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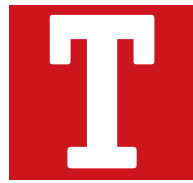
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Investment by Home Buyers: A Fortune or Misfortune?

"Goodness is the only investment that never fails" - Henry David Thoreau

■ Sachin Gupta & Ashu Kansal



The 9th of August, 2017 came as a nightmare to innumerable homebuyers as the National Company Law Tribunal ('NCLT') admitted insolvency

proceedings against one of India's biggest real estate developers, Jaypee Infratech Ltd. on a petition filed by IDBI Bank. The NCLT is also expected to pass orders on petitions filed by financial institutions against various other big real estate developers. The pendency of these proceedings have come to raise various question marks for innumerable homebuyers whose faith in the real estate market in fruitfully catering to their housing plans is now shaken.

The initiation of a Corporate Insolvency Resolution Process ('CIRP') and the subsequent declaration of a moratorium as per Section 14 of the Insolvency & Bankruptcy Code, 2016 ('IBC') means that the fate of innumerable homebuyers will be contingent upon whether the CIRP culminates into a resolution plan or into liquidation of their real estate developer. Most homebuyers belong to the middle class and have invested their life-time earnings to obtain their dream house. However, they are now left to the mercy of the insolvency proceedings for absolutely no fault of their own.

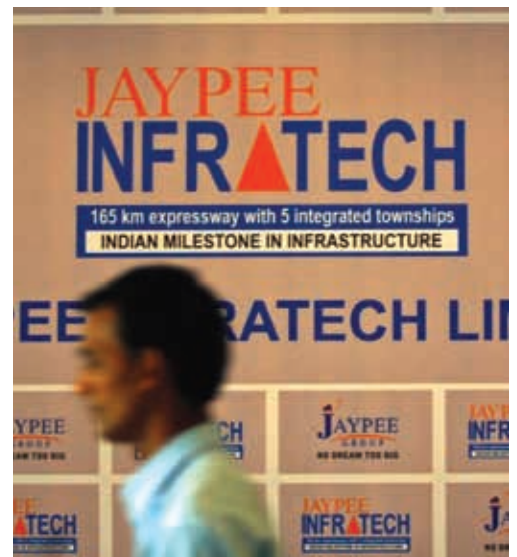
The primary hurdle being faced by the homebuyers is that they do not prima facie fit into the category of either a Financial Creditor or an Operational Creditor as defined under the IBC. Interestingly, as per the waterfall mechanism envisaged under Section 53 of the IBC, once the costs of conducting the insolvency process are cleared, it is the

Financial Creditors' whose claims are to be satisfied in priority to all other claims – thus, the homebuyers do not have any clarity as to where they stand for the recovery of their hard earned money.

The question which begs an answer is that, if the homebuyers are not categorized as Financial Creditors, then where will they stand? If homebuyers' claims are not satisfied in utmost priority, they will lose all chance to recover their dues to the Financial Creditors such as the Banks/Financial Institutions. This outcome would be very undesirable for the many thousand homebuyers, as they will have nothing to recover from the real estate developer. In the given scenario, the distressed homebuyers would thus require immediate options as to what remedy they can seek and obtain in the ongoing insolvency proceedings in order to either preserve their property or to recover their invaluable financial investment.



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MOVE TO ACCOMMODATE HOME BUYERS AS CREDITORS

Over the last decade, it has become standard practice of the real estate industry to refund the financial investment of homebuyers on non-delivery of possession and/or to either provide monetary compensation or provide some additional area in the flats for the delay in handing over of possession. One only needs to think how the Hon'ble Apex Court of the country stepped in to the rescue of innocent home buyers, directing Unitech¹ and Parsvnath to refund amounts to home buyers for failure² to deliver their flats in time.

Subsequently, the Central Government introduced the Real Estate Regulation Act, 2016 ('RERA'), thus codifying the requirements of refund, compensation and payment of interest³ on delayed projects, with the aim to break the stranglehold of the powerful real estate developers on homebuyers. The actual efficacy of RERA on account of the dilution of its provisions is however, the topic of another discussion.

In accordance with the big shift in the legal environment that is now strongly protective of homebuyers' interests, the Insolvency and Bankruptcy Board of India ('IBBI') has readily made a move to accommodate homebuyers suffering on account of the CIRP, allowing them to file their claims as other creditors in the insolvency process, for the time being. To be specific, the IBBI introduced a new form 'F' by amending the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016⁴ as per Rule 9A(1)⁵ of which, a person claiming to be a creditor, other than a Financial or Operational Creditor shall submit proof of its claim to the interim resolution professional or

resolution professional. Despite this effort by the IBBI, the main question on the fate of the homebuyer still remains unanswered: they are still uncertain as to where they stand in the insolvency process and in what priority their claims will be addressed. While the IBBI may only have acted to avoid much chaos from the homebuyers, yet the move echoes the intention of the IBBI to retain the confidence of stakeholders' interests for investment in the real estate market.

It is well known that the stakes of homebuyers are much more than those of the Financial Institution, which has been termed as the Financial Creditor in IBC. If a financial institution fails, the Government is there to secure its investors, but there is no such legal protection that can prima facie be made out for the homebuyers. In the given scenario, it is necessary that the homebuyers have a charge prior to the Financial Institution. This determination of priority is important as without it, the payment of proceeds out of the CIRP will first go to the Financial Creditors, which are the Financial Institution, leaving nothing for the many thousand homebuyers.

HOMEBUYERS: ONLY BUYERS OR FINANCIAL CREDITORS?

It is very well understood that numerous homebuyers invest their hard-earned money to achieve their dream, which is their HOME. It is also well understood that homebuyers play a crucial role in a real estate developer's business, as it is their money that forms the root source of revenue and investment. It is important to show that homebuyers can indeed be considered as Financial Creditors – The investments they make represent the same stream of

cash flow that is considered as 'credit' when made by the banks in favour of the real estate developers. Circumstances that help conceptualize homebuyers is established as below:-

The loan is obtained by the real estate developer by mortgaging the land to its bank and thereafter, obtains an NOC from the bank, in order to sell the flats, which are eventually sold with the proportionate land rights on it to the homebuyers. Thus, after the Homebuyer enters into an agreement/allotment with the real estate of developer for purchase of flat which is along with proportionate land rights, an encumbrance/lien in favor of the Homebuyer is created.

Thus, whether a Resolution Plan is agreed upon, or whether an order of liquidation is made in respect of the real estate developer, the land will still remain encumbered/lien towards the homebuyers. Thus, any action to sell the land to any third party will always carry the encumbrance/lien created in favour of the homebuyers, on an "as is where is" basis. This means that payments to the homebuyers, towards clearing of the encumbrance/lien over the land, would directly or indirectly have to be made by whoever acquires rights to the land.

What is pertinent is that it is the demand for flats by the homebuyers that creates the supply of investment to the real estate developers' from the homebuyers. If there is no financial investment of the homebuyers, the banks would not come into the picture at all. Thus, any debt that is due to the banks from the real estate developers can be linked straight to the homebuyers' demand and financial investment in the flats.

Neither the NCLT (which is the

¹See, <http://www.dnaindia.com/delhi/report-supreme-court-orders-unitech-to-pay-buyers-interest-by-may-8-2414973>

²See, <http://www.livemint.com/Companies/ISXW8pi4gy0sDrqMscfRyi0/SC-directs-Parsvnath-Developers-to-refund-Rs22-crore-to-home.html>

³Section 18 of the RERA Act provides for return of amount and compensation if the promoter fails to complete or is unable to give possession of an apartment, plot or building. Section 19 (4) bestows a right upon the allottee to claim the refund of the amount paid along with interest and compensation from the promoter, in accordance with the terms of the agreement for sale.

⁴See, IBBI (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2017 accessible at http://www.ibbi.gov.in/CIRP_Amendment.pdf

⁵Section 9A (1): A person claiming to be a creditor, other than those covered under regulations 7, 8, or 9, shall submit proof of its claim to the interim resolution professional or resolution professional in person, by post or by electronic means in Form F of the Schedule.

adjudicating authority as per the IBC), nor its appellate forum, the National Company Law Appellate Tribunal ('NCLAT'), has finally resolved this issue of whether homebuyers can be categorized as financial or operational creditors.⁶ What needs to be highlighted here is that the decision on the categorization of homebuyers into financial or operational creditors is only in relation to the capacity to initiate insolvency proceedings against a Corporate Debtor. Homebuyers can hope for recovery of their investment under the IBC, only if they are given utmost priority for repayment of dues, either as financial creditors, or even as a category above financial creditors. The possible remedies for the homebuyers under the IBC are explained below.

REMEDIES FOR HOMEBUYERS

In the midst of all the noise that is being raised on such categorization of homebuyers as either Financial or Operational Creditors, it is important to not forget that they are the main stakeholders in the real estate market. It is worth noting that the IBC was drafted to accommodate its explicitly stated objective of enhancing the 'ease of doing business', while balancing the interests of all stakeholders⁷ (which obviously include the Homebuyers being the biggest and most important stakeholders). It is thus quite necessary to see whether the IBC can ensure reliefs to the homebuyers, regardless of whether they can be classified as Financial or Operational Creditors.

The reliefs that can be envisaged under the IBC for the homebuyers must be discussed at par with the stages and outcomes of the insolvency proceedings against the real estate developers, which are (i). During CIRP and (ii). Liquidation of the Real Estate Developer. However, there is no input pertaining to an order

of resolution, simply because it is too early to predict what course of resolution might be adopted. It is however, reasonably expected that any resolution plan will aim to ensure relief to homebuyers - such as eventually conveying possession of flats to them.

(i). During CIRP

It is logical to assume that a Corporate Debtor subject to a moratorium during the CIRP will also be concerned with separate legal matters that have no correlation with its inability to pay its debts. The effect of a moratorium could thus hinder affected parties from pursuing other legal remedies to their logical conclusion.

It seems that the IBBI has been mindful of how a moratorium can prejudicially affect innocent parties - such as the innumerable Homebuyers, depriving them of remedies for their legitimate claims against the Corporate Debtor. Provision is thus made to allow certain amounts to be set aside for persons that are prejudicially affected from a moratorium under the IBC. Regulation 31 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 lists the amounts that shall constitute 'insolvency resolution process costs' as per Section 5(13)(e) of the IBC. Clause (b) of Regulation 31 specifically includes "the amounts due to a person whose rights are prejudicially affected on account of the moratorium imposed under Section 14(1)(d)." As insolvency resolution process costs are given first priority of payment, a determination that homebuyers are prejudicially affected and entitled to such costs will mean that they have priority of payment over and above the financial creditors, under the IBC. Therefore, the amount under the insolvency process costs, will serve both as security and a remedy for the homebuyers against the uncertain outcome of the CIRP.

The most pertinent observation here is that, regardless of whether homebuyers are included as Financial or Operational Creditors, certain amounts must be set aside for them on account of the immense prejudice they have suffered from the moratorium. Thus, it will be quite prudent to employ Regulation 31 to compensate homebuyers for how the insolvency proceedings threaten to wash away the fruit of the homebuyers' lifetime earnings. Thus, without even having to prove themselves as financial or operational creditors, the claims of the homebuyers will be adjudicated and reliefs will be made available to them under the existing mandate of the IBC.

(ii). Liquidation of the Real Estate Developer

For any entity that has numerous transactions pending completion, any order of liquidation spells doom for those that are relying on due completion of those transactions. Same is for the homebuyers who fear the deprivation of their dream house - an investment that is substantial yet basic to their needs. If an order of liquidation is made against a real estate developer, what happens to its contracts with the numerous homebuyers that expect delivery of their housing flats?

Before the enactment of the IBC, an order of liquidation or winding up against a corporate entity could be challenged in court for realization of remedies flowing from a specific transaction. The IBC however imposes a moratorium, not only during the CIRP, but it also bars the institution of any suits or legal proceedings both by and against the Corporate Debtor upon an order of liquidation against it, under Section 33(5)⁸ of the IBC.

Again, there is provision in the IBC to accommodate the interests of persons in respect of their transactions which are

⁶See, 'AMR Infrastructures v. Nikhil Mehta & Sons', Company Appeal (AT)(Insolvency) No. 07 of 2017 before the NCLAT. Also 'Mukesh Kumar & Anr Vs. AMR Infrastructures Ltd', C.P No.(IB)-30(PB)/2017 before the NCLT.

⁷See, Statement of Objects & Reasons, Insolvency & Bankruptcy Code, 2016


prejudicially affected by an order of liquidation against the Corporate Debtor. The IBC allows the notification of specific transactions which can be enforced regardless of the bar on proceedings by or against a Corporate Debtor. To be specific, Section 33(6)⁹ of the IBC serves as an exception to the bar against institution of suits by or against the Corporate Debtor under Section 33(5) of the IBC. Section 33(6) provides that the Central Government may, in consultation with any financial sector regulator, notify transactions to which Section 33(5) of the IBC shall not apply, once a liquidation order has been passed.

Short of an amendment to the strict yet effective scheme envisaged by the IBC, it will be prudent for the Central Government to take the initiative to single out the transactions of homebuyers with their real estate developers, which if frustrated by a liquidation order, will invariably defeat the ability of the homebuyers to pursue any remedies, for absolutely no fault of their own. There is much force in the argument that the tens of thousands of homebuyers that are affected by liquidation of real estate developers ought to be able to enforce their contracts to obtain refund, compensation and interest, as provided under the RERA. If not, the whole purpose of making real estate developers compliant with the provisions of the RERA will be defeated by the outcome of a liquidation order from insolvency proceedings under the IBC.

Without prejudice to the determination of such remedies, one must also look at the worst case scenario wherein the homebuyers are not given any relief as per the provisions described above. A liquidation order would finally destroy the homebuyers' dreams as also the value of their immense financial investment. This goes against the IBC's explicitly stated objective to promote investment in markets

and 'balance the interests of all stakeholders'.

In this case, attention may be drawn to the IBBI (Liquidation Process) Regulations, 2016 that make provision to accommodate any debt of a stakeholder that is made payable at a future time. As per Rule 28, a person may claim an amount that was not due on the liquidation commencement date, but is still entitled to contribution from the realization of assets, as any other stakeholder. This provision can be quite beneficially applied by the homebuyers towards obtaining a refund, compensation and interest, which though not due yet, i.e., at the insolvency commencement date, will eventually become due on the inability of the corporate entity to deliver timely possession on account of a liquidation order. This provision should be interpreted and employed such that the rights of homebuyers under the RERA are not washed away on account of a liquidation order.

In view of the above stated provisions of the IBC, homebuyers still have hope of a logical end to their efforts towards getting their dream house. What is more, the Supreme Court has stayed the CIRP against Jaypee Infratech Ltd., on being apprised of the situation of homebuyers, through a petition brought before it. It is hoped that the Apex Court will consider the homebuyers' claims which are much greater in value (financial and emotional), than the claims of the banks and financial institutions. The future of implementation of the IBC depends, to a great extent, on the manner in which its provisions are interpreted, so as to allow growth of credit and investment in various markets. It will be heartening to see that not only is the scheme of the IBC rigorously applied, but its provisions are also beneficially employed in consonance with the objective of promoting a robust economy with the ease of doing business. 



Sachin Gupta heads the Litigation Practice of the Firm as a Partner, with prime focus on complex civil & commercial litigation and arbitration matters. He handles matters in the Supreme Court of India, High Courts and various Tribunals, other quasi-judicial and alternate dispute resolution forums.



Ashu Kansal is a Principal Associate having more than 10 years of experience is a Principal Associate with the firm. His main areas of expertise are banking and finance laws, securitization related matters, recovery of debts, Suits and arbitration matters.

⁹Section 33(5): Subject to Section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor.

⁹Section 33(6): The provisions of sub-section (5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.