

INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 5 | Issue 5

2022

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Deconstructing the facets of Allottees in Insolvency Bankruptcy Code, 2016

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ABSTRACT

The Research Paper discusses about the position of allottees in the Insolvency Bankruptcy code. The paper further evaluates the legal position of allottees under IBC. Further, the authors critically assess various landmark judicial pronouncements to understand the present position of allottees under IBC. The paper also tries to critically evaluate the allottees as financial creditors and understand the role of allottees in the committee of creditors. The paper also analyses the recent amendments for allottees, and it enables us to decode the long-term implication of change in a legal position. The researcher will also evaluate the powers of allottees as financial creditors. The researchers have undertaken their research with the aid of doctrinal research. The researchers have closely concentrated on various aspects of allottees. The authors have also tried to address the issue of conflict between multiple legal legislations. The authors have suggested a few solutions to strengthen the position of allottees under IBC.

I. INTRODUCTION

The path for allottees/home-buyers was a rough one until the 2018 amendment. Allottees as defined in “Section 2(d) of The Real Estate (Regulation and Development) Act, 2016”³ states that “*allottee in relation to a real estate project, means a person to whom a plot, apartment or building, has been allotted or sold or otherwise transferred by the promoter, and also includes the person who subsequently acquires the said allotment through sale but does not include a person to whom the plot or apartment is given on rent.*”⁴ The RERA Act whose object is to protect home-buyers as well as help boost investments in the real estate industry has provided a forum for the allottees to approach it for redressal. But, until 2018 the Insolvency and Bankruptcy Code, 2016 had no provision with regards to the allottees. As a consequence, the allottees/home-buyers had no power to approach the NCLT and initiate CIRP.

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³ THE REAL ESTATE (REGULATION AND DEVELOPMENT) ACT, 2016. (n.d.). [online] Available at: https://legislative.gov.in/sites/default/files/A2016-16_0.pdf.

⁴ THE REAL ESTATE (REGULATION AND DEVELOPMENT) ACT, 2016. (n.d.). [online] Available at: https://legislative.gov.in/sites/default/files/A2016-16_0.pdf.

II. POSITION OF ALLOTTEES IN IBC

Section 5 (7) of IBC states that “Financial creditor means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.”⁵

Section 5 (8) of IBC states that “financial debt means a debt along with interest, if any, which is disbursed against the consideration for time value of money and includes items referred to in sub-clauses (a) to (i).”⁶

The Insolvency And Bankruptcy Code (Second Amendment) Act, 2018 amended the Insolvency and Bankruptcy Code, 2016 to include allottees as Financial Creditors in “Section 5(8)(f). The amendment was made to Section 5 of the Insolvency and Bankruptcy Code, 2016 stated

In section 5 of the principal Act,—

(ii) in clause (8), in sub-clause (f), the following Explanation shall be inserted, namely:—
*'Explanation.—For the purposes of this sub-clause,— (i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and (ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016;”*⁷

“As per Section 7 of the IBC, a financial creditor either by itself or jointly with other financial creditors may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.”⁸ Since allottees are included as financial creditors the allottees/home-buyers are now empowered to approach the NCLT and initiate CIRP. In addition to this Right, the inclusion has also increased the preference that they get in the liquidation waterfall.

⁵ Editor, I.L. (2018). Section 5 of IBC – Insolvency and Bankruptcy Code, 2016 : Definitions under Part-II. [online] IBC Laws. Available at: <https://ibclaw.in/section-5-definitions-under-part-ii-part-ii-insolvency-resolution-and-liquidation-for-corporate-persons-the-insolvency-and-bankruptcy-code-2016-ibc-sections/> [Accessed 11 Sep. 2022].

⁶ *ibid*

⁷ Editor, I.L. (2018). Section 5 of IBC – Insolvency and Bankruptcy Code, 2016 : Definitions under Part-II. [online] IBC Laws. Available at: <https://ibclaw.in/section-5-definitions-under-part-ii-part-ii-insolvency-resolution-and-liquidation-for-corporate-persons-the-insolvency-and-bankruptcy-code-2016-ibc-sections/> [Accessed 11 Sep. 2022].

⁸ Laws, I.B.C. (2018). Section 7 of Insolvency and Bankruptcy Code, 2016 (IBC): Initiation of corporate insolvency resolution process by financial creditor. [online] IBC Laws. Available at: <https://ibclaw.in/section-7-initiation-of-corporate-insolvency-resolution-process-by-financial-creditor-chapter-ii-corporate-insolvency-resolution-process-cirp-part-ii-insolvency-resolution-and-liquidation-for-corpor/>.

III. PIONEER JUDGMENT

The case of **Pioneer Urban Land and Infrastructure Ltd v. UOI**⁹ is a landmark case in IBC. The petitioners had approached the Hon'ble Supreme Court challenging the Constitutional validity of inclusion of allottees as financial creditors. The court held that the inclusion was constitutionally valid. It was Observed that allottees as financial creditors did not violate Article 14 and Article 19 of the Constitution of India. It was further held that allottees need not have the characteristics of a financial creditor that were specified in the Swiss Ribbons case. The court also stated it is valid for a single allottee to be given the power to approach the NCLT to initiate CIRP against the corporate debtor since even a single allottee's right must be protected.

IV. CRITICAL ANALYSIS OF INCLUSION OF ALLOTTEES AS FINANCIAL CREDITORS

The inclusion of allottees as financial creditors is quite significant and therefore it is highly debated. There are multiple facets that must be scrutinized to analyze the validity and consequences of the inclusion.

(A) Characteristics Of A Financial Creditor

“A financial creditor is an institution that provides money to the corporate entity in the form of loans, bonds etc. Three important types of financial credit are:

1. Money borrowed against payment of interest
2. Any amount raised by acceptance under any acceptance credit facility, dematerialised form etc.
3. Any amount raised through the issue of bonds, notes, debentures, loan stock or any similar instrument.”¹⁰

An allottee does not fall under any of the above-mentioned categories. Further, it is to be noted that the Hon'ble Supreme Court in the landmark case of **Swiss Ribbons Pvt Ltd.** had described certain essential characteristics that determine who a financial creditor is and an allottee does not possess any of those characteristics.

(B) Time Value For Money

On one hand, it can be stated that the money that is provided by allottees in advance to the developer has no time value. Allottees do not provide their money in return for money, they do

⁹ Pioneer Urban Land and Infrastructure Limited v. UOI SCC OnLine SC 1005

¹⁰ Jose, T. (2019). What is Financial Creditors and Operational Creditors under the IBC? [online] Indian Economy. Available at: <https://www.indianeconomy.net/splclassroom/what-is-financial-creditors-and-operational-creditors-under-the-ibc/> [Accessed 11 Sep. 2022].

not charge interest on their advance amount therefore there is no time value for their money.

But on the other hand, it must also be seen that “in real estate projects, money is raised from the allottee, being raised against consideration for the time value of money. The money/consideration agreed at a time when the flat/apartment is non-existent or incomplete, is significantly less than the price the buyer would have to pay for a ready/complete flat/apartment, and therefore,”¹¹ in such a perspective it can be stated that the allottee gains the time value of money.

(C) Commercial Effect Of Borrowing

“The National Company Law Appellate Tribunal (hereinafter referred to as “NCLAT”) on 21st July, 2017 in **Nikhil Mehta and Sons (HUF) v. AMR Infrastructure Ltd.**, held that the amounts raised by developers under assured return schemes had the “commercial effect of a borrowing”, which became clear from the developer’s annual returns in which the amount raised was shown as “commitment charges” under the head “financial costs”. As a result, such allottees were held to be “financial creditors” within the meaning of Section 5(7) of the Code.”¹²

It has been held in **Pioneer Urban Land and Infrastructure Ltd. & Ors. v. Union of India & Ors.**¹³ by the Hon’ble Supreme Court after in-depth perusal at various dictionaries, banking dictionaries, and other documents that “*so long as an amount is “raised” under a real estate agreement, which is done with profit as the main aim, such amount would be subsumed within Section 5(8)(f) as the sale agreement between developer and home buyer would have the “commercial effect” of a borrowing, in that, money is paid in advance for temporary use so that a flat/apartment is given back to the lender. Both parties have “commercial” interests in the same – the real estate developer seeking to make a profit on the sale of the apartment, and the flat/apartment purchaser profiting by the sale of the apartment. Thus construed, there can be no difficulty in stating that the amounts raised from allottees under real estate projects would, in fact, be subsumed within Section 5(8)(f) even without adverting to the explanation introduced by the Amendment Act.*”¹⁴

(D) Extent Of Power Proffered Upon Allottees

The power that has been conferred upon the allottees is quite extensive. The implication of the inclusion of allottees as financial creditors is that even a single allottee could knock on the doors

¹¹ Manish Kumar Vs. Union of India. [online] Available at: <https://www.latestlaws.com/latest-caselaw/2021/january/2021-latest-caselaw-29-sc/> [Accessed 11 Sep. 2022].

¹² Nikhil Mehta and Sons (HUF) v. AMR Infrastructure Ltd. Company Appeal (AT) (Insolvency) No. 07 of 2017

¹³ Pioneer Urban Land and Infrastructure Limited v. UOI SCC OnLine SC 1005

¹⁴ Pioneer Urban Land and Infrastructure Limited v. UOI SCC OnLine SC 1005

of the NCLT. Once the allottee files an application in the NCLT the CIRP is initiated and the moratorium period starts. Although the Company is allowed to maintain its regular business, it does take a toll on the company. The CIRP process is quite complicated and is time-taking and costly. In addition to that the real estate project gets stalled.

The crucial point to note is that IBC does not mandate the allottee to approach the NCLT or court with clean hands. The result is that even if the allottee is at default, he still has the power to approach the NCLT and initiate CIRP. This adversely affects not only the developer but also the other allottees. Real estate projects and mega real estate projects in India usually involve Crores of Rupees and tens of thousands of allottees who are all affected by any change or stall in the project.

The Supreme Court in the case of **Chitra Sharma and Ors. v. Union Of India and Ors**¹⁵. held that

*"the figures which have been made available presently, following the opening of the web portal by the amicus curiae, indicate that 8% of the home buyers have sought a refund of their monies while 92% would evidently prefer possession of the homes which they have purchased. We cannot be unmindful of the interests of 92% of the home buyers many of whom would also have obtained loans to secure a home. They would have a legitimate grievance if the corpus of Rs 750 crores (together with accrued interest) is distributed to the home buyers who seek a refund. The purpose of the process envisaged by the IBC for the evaluation and approval of a resolution plan is to form a composite approach to deal with the financial situation of the corporate debtor. Allowing a refund to one class of financial creditors will not be in the overall interest of a composite plan being formulated under the provisions of the IBC."*¹⁶

(E) Involvement Of Allottees In The Committee Of Creditors

The Committee of Creditors (CoC) is the foremost decision-making body after the initiation of the Corporate Insolvency Resolution Process (CIRP). It plays a pivotal role in the resolution of the insolvency process and the restructuring of the corporate debtor. As per "Section 18 of Insolvency and Bankruptcy Code, 2016"¹⁷ the Interim Resolution Professional (IRP) constitutes the CoC, after the collation of the proof of claims from the concerned creditors and stakeholders. The Interim resolution professional also ensures that all the financial creditors of the corporate

¹⁵ Chitra Sharma and Ors. v. Union Of India and Ors W.P. (C) 744 of 2017.

¹⁶ Chitra Sharma and Ors. v. Union Of India and Ors W.P. (C) 744 of 2017.

¹⁷ Section 18 of IBC – Insolvency and Bankruptcy Code, 2016 : Duties of interim resolution professional. [online] IBC Laws. Available at: <https://ibclaw.in/section-18-duties-of-interim-resolution-professional/> [Accessed 11 Sep. 2022].

debtor are members of the committee of creditors and the composition of CoC is in accordance with “Section 21 of the code.”¹⁸

“Section 24 of the code”¹⁹ enables the Resolution Professional (RP) to conduct the meetings of CoC under his chairmanship with a minimum of 33% of voting rights to be present at any meeting to hold that meeting good. The CoC is entrusted with the decision making and administration of the corporate debtor after the initiation of CIRP the resolution applicants submit their resolution plans to CoC for consideration. The CoC evaluates the plans from all the perspective and checks financial viability of resolution plans. After the said evaluation by CoC, the resolution plans are presented for voting and the voting percentage of the financial creditors is in proportion to the total debt owed by corporate debtor to the financial creditors. Upon receiving 66% of the total voting percentage on a resolution plan, the plan is said to be approved by the CoC. The CoC is further empowered to take its routine decisions with 51% of the total voting percentage and 75% of the total voting percentage is required in the case of winding-up of promoter company.

In the Landmark case of **Committee of Creditors of Essar steel India Limited V. Satish Kumar Gupta and others**²⁰, the Supreme court of India held that. “94. *The NCLAT judgment which substitutes its wisdom for the commercial wisdom of the Committee of Creditors and which also directs the admission of a number of claims which was done by the resolution applicant, without prejudice to its right to appeal against the aforesaid judgment, must therefore be set aside.*”²¹ Hence the verdict clarifies the legal proposition that the decisions taken by the CoC are supreme and it can be struck down by the tribunal only in the case of gross injustice. The Essar Steel verdict has strengthened the position of CoC and it will play a pivotal role in reducing the resistance between the tribunal and CoC.

The function of the Committee of Creditors is to make decisions and vote in the interest of the promoter company. Allottees are individuals who have invested in the real estate projects of a Promoter company and they are the primary investors for the real estate projects. In addition to this, it can be safely stated that the vested interest of allottees in the financial situation of promoter company and resolution plan would be more in comparison with other financial institutions who constitute the financial creditors. The only option that allottees had previously

¹⁸ Section 21 of IBC – Insolvency and Bankruptcy Code, 2016 : Committee of creditors. [online] IBC Laws. Available at: <https://ibclaw.in/section-21-committee-of-creditors/> [Accessed 11 Sep. 2022].

¹⁹ Section 24 of IBC – Insolvency and Bankruptcy Code, 2016 : Meeting of committee of creditors. [online] IBC Laws. Available at: <https://ibclaw.in/section-24-meeting-of-committee-of-creditors/> [Accessed 11 Sep. 2022].

²⁰ Committee of Creditors of Essar steel India Limited V. Satish Kumar Gupta and others (2020) 8 SCC 531.

²¹ Committee of Creditors of Essar steel India Limited V. Satish Kumar Gupta and others (2020) 8 SCC 531.

was that the allottees could have researched about the project and company before investment as they are empowered to access various documents related to the promoter company. Because of the 2018 Amendment in IBC, now allottees can actively take part in the revival of Promoter Company as financial creditors and also vote on resolution plans of resolution applicants put before the Committee of Creditors.

The inclusion of allottees as financial creditors may cause a disruption in CoC to a certain extent as the allottees don't possess the required financial acumen compared to other financial creditors and the decision-making of debt-ridden Promoter Company is complex. Hence including allottees as financial creditors strengthen the position of allottees in the process of CIRP and improve their standing in the waterfall payment system but with certain perils.

V. THE INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ACT, 2020

“The President of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 on 28th December, 2019. The Standing Committee Report on Insolvency and Bankruptcy (Second Amendment) Bill, 2019 was laid before the Parliament on 4th March, 2020. The legislature enacted the Insolvency and Bankruptcy Code (Amendment) Act, 2020 on 13th March, 2020. The IBC Amendment Act 2020 has amended Section 7 of IBC by inserting three provisos to the section. The first proviso acts as a limitation to the power of the financial creditors who fall under clause (a) and clause (b) of Section 21 (6A). It states that for the financial creditors to initiate CIRP against the corporate debtor, there has to be a minimum of 100 or 10% of the total creditors in the same class, whichever is less.”²²

“The second proviso has been specifically drafted to limit the power of the allottees. It states that in a real estate project, where the allottees as financial creditors intend to initiate the CIRP process against the corporate debtor, the application has to be filed jointly by not less than 100 allottees or 10% of the total number of allottees in the same real estate project, whichever is less.

The third proviso states that applications that have been filed but not yet admitted by the NCLT before this amendment shall be modified to comply with the first or second proviso within thirty days, and if not complied shall be deemed to be withdrawn.”²³

The IBC amendment 2020 has ensured that a single allottee would not be able to approach the NCLT to initiate the CIRP against the Corporate Debtor. The legislature has cured the defect in the legislation. Prior to the amendment, the allottees were given the right to approach the NCLT

²² The Insolvency and Bankruptcy Code (AMENDMENT) ACT, 2020, Section 3, No 1 of 2020.

²³ The Insolvency and Bankruptcy Code (AMENDMENT) ACT, 2020, Section 3, No 1 of 2020.

and initiate CIRP either individually or jointly. This was quite excessive as many real estate projects and mega real estate projects got stalled because of a single allottee. The legislature has used its power of amending the legislation to cure the defect that it has found to ensure that there is a balance of power between the corporate debtors and financial creditors.

In the case of **“Goa Foundation v. State of Goa**, the Hon’ble Supreme Court had held that *“However, where the Court’s judgment is purely declaratory, the courts will lean in support of the legislative power to remove the basis of a Court judgment even retrospectively, paving the way for a restoration of the status quo ante. Though the consequence may appear to be an exercise to overcome the judicial pronouncement it is so only at first blush; a closer scrutiny would confer legitimacy on such an exercise as the same is a normal adjunct of the legislative power.”*²⁴ The same was reiterated by the Hon’ble Supreme Court in the case of **Hindustan Construction Company Limited & Ors. v. Union of India.**²⁵

VI. WAY FORWARD

(A) Ensure that alternate remedies provided in RERA and Consumer Protection Act do not clash with IBC

The Adjudication bodies under various acts in force and the superior courts should co-exist harmoniously to adjudicate matters brought before them. We should apply the Doctrine of Harmonious Construction to avoid a situation of conflict between several adjudication bodies. In the event of a conflict, the special statute prevails over the general statute, hence the IBC prevails over the RERA Act but efforts should be made by the adjudicating bodies to avoid conflicts between them in the long run. The Hon’ble Supreme court of India on various occasions have applied the Doctrine of Harmonious Construction in order to protect the legislative intent of the Acts in conflict.

(B) Insert provision to ensure that the allottees who approach the NCLT come with clean hands. The allottee should have not defaulted and should have performed all the duties of allottees as provided in RERA

The Legislature should insert a new provision within the Insolvency and Bankruptcy Code, 2016 through an amendment, to deter the filing of petitions by allottees who have defaulted in fulfilling their duties enumerated under the RERA Act. In the course of enacting the said

²⁴ Goa Foundation v. State of Goa (2016) 6 SCC 602.

²⁵ www.mondaq.com. (n.d.). Hindustan Construction Company Limited And Anr. v. Union Of India And Ors.* - Litigation, Mediation & Arbitration - India. [online] Available at: <https://www.mondaq.com/india/trials-appeals-compensation/882124/hindustan-construction-company-limited-and-anr-v-union-of-india-and-ors>.

provision the legal maxim, “He Who Comes into Equity Must Come with Clean Hands” must be incorporated. The Maxim bars relief to any person who is guilty of improper conduct or conduct that is not in accordance with the law in force. In certain cases, the allottees who approach the National Company Law Tribunal under IBC themselves are at fault. They initiate CIRP despite the fact that they have failed to fulfil the obligations imposed on them by the RERA Act. Insertion of a special provision in the Code will reduce the burden of the tribunal and also protect the rights of stakeholders, law-abiding allottees and promoters at large.

(C) Use of Alternative Dispute Resolution System before Initiation of CIRP

The alternative dispute resolution mechanisms such as arbitration, conciliation or mediation have proved to be an effective mechanism in reducing the burden of the courts and settling the disputes quickly and efficiently. These dispute resolution forums, with the help of expert professionals, reduce the resistance between two parties. In India, the tribunals and courts are already burdened with numerous pending cases and various Chief Justices of India have made efforts to reduce the said pendency. Alternative dispute resolution mechanisms are not bound by the stringent procedural laws or the Evidence Act. Hence the disputes can be settled in a more efficacious manner and within a shorter time frame. If the disputes between allottees/home-buyers and promoters are settled at the preliminary stage, then it would provide greater benefits to both the parties in conflict, adjudicating bodies as well as infrastructural development at large.
