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HOMEBUYERS ENTITLED TO AN ADDITIONAL REMEDY AGAINST BUILDERS

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Background

On 9 August 2019, a three-judge bench headed by Justice Rohinton F Nariman of the Supreme Court of India ("Supreme Court") upheld the constitutional validity of the amendment to the Insolvency and Bankruptcy Code, 2016 ("Code") confirming the status of '**financial creditors**' given to the allottees of a real estate project. With this ruling, the Supreme Court has opened gates for homebuyers to now approach the NCLT against defaulting developers in addition to seeking remedies before the Consumer Forum and the Real Estate Regulatory Authority.

A series of petitions led by Pioneer Urban Land and Infrastructure Limited were filed by developers challenging the constitutional validity of the 2018 Bill for amendment to the Code ("2018 Amendment") which granted the allottees of a real estate project status of '*financial creditors*' and entitled them to be represented in the Committee of Creditors through their authorised representatives.

The amendment to the Code was necessitated from certain decisions of the NCLT which held that the amounts raised by the developers under assured return schemes had the commercial effect of a borrowing and thus the allottees were to be held as '*financial creditors*'.

Arguments of The Petitioners

The following arguments were *inter alia* made on behalf of the petitioners

- The amendment was violative to Article 14 of the Constitution as the amendment sought to treat the real estate developers and borrowers equally when they are in fact unequal as a result of which the fundamental rights of the petitioners under Article 19(1)(g) read with Article 19(6) and Article 300-A of the Constitution was infringed.
- The Real Estate (Regulation and Development) Act, 2016 ("RERA") is a sector specific legislation which adjudicates disputes between developers and allottees. The Insolvency and other laws should be harmoniously construed, which harmony is disrupted when the Code is applied to cases which ideally should fall under RERA.

- By treating homebuyers as financial creditors, the Code creates rights which home buyers never had to begin with.
- The homebuyers may misuse the protection afforded under the 2018 Amendment to put pressure on the developer to refund their money.

What the Supreme Court Observed and Held

The Supreme Court while upholding the 2018 Amendment made *inter alia* the following observations:

- Payment of instalments by an allottee to the developer for funding the real estate project shall be deemed to be an amount having the commercial effect of borrowing and hence would be considered as a 'financial debt' as was defined under the Code. The amounts raised from allottees would be subsumed within the definition of a financial debt even without adverting to the explanation introduced by the 2018 amendment.
- Amounts raised from homebuyers contribute significantly to the construction of the real estate projects and hence it is necessary to treat homebuyers as financial creditors.
- The provisions of RERA are in addition to and not in derogation of the provisions of any other law and the remedies under RERA were intended to be additional and not exclusive remedies. Remedies that are given to allottees are therefore concurrent remedies. Thus, the allottees can benefit from both the legislations.
- The 2018 Amendment to the Code is later in point of time than RERA and must be given precedence over RERA. RERA and Code must co-exist and in the event of conflict, the provisions of Code should take precedence over RERA.
- The Code is not a recovery mechanism. If a homebuyer triggers the Code by filing an application thereunder, then he takes the risk of the project not being completed. This is because, if the homebuyer's petition is admitted he will have to wait for the entire process under the Code to be completed before he can stand in the long que of recognized creditors to get his due.
- Homebuyers should be treated as operational creditors as they are akin to individual financial creditors like the debenture holders and fixed deposit holders who advance amounts to the corporate debtors. The amounts raised from homebuyers contribute significantly to the financing of the real estate projects. Further, to be categorised as a financial creditor there has to be a consideration for the time value of money and a project allottee does in fact meet these criteria.
- The Code cannot be triggered fraudulently by the homebuyers to put pressure on the developer as NCLT would have to be completely satisfied before admitting any application from an allottee. The NCLT will scrutinize the application to factor the following:
 - Whether the allottee has made out a prima facie case for default on part of the developer;
 - Whether the allottee is in default himself by being in breach of the RERA Agreement and is thus not entitled to any relief;
 - Whether the resolution process elected by an allottee is genuine or a tactic to arm twist the developer; and

- Whether the allottee is a speculative purchaser or whether allottee will suffer on account of having invested his life savings for a "dream house".

Further Directions by the Supreme Court

The Supreme Court with a view to consolidate its decision has directed (i) all States which have not established/appointed adjudicating officers, the Real Estate Regulatory Authority, as also the Appellate Tribunal as required under RERA, to do so within 3 months from the date of the judgment; (ii) NCLT and the NCLAT should be sufficiently staffed to deal with litigation that may arise under the Code on account of this amendment; and (iii) NCLT to decide applications in light of this judgment.

Comments

While this judgment has added a new weapon to the arsenal of the homebuyers by granting them an additional remedy against the developers, it has not left the developer in a lurch as it has also provided an array of defences that can be opted by the developer to keep wily allottees at bay. In this context, the question whether the allottee is a speculative purchaser or a genuine homebuyer will assume great significance. In all probability, the real estate developers may opt to complete construction and only thereafter dispose of the completed inventory to homebuyers. In such circumstances a developer may only run the risk of success of the project and be only required to deal with the lenders. If the developers do move to such a business model, it may lead to increase in real estate prices. This increase in prices however depends upon other factors i.e. unsold stock in the market, new projects etc.

Further the judgment has given NCLT a breather by clarifying that time period of 14 days given to adjudicate an application under the Code is directory and not mandatory thereby giving the NCLT authorities the time to adjudicate the application after considering all relevant aspects and without feeling the heat of time.

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