Such a charge comes into existence immediately and can be on future produce.[43]

On a review of various financial terms of agreements between homebuyers and builders and the manner of utilisation of the disbursements made by homebuyers to the builders, it is evident that the agreement is for disbursement of money by the home buyer for the delivery of a building to be constructed in the future.[44] The amount so raised is used as a means of financing the real estate project and is thus, in effect, a tool for raising finance. On failure of the project, money is repaid based on the time value of money and has an effect of borrowing. Such borrowing has been provided with the status of financial debt.

The above rights provide an arguable indication, that the homebuyers are indeed secured creditors of real estate companies because a secured debt includes a debt secured by a charge under section 100 of the TP Act.[45]

The Hon'ble Supreme Court in the case of *Raghuraj Singh* v. *Murari Lal*[46] has held:

> The High Court seems to be in error when it held that under the definition of "secured debt" only such debts as are secured by a mortgage come in and not debts which are secured by a charge. It seems to have overlooked that part of the definition of the word "mortgage" which lays down that a mortgage will include a charge as defined in Section 100 of the Transfer of Property Act. Therefore, **even though a debt may be secured by a charge it will be a secured debt**…

A prima facie counter-argument to the above can be raised owing to the various provisions of terms and condition documents signed by the homebuyers, which in generic sense state that the allottee shall have no rights, interest or title whatsoever in the premises sought to be bought by them, until and unless an indenture of conveyance is executed in favour of them. The authors believe that such concerns can be tackled appropriately because as stated above, the charge being created in favour of homebuyers is not a contractual charge but it is a statutory charge. The Hon'ble Supreme Court has explained

40 *Janardhan v Anant* (1908) 32 Bom 386.

41 *Kesari Mal Umrao Singh v Tansukh Rai-Kidar Nath* (1935) 16 Lah 137.

42 ibid.

43 *Jugal Kishore v Ram Narain* AIR 1923 All 199.

44 Ministry of Corporate Affairs, *Report of the Insolvency Law Committee* (2018).

45 *Raghuraj Singh v Murari Lal* AIR 1967 SC 1631.

46 ibid.

such distinction in the case of *Videocon Properties Ltd.* v. *Dr. Bhalchandra Laboratories,*[47] where it stated:

> This charge is a statutory charge in favour of a buyer and is different from contractual charge to which the buyer may become entitled to under the terms of the contract, and in substance a converse to the charge created in favour of the seller under section 55(4)(b). Consequently, the buyer is entitled to enforce the said charge against the property and for that purpose trace the property even in the hands of third parties and even when the property is converted into another form.. ..The said statutory charge gets attracted and attaches to the property for the benefit of the buyer the moment he pays any part of the purchase money and is only lost in case of the purchaser's own default or his improper refusal to accept delivery.

In any event, it is trite law that a statutory provision would override contractual arrangements. The statutory first charge prevails over any other charge and would get precedence over any other existing right. The precedence or priority is not confined to the right to redemption alone.[48] The charge created under section 100 of the TP Act cannot be defeated by a charge which comes into operation at a later stage.[49] Thus, this argument will provide homebuyers with a charge prior to that of the banks / financial institutions.

It must also be noted that such terms of the documents signed by the homebuyers are unconscionable. These terms and conditions form part of standard contracts that are signed by the buyers/allottees in real estate transactions. These contracts are drafted keeping in mind the unequal bargaining power of buyers and such one-sided conditions are imposed as a general industry practice by the developers, taking advantage of the power asymmetry to protect their interest.[50] The National Consumer Redressal Forum while dealing with the dispute of deficiency of service by a developer in *Sheo Gupta & Anr.* v. *Kanpur Development Authority*[51] held such clauses to be unconscionable. Similar directions have been given in other cases too.[52]

It is to be noted that the homebuyers are classified as 'allottees' in a 'real estate project' under RERA. Under RERA, section 2(d) defines "'allottee' in relation to a real estate project, means the person to whom a plot, apartment or building, as the case may be, has been allotted, sold (whether as freehold or leasehold) or otherwise transferred by the promoter, and includes the person who subsequently acquires the said allotment through

47 *Videocon Properties Ltd v Dr Bhalchandra Laboratories* (2004) 3 SCC 711.

48 *Canara Bank v State of Kerala* AIR 2005 Ker 50.

49 ibid.

50 *Neelkamal Realtors Suburban Pvt Ltd v Union of India* (2017) SCC OnLine Bom 9302.

51 *Sheo Gupta v Kanpur Development Authority* (2017) SCC OnLine NCDRC 178.

52 *DLF Homes v Himanshu Arora* (2017) SCC Online NCDRC 1992.

sale, transfer or otherwise but does not include a person to whom such plot, apartment or building, as the case may be, is given on rent". This means that any person to whom a plot, apartment or building is allotted or sold or transferred by a promoter is an allottee under the act. The definition also intends to include the person who subsequently acquires the said allotment through sale, transfer or through any other mode.

Furthermore, a 'real estate project' under the Act is defined to mean 'the development of a building or a building consisting of apartments, or converting an existing building or a part thereof into apartments, or the development of land into plots or apartment, as the case may be, for the purpose of selling all or some of the said apartments or plots or building, as the case may be, and includes the common areas, the development works, all improvements and structures thereon, and all easement, rights and appurtenances belonging thereto'.

Section 19 (3) of RERA states that 'the allottee shall be entitled to claim the possession of apartment, plot or building, as the case may be, and the association of allottees shall be entitled to claim the possession of the common areas, as per the declaration given by the promoter under sub-clause (c) of clause (I) of sub-section (2) of section 4. It is necessary to highlight that the object and reasons behind enacting a legislation like RERA was to protect the interest of 'allottees' like the homebuyers in the present situation. Therefore, the homebuyers are granted the right to claim possession of the immovable property allotted in the real estate project. This claim of possession awarded to allottees when read with section 3(31) of IBC, amounts to creation of security interest.

In the present scenario, a claim in property is created through possession. Therefore, by virtue of claim of possession the homebuyers have on their respective flats/apartments, they qualify as 'secured creditors'. This proposition is also buttressed from the negative obligation on the promoter under section 11(4) of RERA, which states that once the promoter has entered into an agreement with an allottee, the promoter cannot create a charge on such apartment, plot or building, as the case may be, and if any such mortgage or charge is made or created then notwithstanding anything contained in any other law for the time being in force, it shall not affect the right and interest of the allottee who has taken or agreed to take such apartment, plot or building. Such arguments can be made to stress that homebuyers have a valid charge on its immovable property, which cannot be tampered with.

The issue as to whether the homebuyers are secured or unsecured financial creditors was agitated before the Hon'ble Supreme Court in the case concerning *Chitra Sharma & Ors. v. Union of India & Ors*. However, the Court, without commenting on the question, decided to leave the issue open. Thereafter, this issue could not be decided appropriately by any court. The Hon'ble Supreme Court in the case of *Pioneer Urban Land and Infrastructure Ltd. v. Union of India*[53] has at various junctures referred to homebuyers as unsecured financial creditors, without providing any finding on this issue. Hence, the conundrum persists. The

53 *Pioneer Urban Land and Infrastructure Ltd v Union of India* (2019) SCC OnLine SC 1005.

authors wish that this issue would soon attract traction in an appropriate case.

VII. The Dual Status of The Homebuyers

The homebuyers are not only the financial creditors of real estate companies but also the end consumers of such companies. In this context, a major aberration in the scheme of the Code is highlighted. This issue also requires a prompt solution.

Section 14 of the Code describes the effect of the moratorium.[54] The purpose of the moratorium includes keeping a corporate debtor's assets intact during a CIRP and facilitating orderly completion of the resolution process and ensuring that the corporate debtor may continue as a going concern while its creditors take a view on the resolution of default. This also ensures that multiple proceedings are not taking place simultaneously and helps obviate the possibility of potentially conflicting outcomes of related proceedings. The moratorium ensures a stand-still period during which creditors cannot resort to individual enforcement action which may frustrate the objective of the CIRP.[55] The motivation behind the moratorium is to preserve value for the corporate debtor to continue operations, even as viability is being assessed during the CIRP.[56]

In specific, section 14 prohibits disposing of any assets of the corporate debtor[57] and any action to foreclose/recover/enforce any security interest against the assets of the corporate debtor[58]. It is a settled position of law that after the admission of an application under the Code for initiating CIRP and once moratorium has been declared, it is not open to any person, including the financial creditors to recover any amount from the corporate debtor.[59]

Furthermore, section 20(1) of the Code imposes two duties upon the IRP. First, to protect and preserve the value of the property of the corporate debtor[60] and second, to manage the operations of the corporate debtor as a going concern.[61]

The Code provides that the IRP should take all steps to not only physically protect and preserve the assets of the corporate debtor but should also take steps to protect and preserve the value of the assets of the corporate debtor. The preservation of the value of the assets during the CIRP is of utmost importance or else the stakeholders will suffer. The task of managing the affairs of the corporate debtor as a going concern is itself crucial. The

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54 Insolvency and Bankruptcy Code 2016, s 14.

55 Insolvency and Bankruptcy Code 2016, Preamble.

56 Bankruptcy Law Reforms Committee, *The Report of the Bankruptcy Law Reforms Committee Vol. 1: Rationale and Design* (2015) Ch 5.

57 Insolvency and Bankruptcy Code 2016, s 14(b).

58 Insolvency and Bankruptcy Code 2016, s 14(c).

59 *Indian Overseas Bank v Dinkar Venkatsubramaniam Resolution Professional for Amtek Auto Ltd* (2017) SCC Online NCLAT 584.

60 Insolvency and Bankruptcy Code 2016, s 20(1).

61 Insolvency and Bankruptcy Code 2016, s 20(1).

term 'going concern' is an accounting term for a company that has the resources needed to continue to operate indefinitely until a company provides evidence to the contrary, and this term also refers to a company's ability to make enough money to stay afloat or avoid liquidation.[62]

While the above two provisions (i.e, section 14 and section 20(1)) appear to have the same end goal – preservation of assets of corporate debtor and keeping it as a going concern; for a real estate company to be kept as a going concern, it must keep on constructing the premises and subsequently sell it to the homebuyers and grant them possession.[63] However, this is where the problem arises for a real estate company. The homebuyers are also financial creditors. If they end up taking the possession during the CIRP from an IRP, to keep the corporate debtor as a going concern as is mandatory for the IRP to do under section 20 (1) of the Code, it will be in violation of section 14 of the Code, which specifically prohibits disposing of any assets of the corporate debtor[64] and any action to foreclose/recover/enforce any security interest against the assets of the corporate debtor[65].

It is a situation where if the Corporate Debtor must be kept as a going concern, then the end consumers (homebuyers, who are also financial creditors), end up foreclosing their debts or enforcing their security. This violates the specific prohibition under section 14. However, if such violation is not committed then the corporate debtor cannot be kept as a going concern and this will be a violation of section 20(1) of the Code.

When there is a conflict between two or more parts of a statute (as in the present scenario) then the rule of harmonious construction needs to be adopted. The rule follows a very simple premise that every statute has a purpose and intent as per law and should be read as a whole. An interpretation which makes the enactment a consistent whole, should be the aim of the Courts and a construction which avoids inconsistency or repugnancy between the various sections or parts of the statute should be adopted.[66] The Courts should avoid 'a head on clash' between the different parts of an enactment and conflict between the various provisions should be sought to be harmonized. The rule of harmonious construction has been tersely explained by the Supreme Court which has stated that when there are, in an enactment, two provisions which cannot be reconciled with each other, they should be so interpreted, that if possible, effect should be given to both.[67]

In such a scenario, it is warranted that both provisions should be construed harmoniously,

62 *State Bank of India v Director of Mines* (2018) SCC Online NCLT 11920.

63 See CF Floyd and MT Allen, *Real estate principles* (Dearborn Real Estate 2002); See also B Al Dalayeen, 'Working capital management and profitability of real estate industry: An empirical study' (2017) 7(2) Journal of Applied Finance and Banking 49.

64 Insolvency and Bankruptcy Code 2016, s 14(b).

65 Insolvency and Bankruptcy Code 2016, s 14(c).

66 *CIT v Hindustan Bulk Carriers* AIR 2002 SC 3491.

67 *MSM Sharma v Krishna Sinha* AIR 1959 SC 395.

and the homebuyers should be allowed to set-off their debt during the CIRP. This can either be done by way of an amendment or by a direction from an appropriate forum. However, no such step has been taken so far as the issue has not got the appropriate traction.

VIII. Conclusion

By way of the present paper, the authors have endeavoured to bring to light the detailed and groundbreaking work done by the judiciary and the legislature to protect the interest of the homebuyers in the real estate companies which are facing insolvency. The issue of the constitutional validity of a minimum number of homebuyers being required to initiate a CIRP against a real estate company is sub-judice before the Supreme Court of India. The authors welcome the proactive steps being taken by the authorities to iron-out the coarse edges of CIRP in the case of real estate companies and emphasize that indeed it takes a village to raise a child – in the present case the figurative child being the law and practice of resolution of insolvency of real estate companies.