

## Homebuyers Gets Status of Financial Creditors - Supreme Court Upheld IBC 2018 Amendment

written by Rajdev Singh | October 24, 2019

The Hon'ble Supreme Court of India's bench comprising of Justices R F Nariman, Sanjiv Khanna and Surya Kant in the matter of *Pioneer Urban Land and Infrastructure*

*Limited vs. Union of India*<sup>[1]</sup> while rejecting a batch of more than 200 petitions

filed by the real estate developers challenging the constitutionality of the Insolvency and Bankruptcy Code, 2018 Amendment ("2018 Amendment"), which granted status of "Financial Creditors" to the homebuyers and gave them the right to be represented in the committee of creditors by authorized representative, has upheld the constitutional validity of the 2018 Amendment. Financial Creditors: Insolvency and Bankruptcy Code, 2018 Amendment

The Insolvency and Bankruptcy (Amendment) Ordinance, 2018, ("2018 Ordinance") which came into force on 6th June 2018 provided clarity on the status of homebuyers under the Insolvency and Bankruptcy Code ("IBC"). Section 5 (8) (f) of the IBC was amended to bring homebuyers within the purview of "Financial Creditors" as defined under the IBC. Section 5 (7) of the

IBC defines *Financial Creditors* as "any person to whom a financial debt is owed and includes a person to whom such debt

has been legally assigned or transferred to."

"Financial Debt" is defined under Section 5 (8) of the IBC as "a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes:

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialized equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the

Indian Accounting Standards or such other accounting standards as may be prescribed;

(e) receivables sold or discounted other than any receivables sold on nonrecourse basis;

(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect

of a borrowing;

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;

*(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;"*

2018 Ordinance has inserted an explanation in Section 5 (8) (f) of the IBC to bring homebuyers under the purview of "Financial Creditors" which is read as below:

*"(i) any amount raised from an allottee under the real estate project shall be deemed to be an amount having commercial effect of a borrowing, or*

*(ii) the expressions "allottee" and "real estate project" shall have the meanings respectively assigned to them in clause (d) and (zn) of*

*section 2 of the Real Estate (Regulation and Development) Act, 2016;"*

That the amount advanced to the real estate developers by the homebuyers under the real estate projects shall be deemed to have the commercial effect of borrowing and the said amount shall come under the definition of "Financial Debt".

Henceforth, the flat allottees who were given the status of financial creditors under the IBC can initiate corporate insolvency resolution process against the real estate developers by filing petition under

Section 7 of the IBC and further are entitled to be a part of the committee of

creditors with voting rights in proportion to the amount of financial debt owed.

Grounds on Which the Amendment was Challenged by the Real Estate Developers

1. The amendment violates Article 14 of the Constitution of India as it treats unequal equally and equals unequally having no intelligible differentia. Real estate developers and borrowers are treated equally whereas they are unequal.
2. The amendment has no nexus with the object sought to be achieved by the IBC.
3. The amendment violates Article 19(1)(g) and Article 300-A of the Constitution of India as in the case of a real estate developer who completes projects on time and never defaults, can be removed or replaced by somebody if a single allottee manages to obtain an insolvency order from NCLT.
4. The amendment would dissuade foreign investors from investing in India.
5. Flat/apartment allottees do not come under the purview of financial creditors as in the event of any breach of agreement on the part of the real estate developer, the homebuyers are entitled to get a refund of the amount paid by them, which does not make them financial creditors.
6. The amendment is against the UNCITRAL Legislative Guide on Insolvency Law as the difference between financial creditor and the operational creditor was ignored. Homebuyers should fall under the category of operational creditors and not financial creditors.

## Financial Creditors: Judgement

The Hon'ble Supreme Court of India, in this present case, has delivered a significant judgment by upholding the constitutional validity of the Insolvency and Bankruptcy Code, the 2018 Amendment, and re-affirming the status of homebuyers as "Financial Creditors".

### i. Constitutional Aspect

The three judges' bench has upheld the constitutionality of the amendment of Section 5 (8) (f) of the IBC and has held that the amendment does not violate any rights of the real estate developers and is not in any way arbitrary or discriminatory. The bench has further observed that *"not all forward sale or purchase are financial transactions, but if they are structured as a tool or means for raising finance, there is no doubt that the amount raised may be classified as financial debt under section 5(8)(f)."*

*Drawing an analogy, in the case of homebuyers, the amounts raised under the contracts of home buyers are in effect to raise finance, and are a means of raising finance. Thus, the Committee deemed it prudent to clarify that such amounts raised under a real estate project from a home buyer fall within entry (f) of section 5(8)."*

Further, it has been held that the amendment does not infringe Article 14, 19 (1)(g) read with Article 19(6) or 300-A of the Constitution of India.

### ii. Homebuyers need to *prima facie* establish that a "default" exists to trigger the IBC

To trigger the corporate insolvency resolution process, the homebuyers need to *prima facie* establish that a default exists with regards to any unpaid amount. Once a homebuyer has established that a default exists in relation to unpaid amount from the developer, then the onus shall shift on the developer to show that the homebuyer is itself a defaulter as per the agreement entered between both the parties and Real Estate Regulatory Authority ("RERA") Rules and Regulations and

hence, the homebuyer is not entitled to any compensation or refund of the amount. If the developer can successfully prove the same, then it will amount to the dismissal of the petition under Section 7 of the IBC.

### iii. IBC and RERA to be read harmoniously

The bench has held that the homebuyers can avail remedy under the Consumer Protection Act, RERA as well as IBC. Further, the bench has

said that RERA is not in derogation to any statute, but in the event of any conflict between IBC and RERA, the former shall prevail. The bench has also made it clear that RERA should be read in harmony with IBC.

## Conclusion

In this landmark verdict, the Hon'ble Supreme Court of India has reaffirmed the status of homebuyers as financial creditors with voting rights and has upheld the constitutional validity of the 2018 Amendment.

Through this judgment, the distressed homebuyers are given the power to take

legal actions against the real estate developers by triggering the IBC. The Hon'ble Supreme Court of India has also directed the Government of India to provide proper infrastructure to the NCLTs and NCLAT for speedy disposal of the petitions filed under the IBC by the homebuyers. Further, the Court has also directed the Government of India to appoint Adjudicating Officers, Real Estate Regulatory Authority and Appellate Tribunals within three months from the date of passing of the judgment. The Hon'ble Supreme Court of India, through this landmark judgment has rightly held that IBC is a beneficial legislation and the distressed homebuyers can trigger IBC in the event of default on the part of the real estate developers and can recover their dues from the liquidated assets of the corporate debtor.

[1] MANU/SC/1071/2019

Contributed By - Rajdev Singh, Partner  
Pathik Choudhury, Associate

King Stubb & Kasiva,  
Advocates & Attorneys

[Click Here to Get in Touch](#)

[New Delhi](#) | [Mumbai](#) | [Bangalore](#) | [Chennai](#) | [Hyderabad](#) | [Kochi](#)

Tel: [+91 11 41032969](#) | Email: [info@ksandk.com](mailto:info@ksandk.com)